



MEMORANDUM

DATE: June 21, 2018

TO: Members of the South Dakota Legislature

FROM: Wenzel J. Cummings, Legislative Attorney

RE: *South Dakota v. Wayfair*

This morning the Supreme Court of the United States released their decision in the case of *South Dakota v. Wayfair*, regarding the authority of states to impose a requirement that out-of-state retailers with no "physical presence" in the state collect sales taxes on sales transactions to consumers who are located within the state. The Court found by a majority of 5-4 that states may impose this requirement. In short, the Court found in favor of South Dakota. Justice Kennedy authored the majority opinion, in which he was joined by Justices Thomas, Ginsburg, Alito, and Gorsuch. Chief Justice Roberts' dissent was joined by Justices Breyer, Sotomayor, and Kagan.

The specific issue the Court addressed revolved around a line of cases that placed a binding precedent on states forbidding them from imposing tax-collection responsibility on retailers located outside the state's borders with no in-state physical presence. If a retailer is headquartered outside the state but has a retail location within the state (e.g., Target, Gap, or Home Depot) the state had the authority to impose this tax-collection requirement already. However, under the Court's earlier, binding precedent, if an out-of-state retailer had no physical presence in the state (e.g., Amazon, Wayfair, Newegg, or Overstock.com) with no retail location or distribution center located within the state, the state was forbidden from imposing the tax-collection requirement on the retailer.

In its case, South Dakota asked the Court to overrule its binding precedent. This morning, the Court agreed.

The Court began its decision with a discussion of its case law interpreting the Commerce Clause of the U.S. Constitution. Under the Commerce Clause, Congress is granted explicit authority to "regulate Commerce . . . among the several states."¹ Over the course of the past two centuries, the Supreme Court has gradually interpreted this explicit grant of authority to Congress to mean an implicit denial of authority to the states. This doctrine is commonly called either the "Dormant Commerce Clause" or "Negative Commerce Clause." Because taxation by states can be considered a "regulation" of commerce, the Court established a balancing test by which a state's tax burden may be determined to be too burdensome to be upheld under the Dormant Commerce Clause.²

Prior to its creation of this balancing test, the Court had already imposed a "physical presence" requirement that disallowed states from imposing a burden of tax collection on retailers unless those retailers had an actual physical location (commonly called a "brick-and-mortar" location) within the state.³ Subsequent to both the physical

¹ Art. I, § 8, cl. 3.

² See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1974).

³ See *Nat'l Bellas Hess, Inc. v. Dept. of Revenue of Ill.*, 386 U.S. 753 (1967).

presence case and the balancing test, the Court upheld the physical presence requirement in *Quill Corp. v. N.D.*, 504 U.S. 298 (1992). Recognizing that these two cases reflect an economy that pre-dates the vast expansion of consumer activity on the Internet with retailers who do not have brick and mortar locations in most states but yet engage in extensive consumer activity in those states, the Court this morning overruled both of these two cases, eliminating the "physical presence" requirement entirely and retaining instead only the balancing test.

After overruling its precedents, the Court then used the balancing test to determine whether South Dakota's law violates the Dormant Commerce Clause. First, the test requires a nexus between the retailer and the state. The Court found that, by limiting the requirement to those retailers with sales over \$100,000 or with over 200 transactions to persons located within the state, there is a sufficient nexus between the retailers and the state to survive the Dormant Commerce Clause.

There are three other factors that a court must balance, however the Court this morning did not provide definitive answers to any of those factors, effectively leaving that balancing to be done by the South Dakota Supreme Court when the case is on remand.⁴ The Court did opine (without concluding) that the state appears to have taken due consideration of these factors in its statute; but the factors will need to be briefed and litigated further.

The Court also recognized that there may be other claims against South Dakota's law either under the Commerce Clause or under another constitutional provision entirely. However, because *Quill* had foreclosed consideration of these claims, they need to be litigated at a lower court.

The case will be sent back to the South Dakota Supreme Court, which will then send it back to the circuit court for further consideration. The Department of Revenue will be able to enforce the law following the formal dissolution of the injunction currently placed on it by the circuit court in Hughes County, and assuming no further injunctions are imposed. The time frame is estimated to be around 60 days, barring any unforeseen delays.

⁴ Those factors include that the tax must be fairly apportioned, does not discriminate against interstate commerce, and has a fair relationship to the services the state provides. See *Complete Auto*, 430 U.S. at 279.



MEMORANDUM

DATE: June 25, 2018

TO: Members of the South Dakota Legislature

FROM: Wenzel J. Cummings, Senior Legislative Attorney

RE: Collection of Sales Taxes from Out-of-State Sellers

As a follow-up to the memorandum of June 21, 2018, which summarized the holding of the Supreme Court of the United States ("SCOTUS") in *S.D. v. Wayfair*, this memorandum will provide greater detail of the events leading to the Court's decision. Part I of this memorandum will summarize the contents of SB106 and HB1182 (2016), related to sales tax collection by out-of-state sellers. Part II will provide a timeline of the litigation that culminated in the Court's holding in *Wayfair*. Part III will provide a more detailed discussion of the procedural steps that will need to occur before the law may be enforced by the South Dakota Department of Revenue. Part IV will provide brief bullet points.

Part I – SB106 and HB1182 (2016)

Senate Bill 106 (2016) was hoghoused by the Senate State Affairs committee to become the language as signed by the Governor. No further amendments were made to the bill.

The bill included 9 sections as follows:

- Section 1: Any seller who does not have a "physical presence in the state" and who sells "tangible personal property, products transferred electronically, or services for delivery into South Dakota" is subject to the provisions of the state sales tax¹ and the municipal non-ad valorem tax.² Sellers are subject to this requirement only if their sales exceed \$100,000 or their number of transactions reaches at least 200 separate transactions to persons in the state.

- Sections 2 - 4: Provide the process by which the state may enforce the requirements of Section 1 through the filing of a declaratory judgment action. During this action, the state may not enforce Section 1.

- Section 5: The obligation to remit sales tax by the seller under Section 1 may not be applied retroactively.

¹ SDCL Ch. 10-45.

² SDCL Ch. 10-52.

- Section 6: For any seller involved in legal action under Sections 2 – 4, the state will assess and apply the sales tax remittance under Section 1 from the date the legal action ends.
- Section 7: Provides protections for sellers who voluntarily comply with the requirements of Section 1.
- Section 8: Legislative findings.
- Section 9: Emergency clause providing that the bill would become law as of the first day of the first month that is at least 15 days following the date of the Governor's signature.

House Bill 1182 (2016) increased various taxes, including the state sales and use taxes, from 4% to 4.5%. Among other amendments, the bill was amended on the House floor with amendment 1182fb,³ which provides that, if the state is able to enforce the obligation to collect and remit sales tax on remote sellers, the additional net revenue "shall be used to reduce the rate of certain taxes." Those "certain taxes" were each of the tax rates that were subject to the increase under the other provisions of HB1182 (2016). Under the amendment, those rates would be reduced by 0.1% on July 1st following the calendar year in which "each additional 20 million dollar increment of net revenue is collected and remitted." The amendment also provides that the tax rate could not be reduced below 4%.

Part II – Timeline of Litigation

- March 22, 2016: The Governor signed SB106.
- April 27, 2016: The state filed a declaratory judgment action under Sections 2 – 4 of SB106 (2016) against certain named sellers, thus temporarily halting the enforcement of the law pursuant to Section 3.
- January 2017: After the sellers attempted to have the case heard in federal district court instead of state circuit court, the federal district court rejected their attempt and sent the case back to state circuit court.
- March 6, 2017: Judge Mark Barnett, Circuit Court Judge of the Sixth Judicial Circuit granted the sellers' Motion for Summary Judgment, finding in favor of the sellers and thereby placing a more permanent halt on the state enforcing the law. Judge Barnett cited the precedent established under SCOTUS as binding upon the circuit court.
- August 29, 2017: After the state appealed to the South Dakota Supreme Court, the parties appeared before the Court for oral argument.
- September 19, 2017: The South Dakota Supreme Court affirmed the circuit court's grant of summary judgment against the state, leaving in place the more permanent halt on the law's enforcement. The Court cited the precedent established under SCOTUS as binding upon the Court.
- October 2, 2017: The state filed a petition for a writ of certiorari with SCOTUS requesting that the Court hear the case.
- January 12, 2018: SCOTUS granted the state's petition and agreed to hear the case.

³ Currently codified at § 10-64-9.

April 17, 2018: The parties appeared before SCOTUS for oral argument.

June 21, 2018: SCOTUS issued its decision in *S.D. v. Wayfair*, finding in favor of the state, overturning its previous binding precedent, and sending the case back to the state courts for further consideration of any other arguments the sellers may choose to make against the law's constitutionality.

Part III – Procedural Next Steps Following the Court's Decision in *Wayfair*

Although SCOTUS found in favor of South Dakota, the provisions of SB106 (2016) are still subject to the injunction imposed by the circuit court on March 6, 2017. Until this injunction is dissolved, the law may not be enforced. Only the court that imposed the injunction may dissolve it. That process will occur as follows:

1. Under the Rules of the Supreme Court of the United States, the sellers have 25 days within which they may ask SCOTUS to hear the case again and reconsider their decision.⁴ Even if the sellers file a petition for rehearing, these petitions are very rarely granted.
2. After this 25-day period, SCOTUS will officially return the case back to the South Dakota Supreme Court for further action.
3. The South Dakota Supreme Court will return the case back to the circuit court for further action (timeframe uncertain).
4. When the circuit court receives the case from the South Dakota Supreme Court, the next step will depend on the parties to the litigation and the circuit court judge. The sellers may choose to make an argument against the law under another theory of unconstitutionality. In any event, until the injunction is dissolved by the circuit court, the law may not be enforced.
5. Once the injunction is formally dissolved by the circuit court, the law may be enforced.

Part IV – Summary

- The provisions of SB106 (and the limiting provisions of HB1182) are still under an injunction and may not be enforced.
- Before the law may be enforced, the circuit court must dissolve its injunction, which may take several more weeks.
- Once the injunction is removed, the Department of Revenue may proceed with its enforcement with no further action required from the Legislature or the Governor.
- Once the law is enforceable, under HB1182 "the additional net revenue" generated from "the obligation to collect and remit sales tax on remote sellers . . . shall be used to reduce the rate of certain taxes." This cannot occur until at least \$20 million of net revenue is generated during a calendar year.
- If any other state has enacted a law similar to South Dakota's, that state may enforce its law immediately (unless that state is prohibited from doing so by a separate court injunction).

⁴ See Rule 44, 28 U.S.C.