

South Dakota Blatantly Defies *Quill*'s Physical Presence Standard, Adopts Economic Nexus for Sales Tax

By Sylvia Dion, MPA, CPA

INTRODUCTION: I originally authored this article in May of 2016, just two months after South Dakota's economic nexus law was enacted. South Dakota was the first state in the country to enact legislation which established sales and transactional thresholds which, if met, would impose a registration, reporting and remittance obligation on an out-of-state retailer, even if the retailer had no physical presence in the state or engaged in any other activities within the state that would create nexus for South Dakota's sales and use tax. Although South Dakota's "economic nexus" law was the first legislated law, Alabama was the first state to "kick-off" the economic nexus trend when in October of 2015, it adopted a sales tax regulation imposing a sales tax registration, collection and remittance obligation on out-of-state sellers with a substantial economic nexus presence in the state.¹ Since then, several more states have adopted economic nexus for sales tax purposes either through legislation or regulation. Many of these states' economic nexus laws are modeled after the South Dakota law, and use the same sales and transactions thresholds, notably the economic nexus laws of Indiana, Maine, North Dakota, Vermont and Wyoming. Much has transpired since I first authored this article almost 2 years ago, the most significant being the U.S. Supreme Court's decision to grant cert to *South Dakota v. Wayfair, Inc.*,² a legal challenge which could ultimately overturn *Quill*.

I hope you'll find this article informative as you revisit the genesis of this development and familiarize yourself with South Dakota's economic nexus law. ~ Sylvia Dion, CPA ~

On March 22, 2016, South Dakota became the most recent state to take aggressive action in an effort to capture sales tax revenue associated with sales by out-of-state remote retailers to consumers in its state. This latest effort, set into law by the enactment of S.B. 106, imposes South Dakota collection and remittance duties on out-of-state remote retailers who meet the new legislation's economic nexus criteria. Unlike states' prior efforts to focus on simply expanding the definition of a physical presence in their state in order to comply with the *Quill* physical presence requirement, by adopting an economic nexus standard the South Dakota legislation clearly violates *Quill*. The new legislation is notable in that it provides numerous justifications for its enactment and, anticipating a legal challenge, addresses judicial concepts and procedures should a legal challenge be presented.

South Dakota's Economic Nexus Law

South Dakota's economic nexus legislation, S.B. 106, was signed into law on March 22, 2016 by Governor Dugaard. The new law, which is set to go into effect on May 1, 2016,³ requires certain remote sellers that sell tangible personal property, products transferred electronically, or services for delivery into South

¹ Ala. Admin. Code. R. 810-6-2-.90.03., effective January 1, 2016.

² *South Dakota v. Wayfair, Inc.*, et al. No. 17-494.

³ S.B. 106, Laws 2016, § 9 provides that this "Act shall be in full force and effect on the first day of the first month that is at least fifteen calendar days from the date of this Act." As the law was signed into effect on March 22, 2016, the first day of the first month that falls at least 15 days after enactment is May 1, 2016.

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Dakota, and that meet one of two economic thresholds in either the previous or current calendar year, to collect and remit South Dakota sales tax *as if* they had a physical presence in the state. More specifically, a remote seller will be subject to South Dakota's collection and remittance duties if during the previous or current calendar year;

- 1) the seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeds \$100,000; or,
- 2) the seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in 200 or more separate transactions.⁴

South Dakota Legislature Justifies Enacting an Economic Nexus Law

While the fact that the new legislation adopts an economic nexus standard which clearly violates the physical presence standard established in the U.S. Supreme Court's landmark decision in *Quill Corp. v. North Dakota*⁵ is significant, what is equally notable is expansive language in S.B. 106 which articulates the legislature's justification and necessity for adopting an economic nexus standard for establishing South Dakota sales tax nexus.

Amongst the legislature's justifications for the law are its finding that South Dakota's ability to effectively collect sales or use tax from remote sellers has seriously eroded the state's sales tax base, thus leading to significant revenue shortages and imminent harm to the state due to critical funding shortages for state and local government services.⁶ The legislature also notes that the loss of revenue from remote sales is particularly significant for South Dakota, a state with no state income tax, which relies heavily on sales and use tax revenues for the funding of its state and local government services.⁷

"...remote sellers who make a substantial number of deliveries into or have large gross revenues from South Dakota benefit extensively from the state's market as well as infrastructure. Yet many remote sellers "actively market sales as tax free or no sales tax transactions."

The legislature also focuses its justification for adopting an economic nexus standard on its finding that remote sellers who make a substantial number of deliveries into or have large gross revenues from South Dakota benefit extensively from the state's market as well as infrastructure.⁸ Yet many remote sellers

⁴ S.B. 106, Laws 2016, § 1.

⁵ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁶ S.B. 106, Laws 2016, § 8(1).

⁷ S.B. 106, Laws 2016, § 8(2).

⁸ S.B. 106, Laws 2016, § 8(5).

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“actively market sales as tax free or no sales tax transactions.”⁹ Other findings noted in S.B. 106 include the legislatures’ belief that absent such action, the erosion of South Dakota’s sales tax base is expected to continue due to the ongoing popularity of online sales.¹⁰ Yet, despite continued growth in harm to the state from exempting remote sellers from sales tax collection duties, modern computing and software options have lessened the difficulty and burden on remote sellers to comply with collection and remittance duties.¹¹

South Dakota’s Economic Nexus Law Invites a Legal Challenge

In addition to the justifications and findings noted above, also significant were references in S. B. 106 to Supreme Court Justice Kennedy’s concurring opinion in *Direct Marketing Association v. Brohl*.¹² Although the *Direct Marketing* case dealt with Colorado’s 2010 notification and reporting law, which imposed administrative obligations and punitive sanctions on “non-collecting” retailers, Justice Kennedy took the opportunity to express his strong view that the time had come to reconsider *Quill*, urging that the “*the Supreme Court of the United States should reconsider its doctrine that prevents states from requiring remote sellers to collect sales tax, and as the foregoing findings make clear, this argument has grown stronger, and the cause more urgent, with time.*” S.B. 106 similarly urges that the U.S. Supreme Court should reconsider the *Quill* doctrine.¹³ Thus, S.B. 106 clearly invites an invitation to challenge *Quill*, but also notes that the “expeditious review” of the constitutionality of S.B. 106 is warranted necessary due to the refusal by remote sellers to collect the sales tax and the resulting imminent harm to the state.¹⁴

The legislation acknowledged that since the existing constitutional doctrine calls S.B. 106 into question, S.B. 106 places remote sellers in a “complicated position.” Thus, the legislature also provides that the obligations created by S.B. 106 would be stayed by the courts “until the constitutionality of this law has been clearly established by a binding judgment, including, for example, a decision from the Supreme Court of the United States abrogating its existing doctrine, or a final judgment applicable to a particular taxpayer.”¹⁵ The legislation also notes its intention to apply South Dakota’s sales and use tax obligations “to the limit of federal and state constitutional doctrines” and to clarify that South Dakota law allows the state to immediately argue in any litigation that constitutional doctrine should be changed to permit the collection obligations under S.B. 106.¹⁶

⁹ S.B. 106, Laws 2016, § 8(3).

¹⁰ S.B. 106, Laws 2016, § 8(4).

¹¹ S.B. 106, Laws 2016, § 8(6).

¹² *Direct Marketing Ass’n v. Brohl*, 135 S. Ct. 1124 (2015).

¹³ S.B. 106, Laws 2016, § 8(7).

¹⁴ S.B. 106, Laws 2016, § 8(8), (9).

¹⁵ S.B. 106, Laws 2016, § 8(10).

¹⁶ S.B. 106, Laws 2016, § 8(11).

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In anticipation that a legal challenge is a likely outcome, S.B. 106 provides that South Dakota may bring a declaratory judgment action in a circuit court against any person it believes meets the economic nexus criteria to establish that the obligation to remit sales tax is applicable and valid under state and federal law. S.B. 106 also directs the circuit court to act on the declaratory judgment "expeditiously" and to presume that the matter can be resolved through a motion to dismiss or a motion for summary judgment.¹⁷

Citing Supreme Court Justice Kennedy's concurring opinion in Direct Marketing Association v. Brohl, S.B. 106 similarly urges that the U.S. Supreme Court should reconsider the Quill doctrine and argues that the need for reconsideration has grown stronger and more urgent.

And further, if these motions are not sufficient to resolve the issue, S.B. 106 adds that discovery is subject to the limited and simplified discovery procedures contained in the South Dakota laws dealing with motions for leave of court¹⁸ and that any provision authorizing attorney's fees does not apply to any action, or appeal from any action, brought under S.B. 106.¹⁹

Also significant is that S.B. 106 provides that the filing of a declaratory judgment action by the state would operate as an injunction while the case is pending, thus prohibiting any state entity from enforcing the sales tax remittance obligations against any taxpayer who does not comply.²⁰ Another provision in S.B. 106 would also allow any appeal to go directly to the state's Supreme Court.²¹ The legislation specifically provides that the obligation to remit sales tax under S.B. 106 may not be applied retroactively.²² However, if the injunction provided by S.B. 106 is lifted or dissolved generally, or specifically with respect to a taxpayer, the state is prospectively allowed to assess and apply the sales tax on any taxpayer covered by the injunction.²³

Finally, the legislation emphasizes that a taxpayer in compliance with S.B. 106 may seek recovery of taxes, penalties or interest by following the state's administrative recovery procedures.²⁴ However, a refund claim will not be granted if it is based on the fact that the remote retailer lacked a physical presence in South Dakota and complied with S.B. 106 voluntarily while covered by the injunction provided in S.B. 106.²⁵

¹⁷ S.B. 106, Laws 2016, § 2.

¹⁸ S.D. Codified Laws Sec. 15-6-73(2) and Sec. 15-6-73(4)

¹⁹ S.B. 106, Laws 2016, § 2.

²⁰ S.B. 106, Laws 2016, § 3. S.B. 106, Laws 2016, § 3

²¹ S.B. 106, Laws 2016, § 4.

²² S.B. 106, Laws 2016, § 5.

²³ S.B. 106, Laws 2016, § 6.

²⁴ S.B. 106, Laws 2016, § 7.

²⁵ S.B. 106, Laws 2016, § 7.

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Conclusion

On March 22, 2016, South Dakota enacted legislation which adopts an economic nexus standard that will impose South Dakota's collection and remittance duties on out-of-state remote retailers that lack a physical presence in the state. Because the new legislation clearly violates the physical presence standard established in *Quill*, it is ripe for a legal challenge.

And indeed, several provisions in S.B. 106 focus on the course of action should a legal challenge be presented. Also notable about the legislation are the compelling justifications for adopting an economic nexus law including the harm to South Dakota from exempting remote sellers from the state's tax collection and remittance duties, the fact that such harm is exacerbated due to the state's heavy reliance on sales tax revenue and absence of a state income tax, and the argument that due to modern computing and software options, the collection burden on remote sellers is no longer burdensome.

Just months ago, the Alabama Department of Revenue issued a regulation which, like S.B. 106, requires certain out-of-state retailers that make sales into Alabama to collect and remit Alabama sales and use tax even though such sellers do not have a physical presence in the state.²⁶ The Alabama regulation, which went into effect on January 1, 2016, along with South Dakota's newly enacted economic nexus law, signal that states are no longer content to wait on Congress to enact federal remote seller legislation²⁷ and are instead ready to force the U.S. Supreme Court to finally reconsider whether *Quill* should be overturned.

Author's Update, April 25, 2018: South Dakota indeed achieved its goal of enacting legislation that would compel the U.S. Supreme Court, for the first time in 26 years, to reconsider *Quill*. For a law to move from enactment (March 22, 2016) to review by the U.S. Supreme Court in less than two years (oral argument heard on April 17, 2018) is indeed an expeditious journey. Since the enactment of S.B. 106, several more states have adopted economic legislation or promulgated regulations which assert sales tax nexus based on economic factors, including Indiana, Maine, Massachusetts, North Dakota, Vermont and Wyoming. In April 2017, the 115th U.S. Congress reintroduced both the Marketplace Fairness Act (S. 976) and the Remote Transactions Parity Act (H.R. 2193), but neither federal remote seller proposal has advanced to date. It's unlikely either proposal will make any progress prior to the Supreme Court's decision, which is expected this summer – thus, leaving the immediate verdict on *Quill*'s survival in the Supreme Court's hands.

²⁶ Ala. Admin. Code. R. 810-6-2-.90.03.

²⁷ There are currently two federal remote seller proposals under consideration by the 114th Congress: S. 698, the Marketplace Fairness Act of 2015, 114th Congr. 1st Sess. (2015), March 10, 2015; H.R. 2775, the Remote Transactions Parity Act of 2015, 114th Congr. 1st Sess. (2015, July 15, 2015, July 15, 2015. For an in-depth discussion of both federal proposals see: "*The MFA v. RTPA: Will Changes in the House and an Expiring ITFA Help Advance or Further Stall Federal Remote Seller Bills?*" by Sylvia Dion, BloombergBNA Weekly State Tax Report, November 20, 2015.

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About the Author



Sylvia Dion, MPA, CPA, is the Founder and Managing Partner of **PrietoDion Consulting Partners LLC**, a State & Local Tax (SALT) consulting practice a tax consulting firm specializing in providing State & Local Tax (SALT) consulting and compliance services to companies throughout the U.S. and in Europe, Canada, Australia, Asia and Latin America. Sylvia's primary focus is advising U.S. and foreign companies on their multi-state nexus, the taxability of their products and services, and managing and mitigating their exposure such as through the Voluntary Disclosure and amnesty process. Her industry focus is eCommerce (online retail), software, technology and manufacturing. Prior to launching **PrietoDion Consulting Partners, LLC**, Sylvia's held SALT Senior Management and Leadership positions with Ernst & Young (EY) and Grant Thornton.

Sylvia is also a speaker and tax writer whose articles on tax issues and developments have been published in the *Journal of Accountancy*, *Journal of State Taxation*, *Journal of Multistate Taxation and Incentives*, *Journal of Practical US/Domestic Tax Strategies*, *Bloomberg BNA State Tax Weekly*, *Bloomberg BNA Multistate Tax Report*, the *Institute for Professionals in Taxation (IPT) Tax Report* and *e-Commerce Law & Policy*. She is also the author of "Minding Massachusetts", a quarterly column on Massachusetts tax developments, published in *State Tax Notes*, a Tax Analyst publication. Sylvia is also an avid tax blogger who covers '*Internet Sales Tax*', '*U.S. Sales Tax for Foreign Sellers*', and '*Massachusetts Sales Tax*' for SalesTaxSupport.com, a premier sales tax resource website.

Both in her practice, and in her writing, Sylvia focuses extensively on following and reporting on states' efforts to redefine what constitutes a physical presence and the evolution of nexus expanding laws. Sylvia has also written extensively on the federal remote seller legislation and has reported on every federal remote seller proposal introduced since 2010.

She frequently presents to executive and industry groups and on practitioner webcasts and has been quoted in several news reports and articles, including in *Bloomberg BusinessWeek*, the *Boston Globe*, *Forbes.com*, *NPR* and other media.

Sylvia is Certified Public Accountant with a Masters of Professional Accounting – Taxation Specialization, from the Red McCombs School of Business at the University of Texas at Austin.



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About PrietoDion Consulting Partners LLC

PrietoDion Consulting Partners LLC is Tax Consulting firm specializing in advising U.S. and International businesses with complying with their State & Local Tax (SALT) obligations. With extensive knowledge in e-Commerce taxation, PrietoDion is the top choice for U.S. and International online sellers who wish to understand how the U.S. sales tax laws impact their online business. In addition to serving e-Commerce clients, PrietoDion also specializes in the software, technology and manufacturing industries. Based in Westford, Massachusetts, PrietoDion has broad experience guiding U.S. and international businesses with understanding their state tax nexus, registration and filing requirements in all areas of multistate taxation including sales & use, corporate income, franchise, gross receipts and payroll tax. PrietoDion's services include nexus evaluations, state registration assistance, sales tax compliance (filing) services, Voluntary Disclosure representation, state audit assistance, state tax research and analysis, consultations for international sellers on legal entity structure and treaty implications.

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