The U.S. Supreme Court Changes the U.S. State and Local Tax Landscape

By Terence Wong, CPA, CA, CPA (Illinois), Taxation **June, 2018**

The Supreme Court of the United States have rendered a decision on South Dakota v. Wayfair. In a 5-4 decision, the Court could now require online retailers to collect sales taxes even if they don't have a physical presence, such as a store or warehouse, in the jurisdiction. It also set out two overriding principles:

- A state tax system should not discriminate against out-of-state businesses; and
- It should not place an "undue burden" on interstate commerce.

BACKGROUND

Similar to several other states, South Dakota enacted an "economic nexus" statute for sales and use tax collection on March 22, 2016. Under that statute, any seller with South Dakota customers is required to collect and remit sales tax if, in a fiscal year,:

- the seller's South Dakota sales exceed $100,000; or
- the seller has more than 200 separate sales transactions into South Dakota.

SIGNIFICANT RULING

It is rare that the Supreme Court of the United States would hear a tax related case so we can conclude that this case is of significant importance to all U.S. taxation authorities.

Considering that it was January 12, 2018 when the Court agreed to hear the case and it was April 17, 2018 when the Court actually heard arguments from both sides; it is quite amazing that it is able to issue its verdict on June 21, 2018.

SUMMARY

The court ruled that the "physical presence rule, both as first formulated and as applied today, is an incorrect interpretation of the Commerce Clause." Further, the majority ruled that South Dakota's $100,000 of sales or 200 separate sales transactions statutory requirement satisfied the substantial nexus requirement. This ruling differed significantly from Quill Corp. V. North Dakota, where the same court ruled, 26 years ago, that physical presence was required to the application of state taxes.

PENDING LITIGATION

As noted, most states have enacted (or have begun to enact) economic nexus statutes where a foreign seller (including Canadians) is required to collect and remit sales taxes (and/or pay income taxes) if the foreign seller sells to customers within the state, regardless of whether the seller has any physical presence in the state. The processes for many of these states were stayed because of pending litigation. Now that the Supreme Court has ruled, we expect all of the pending litigations will be resolved quickly and states which have not introduced economic nexus statutes yet will introduce them in due course.

WHAT DOES THIS MEAN?

For U.S. federal tax purposes, if your organization has material sales to U.S. customers, it is important that it file the necessary protective U.S. federal income tax returns to protect itself from potentially significant federal tax penalties. With the new Supreme Court ruling, the state tax landscape will change rapidly and dramatically. If your organization has sales to the United States, it is now more important than ever to review sales to U.S. customers to make a determination on whether your organization is required to collect and remit sales taxes (and whether it is liable for state level income taxes) under current and proposed rules. Advance planning is critical if U.S. federal and state liabilities are to be prevented or at a minimum, isolated.

Contact your KRP Advisor for further details.