

Online Shoppers Beware: State Sales Taxes Likely Will Be Added to Your Shopping Cart

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I like to shop online (a lot). I enjoy the convenience of shopping from home, and I find that I can usually get a better deal by comparing the prices of different online retailers. For some, online shopping also has another financial incentive: avoiding state sales taxes. But a recent decision from the United States Supreme Court likely will change this.

Until recently, online retailers were not required to collect sales tax for purchases made in a state where the retailer did not have a physical presence, such as an office, warehouse, or shipping facility. For example, if an online retailer that only had a physical presence in North Carolina sold a product to a consumer located in Florida, the online retailer had no duty to collect Florida sales tax. In contrast, that same retailer would be required to collect North Carolina sales tax and remit it to the state for a purchase made by a consumer in North Carolina.

On June 21, 2018, in *South Dakota v. Wayfair*, the United States Supreme Court overruled two of its prior decisions that had previously established the "physical presence rule." In *Wayfair*, South Dakota sought to collect sales tax from online retailers, including Wayfair and Overstock.com. Neither retailer has a physical presence in South Dakota, but each of them has a volume of business with South Dakota residents making them subject to a South Dakota law requiring them to collect and remit sales tax.

The South Dakota law conflicts with two prior Supreme Court rulings that found these types of tax laws to be an undue burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

In *Wayfair*, the Court re-examined these prior rulings and determined that the physical presence rule should be eliminated and that South Dakota's law does not unduly burden interstate commerce.

In reaching this decision, the Court discussed changes in out-of-state sales transactions since it last addressed the issue in 1992 in *Quill Corp. v. North Dakota*. At the time, only 2% of Americans had access to the Internet, and mail-order sales totaled \$180 billion. Today, the largest retailer in the United States is an online retailer, Amazon, and in 2017, e-commerce sales reached more than \$450 billion.

The Court also discussed the importance of sales taxes to state government budgets. For example, South Dakota estimates that it lost about \$50 million a year from out-of-state retailers who did not collect and remit sales tax for purchases made by South Dakota residents. Significantly, forty-one states, including North Carolina, joined South Dakota in asking the Court to reconsider the physical presence rule.

The Supreme Court does not often overrule its prior decisions. In fact, Chief Justice Roberts wrote a dissenting opinion in *Wayfair* concluding that the Court should have waited for Congress to enact legislation if it wanted to correct the problem resulting from the Court's prior decisions. Indeed, in its 1992 decision in *Quill*, the Court invited Congress to address the issue of whether laws of this nature unduly burden interstate commerce, but Congress took no action in response to the Court's suggestion.

In light of the Court's ruling and Congress's failure to pass national legislation on the issue, there is much uncertainty about how the *Wayfair* case will affect online retailers going forward. With only the Court's opinion as guidance, there is no comprehensive law to guide states wishing to enforce tax regimes similar to the one in South Dakota.

Notably, it is unclear if all online retailers, including small companies with limited resources, will be required to collect out-of-state sales tax. During oral argument in *Wayfair*, the Justices expressed concern about the potential burden collecting and remitting out-of-state sales taxes could create for small companies. But that issue was never addressed in *Wayfair's* majority opinion.

Large companies like Wayfair and Overtsock.com are seemingly capable of developing the software and technology to ensure that they collect and remit taxes based on the state in which their consumers reside—Amazon, for example, already does this. But such technology may not be reasonably accessible to smaller retailers, creating the possibility that the Court's ruling will have a serious and detrimental effect on interstate commerce.

With this in mind, other states may create laws similar to South Dakota's, which seeks to limit the tax collection burden on smaller companies. The South Dakota law only requires retailers to collect and remit state sales tax if they deliver more than \$100,000 worth of goods or services to residents of the state, or engage in more than 200 separate transactions with state residents per year.

Regardless, the next time you shop online, it will be worth noting whether you are charged state sales tax by an online retailer who has never charged those taxes before.

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