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ADVERTISING, MARKETING & PROMOTIONS

>> ALERT

SUPREME COURT RULES "AMAZON" / "NEXUS" TAXES ARE PERMISSIBLE

The Supreme Court recently issued a 5-4 ruling in *South Dakota v. Wayfair*, overturning a 1992 Supreme Court decision in *Quill v. North Dakota*, that will now allow states to collect tax on internet sales between residents of the state and remote retailers without a physical presence in such state. This ruling is of particular importance to the internet affiliate marketing industry, whose model is predicated on merchants engaging numerous individual marketing affiliates around the country to promote the merchant's products through various online marketing techniques. In the past, merchants have not always been obligated to collect sales tax in a state merely due to the presence of a marketing affiliate.

In response to *Quill*, which had determined that the Dormant Commerce Clause required a retailer to have a physical presence in the state in order for the state to collect sales tax, several states — including South Dakota — had passed so-called "Amazon" or "nexus" tax laws that would allow them to require internet retailers to collect sales taxes on transactions between the retailer and a resident of the state; provided that the retailer's gross sales or number of transactions in that state exceeded a specified threshold. These laws often used the existence of an in-state marketing affiliate to establish the tax nexus. South Dakota's law, passed in 2016, allowed the state to collect sales taxes on internet transactions where the retailer delivered more than $100,000 of goods or services or engaged in more than 200 transactions with South Dakota residents. There are now approximately 30 states with such nexus tax laws; creating a complex web of compliance obligations.

THE BOTTOM LINE

The Supreme Court's *Wayfair* decision confirmed that states may collect sales tax on internet sales between consumers and retailers who don't have a physical presence in the state. In anticipation of a flurry of related legislation, online retailers, marketing affiliates and all participants in the e-commerce ecosystem should monitor legislation to determine their tax obligations in each state going forward.

Wayfair, Overstock.com and Newegg challenged the law based upon the Supreme Court's decision in *Quill*.

In deciding the *Wayfair* case, the Court held that the physical presence requirement in *Quill* was "unsound and incorrect" and determined that South Dakota is allowed to collect sales taxes from internet retailers without a physical presence in the state. Writing for the majority, Justice Kennedy determined that physical presence is not a necessary requirement and that sales tax must be "applied to an activity with a substantial nexus with the taxing State" and *Quill* created an arbitrary distinction counter to modern Commerce Clause precedent. He also noted that *Quill* essentially created a tax shelter that incentivized online retailers to avoid creating a physical presence in a state to evade collecting sales tax on transactions.

As a result of this decision, there are bound to be many changes to e-commerce, tax, affiliate marketing and other online business activities.

>> Following the decision in *Wayfair*, it is anticipated that the remaining states that have not already passed Amazon tax laws will do so to capture sales tax on internet transactions.

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- States that have already passed Amazon tax laws with lower thresholds may modify their laws to mirror South Dakota's.
- Online retailers may further scrutinize the decision as they analyze how to comply with such laws or modify their practices to avoid a compliance obligation. Many nexus laws contain provisions which allow a remote seller to rebut the presumption that they are obligated to collect sales tax through the use of in-state marketing affiliates.
- Retailers will likely face increased tax compliance costs due to new or updated laws in states that will now require them to collect and remit sales tax even though the retailer does not have physical presence in the state.
- Consumers could also see an increase in the total cost paid for products they purchase on-line as retailers begin adding sales tax to the bill in compliance with state law.
- There may be renewed interest in reviving previously stalled federal legislation that was aimed at resolving the uncertainty and complexity of these varying tax standards.

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