

Capitol Contact

Virginia General Assembly

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U.S. Supreme Court Rules in Online Sales Tax Case

On June 21, the U.S. Supreme Court ruled in *South Dakota v. Wayfair, Inc., et al.* that states may require out-of-state retailers to collect sales taxes, even if the retailer has no physical presence in the state. The case centered around South Dakota's law requiring businesses selling more than \$100,000 in goods per year in the state, or conducting 200 or more transactions per year with South Dakota customers, to collect and remit sales taxes. The law had been passed in the wake of comments by Justice Anthony Kennedy in 2015 suggesting that the major precedent in this area of law, the 1992 case *Quill Corp. v. North Dakota*, was ripe for re-examination. *Quill* dealt with mail-order catalog sales and held that physical presence in a state was necessary in order for a state to require a business to collect sales taxes (reaffirming a 1967 precedent). In a major victory for states and localities, the *Wayfair* ruling overturns the Court's previous holding in *Quill*.

Major Elements of the Opinion

In a 5-4 opinion, the Court outlined several major reasons for its ruling, noting that the physical presence rule is not necessary to satisfy requirements set out in earlier cases stipulating that there must be some connection between a state and the property or transaction being taxed. The opinion acknowledges that the physical presence requirement gave out-of-state sellers a competitive advantage over in-state brick-and-mortar sellers, thus creating market distortions by "treat[ing] economically identical actors differently for arbitrary reasons."

Despite the narrowness of the majority, the opinion voices a strong defense of states' ability to collect necessary revenues to provide critical public services, calling the *Quill* decision "an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions" and "a judicially created tax shelter for businesses that limit their physical presence in a State but sell their goods and services to the State's consumers, something that has become easier and more prevalent as technology has advanced." The opinion is particularly critical of online sellers' use of their ability to avoid collecting sales taxes as an enticement to consumers, remarking about one example, "What Wayfair ignores in its subtle offer to assist in tax evasion is

that creating a dream home assumes solvent state and local governments” that can provide, for example, police and fire protection.

Unanswered Questions

Removing the *Quill* roadblock from states’ paths is a major step forward in allowing states to set their own policies on collection of sales taxes on purchases from out-of-state sellers. However, as the Tax Foundation notes, “This ruling is not a blank check for states.” The Court’s opinion does not specify which elements of a state law would withstand legal challenge, although the ruling signals that elements of South Dakota’s law, such as the exemption for small sellers and the non-retroactive application of the law, would likely protect similar state laws.

The dissenting Justices argue that Congress is the appropriate venue for resolution of the issue of state taxation of out-of-state entities, suggesting that a legislative solution could balance the states’ need to collect revenue with the potential compliance costs imposed on businesses. It is difficult to predict whether Congress will act to provide more definitive guidance for states in the wake of this ruling. Congress has wrestled with the issue in the past, and the Senate passed legislation in 2013, but the bill failed to emerge from the House.

Potential Effects in Virginia

Virginia’s retail sales and use tax, the second-largest source of state General Fund dollars after the individual income tax, is a major component of state and local revenues. Nationally, online sales continue to grow as a proportion of total sales, so the ability to collect taxes on these sales is an important step in preserving the viability of this revenue source in the future. In 2017, then-Secretary of Finance Ric Brown estimated that \$229 million per year in sales taxes on out-of-state sales was owed but not collected; in media reports last week, Secretary of Finance Aubrey Layne estimated that the enhanced ability to enforce sales tax collections could generate an additional \$280 - \$300 million per year.

The General Assembly will likely need to consider how it structures requirements for remote sellers to collect sales taxes – for example, whether Virginia should model its collection requirements on South Dakota’s law. The General Assembly also may revisit earlier decisions regarding how additional revenue might be distributed. In 2013, major transportation legislation was enacted in Virginia that included provisions governing the distribution of additional revenue that was expected to be generated by the enhanced collection of taxes on sales by remote sellers, but the state legislation assumed that this enhanced authority would be the result of passage of legislation in Congress, not action by the judiciary.

Ensuring parity in the tax treatment of in-state and remote sales transactions has been a long-standing priority of VACo, and we appreciate members’ advocacy on this issue. VACo will continue to keep members updated as the state considers actions in the wake of this important ruling.

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