E-commerce Businesses Beware: Supreme Court Ruling May Expose You to Sales Tax on Interstate Sales

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Earlier this summer, in Justice Anthony Kennedy's final opinion before announcing his retirement, the Supreme Court threw 50 years of precedent into the wind with a decision that underscores the rise of e-commerce in our daily activities.

"I wish there was a way to know you're in the good old days before you've actually left them."
-Andy Bernard, *The Office*

For online businesses that are not currently collecting sales tax on interstate sales, the above quote took on special meaning this summer. Those businesses, whether they know it or not, are in the good old days right now as a recent Supreme Court ruling is likely to leave them exposed to new sales tax obligations as well as burdensome and cumbersome compliance requirements.

New Supreme Court Ruling on Sales Tax

The Supreme Court's ruling is a response to a twenty-first century problem. In short, the evolution of the Internet brought with it a new marketplace – a virtual one, where buyers can do everything from grocery shopping to annual birthday and holiday shopping, all from the comfort of their living room sofas. Indeed, consumers are prone to laziness and, when given the choice, have generally opted against getting dressed and leaving their house to go to the store. As such, the convenience of the online shopping experience, combined with the sales tax savings, has given shoppers the incentive (or justification) to change their purchasing habits.

However, the rules are changing and the playing field is leveling, albeit slightly.

In South Dakota v. Wayfair, 585 U.S. ___ (2018), the Court concluded that the long-standing rule for allowing states to compel out-of-state retailers to collect sales tax was not only "unsound and incorrect," but antiquated by modern standards. That long-standing rule? Actual, physical presence in the taxing state. In other words, a Maryland business that hasn't stepped one foot in Virginia can ship sales across the Potomac and incur no obligation to collect sales tax from the Virginian that bought its products. However, if that Maryland business shipped its sale to Ocean City, MD, the sales tax obligation kicks in. An advantage? Most likely the failing brick and mortar stores like Sears, Toys R Us, and Circuit City would say so.

However, the physical presence rule was fraught with issues almost from the beginning. Indeed, limiting physical presence had generally been manageable, but with the dawn of the Internet and the rise of e-commerce, restricting physical presence has become easier and more prevalent. In turn, states began losing tax revenue to the current tune of between "$8 billion and $33 billion every year," according to the Court. In response, states began enacting laws in an attempt to recapture as much of that money as possible. In doing so, the states started stretching the definition of physical presence, or they began ignoring it altogether.

In short, the Wayfair concluded that other connections or contacts with the taxing state are sufficient to meet with constitutional requirements.

What Does this Mean for Your Online Businesses and Why You Need a Tax Attorney?

Now, not only is physical presence adequate, certain economic contacts or “virtual connections” are enough to expose an online business to a state’s sales tax regime.

However, Wayfair leaves the issue unsettled. Specifically, the Court failed to provide guidance for the type of contacts or connections, whether economic or virtual, or both, that will meet this new, constitutional standard. But what happens in response to Wayfair is entirely predictable –legislatures will pass new laws, or expand old ones, to take advantage of this new revenue stream. In doing so, they will push the boundaries to test the uncertainty created by Wayfair. Accordingly, this issue will work its way back through the courts for further guidance on the type or amount of economic activity now required.

Presently, online businesses need to know how Wayfair impacts their business models and operations. An experienced tax attorney can review the states and local jurisdictions where a business ships purchases or delivers services, or where it otherwise has any type of physical or economic presence or connection. An in-depth analysis of the definitions for “sellers,” “vendors,” “dealers,” “retailers,” or the like, will help an online business understand its exposure to a particular sales tax regime. If there is exposure, a review of that state or local jurisdiction’s sales tax code will be required to determine whether such exposure has ripened into an obligation. Indeed, where a business has sales tax obligations, not only will collecting and remitting be required, but so will registration, reporting and filing; and most states have laws holding business owners or officers personally liable for failing to comply with its sales tax laws. In addition, not only will businesses need to educate themselves with the legal and regulatory framework of multiple jurisdictions, but they will need to stay current with any new developments which may affect how and where they sell products or deliver services. Accordingly, the good old days of sales tax being either a minor inconvenience or inconsequential are likely over for many unknowing and unsuspecting online businesses.

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