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US Sales and Use Tax Update: What South Dakota v. Wayfair, Inc. Means For Your Business' US Sales

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Online Tax Strategies

The Supreme Court of the United States has just made a landmark ruling that will reshape Sales and Use Tax compliance for Canadian businesses selling into the United States.

Before South Dakota v. Wayfair, Inc.

Previously, states could not impose sales and use tax registration or collection obligations on a business if the business had no physical presence in the state (for example: a place of business, inventory, equipment, sales staff, independent agents, contractors, technicians). States could provide for a minimum threshold of sales for registering; however, they could not force a business to register based solely on a business' volume of sales **if they did not have any physical presence.**

These precedents were established long before the rise to prominence of internet sales, when the closest equivalent was catalogue sales (see *National Bellas Hess* v. *Department of Revenue*, 386 U.S. 753 (1967), *Quill Corp*. v. *North Dakota*, 504 U.S. 298 (1992))

However, recently states have grown increasingly frustrated with the loss of tax revenue and have been challenging these precedents on the basis that they are outdated and were formulated at a time that does not square adequately with today's economic reality.

The Supreme Court's Ruling

In its ruling, the Court overturned its longstanding physical presence rule. The Court determined that an economic and virtual presence (e.g. online, digital) is sufficient to allow states to impose sales and use tax compliance obligations on out-of-state businesses.

In the case in question, South Dakota's statute required an out-of-state business to register if they had over $100,000 in gross sales or if they had made more than 200 separate transactions in South Dakota, even if the business had no physical presence in the state. Under its new standard, the Court found that such a rule did not create an undue burden for out-of-state businesses, since it only applied to businesses with a significant economic or virtual presence.

The Court also highlights certain aspects of the statute:

- The statute offers a safe harbor for smaller businesses;
- The statute is not applicable retroactively (i.e. registration and collection obligations would only exist after the ruling);
- South Dakota is part of the Streamlined Sales and Use Tax Agreement ("SSUTA");
- South Dakota offers access to sales tax administration software paid for by the state

What this means going forward

A number of other states have already enacted similar legislation that would require out-of-state businesses to register if they are above a certain threshold in sales. While Quill and Bella Hess were applicable, these statutes were unconstitutional and not enforceable. However, now that these precedents have been set aside, these statutes are likely constitutional and enforceable. Note that certain statutes do not contain all the features of the South Dakota statute (i.e. no retroactivity, SSUTA membership, free sales tax administration software). It is possible that certain these statutes will be challenged in court on the basis of these differences.

Regardless, we are now likely to see a massive move towards creating new registration and collection obligations for out-of-state businesses. Failure to comply with these obligations could lead to

significant costs for the businesses caught unaware in terms of uncollected taxes, penalties and interest.

What this means for your business

Do you have significant sales in the United States but are not registered for any state sales and use taxes? Do you have a high volume of transactions in the United States (e.g. via an online store)? If so, you are likely affected by these changes.

If you would like to know more about how your business may be impacted, contact your RCGT tax professional.