

***SOUTH DAKOTA V. WAYFAIR* AND TAX MODERNIZATION IN NEBRASKA**

Adam B. Thimmesch*

On January 12, the Supreme Court granted certiorari in *South Dakota v. Wayfair*, a case that could have an immense impact on Nebraska. The *Wayfair* case involves the issue of whether states can require out-of-state vendors to collect their sales taxes on online sales.¹ Current Supreme Court precedent—*Quill Corporation v. North Dakota*—restricts states from doing so unless the vendors have some physical presences within their boundaries. If the Court were to overrule *Quill*, Nebraska would presumably have greatly expanded power and could see up to \$95 million in additional annual tax collections.² That amount of revenue could be critically important given Nebraska’s current budget situation.

This essay introduces the origin of the Court’s current doctrine in this area and discusses legislation in Nebraska that would ready the state to collect this tax revenue if the Court were to overturn its long-standing physical-presence rule.

I. INTRODUCTION

The basic question presented in *Wayfair* is whether the Court should abrogate the physical presence rule of *Quill*.³ In modern discussions, that rule is best known as what protects consumers from “online sales tax.” The case has always been about more than online sales, though, as its

* Associate Professor of Law, University of Nebraska College of Law.

¹ The tax that should be collected on online sales is technically the state’s “use tax” rather than its “sales tax.” The taxes are functionally equivalent, but they are different. Sales taxes apply to in-state *transactions* whereas use taxes apply to in-state *uses* of taxable property or services. See Adam B. Thimmesch, *Taxing Honesty*, 118 W. VA. L. REV. 147, 151–57 (2015). When discussing the tax collected on online sales, it is the use tax that we are discussing because the taxable sale generally occurs outside of the state where the product is ultimately consumed.

² U.S. Gov’t Accountability Off., *States Could Gain Revenue from Expanded Authority but Businesses are Likely to Experience Compliance Costs* appx. II (Nov. 2017), <https://www.gao.gov/products/GAO-18-114>.

³ Petition for Writ of Certiorari at *i, *South Dakota v. Wayfair*, No. 17-494, 2017 WL 4404984 (Oct. 2, 2017).

origin would suggest. The *Quill* Court was not the first to impose a physical-presence limitation.⁴ Rather, the *Quill* Court merely affirmed that rule—as a dormant Commerce Clause matter—by upholding a part of its 1967 decision in *National Bellas Hess v. Illinois*.⁵

National Bellas Hess involved a challenge to an Illinois statute that imposed use-tax collection obligations on vendors that solicited orders from in-state customers through the use of catalogues or other advertising, but did not require them to have any physical presences in the state.⁶ The Court evaluated whether that statute violated the Due Process Clause or created an “unconstitutional burden on interstate commerce.”⁷ In a relatively short opinion, the Court noted that it had “never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail.”⁸ The Court noted that it had drawn a “sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.”⁹ It declined to abandon that distinction, and the physical presence rule was born.

The decades that passed after *National Bellas Hess* saw many changes in technology, the economy, and to the Court’s Due Process and dormant Commerce Clause doctrines.¹⁰ Those changes caused North Dakota to test the validity of *National Bellas Hess* by passing a statute that imposed tax-collection obligations without regard to physical presences, much like Illinois had

⁴ See Hellerstein & Hellerstein, STATE TAXATION ¶ 19.02 (3d ed. 2017) (outlining the history of the Court’s nexus requirement).

⁵ *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753 (1967).

⁶ *Id.* at 755.

⁷ *Id.* at 756.

⁸ *Id.* at 758.

⁹ *Id.*

¹⁰ *Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 208–13 (1991) (outlining the “wholesale changes in the social, economic, commercial, and legal arenas” since *National Bellas Hess*).

done decades ago.¹¹ The Quill Corporation challenged that requirement, the North Dakota Supreme Court upheld it, and the Supreme Court weighed in again.

The Supreme Court issued a much lengthier opinion in *Quill* than it had done in *National Bellas Hess*, and it took great care to explain the different concerns that had animated its Due Process and dormant Commerce Clause doctrines—the former being focused on fairness to individual taxpayers and the later on “the effects of state regulation on the national economy.”¹² It recognized that its Due Process doctrine had indeed evolved in a way that justified a repeal of the physical-presence rule, but it declined to remove that barrier as a dormant Commerce Clause matter.¹³ The *Quill* Court did not delve into the substantive merit of the physical-presence rule, but instead relied heavily on *stare decisis* and the benefits that it perceived stemmed from having a bright-line rule governing the field.¹⁴ The Court was comforted in its decision by the fact that Congress could ultimately overrule *Quill* by exercising its affirmative Commerce Clause power.¹⁵

Twenty-six years have passed since the Court last spoke on this matter. And again, much has changed. The explosive growth of online commerce was certainly not foreseeable in 1992. It seems equally as unlikely that the Court could have foreseen the immense amount of uncertainty that its physical-presence rule would beget as businesses and states attempted to work within, and

¹¹ *Quill*, 504 U.S. at 302–03.

¹² *Id.* at 305–06.

¹³ *Id.* at 307–18.

¹⁴ *Id.* at 317 (holding that “the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law”). The Court directly admitted that it might not adopt the physical-presence rule if it were being considered as a matter of first impression. *Id.* at 311.

¹⁵ *Id.* at 318 (“This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.”).

around, its parameters.¹⁶ Indeed, one of the *Quill* Court’s primary motivations in upholding the physical-presence rule was that it provided a bright line, which it thought would reduce litigation.¹⁷

At this point, scholars have offered many reasons for the Court to abandon *Quill*.¹⁸ States are certainly keen to see it eliminated as well, and their efforts have been labelled the “Kill *Quill* movement.”¹⁹ Even President Trump has expressed a desire to see it go.²⁰ The physical-presence rule seems to be on its way out, one way or another.

II. WAYFAIR

The Kill-*Quill* movement has been gaining momentum for the last decade, but it received a significant boost following the Supreme Court’s 2015 decision in *Direct Marketing Association v. Brohl*.²¹ That case involved a challenge to a Colorado law that required remote vendors to (1) provide their Colorado customers with notifications that their purchases were subject to Colorado tax and (2) provide those customers with annual summaries of their purchasing activity. The law also required those vendors to send annual summaries of their Colorado purchasers’ transaction volume to the state revenue authority as well.²²

¹⁶ These efforts have been going on since the emergence of Internet commerce. See, e.g., John Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. CAL. L. REV. 419, 420–25 (2002).

¹⁷ *Quill*, 504 U.S. at 315–19.

¹⁸ See, e.g., Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 394–95 (1997); Richard D. Pomp, *Revisiting Miller Brothers, Bellas Hess, and Quill*, 65 AM. U. L. REV. 1115, 1121 (2016); John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 WM. & MARY L. REV. 319, 337–44 (2003) (questioning *Quill* on many grounds); see also Pomp, *supra*, at 1120 (noting that “[m]any, many articles have discussed *Quill*” and that “[a]lmost all of these articles...agree” that *Quill* should be overruled).

¹⁹ Hayes Holderness, *The Next Tax Reform: Internet Sales Tax*, THE HILL (Jan. 17, 2018), <http://thehill.com/opinion/judiciary/369157-the-next-tax-reform-internet-sales-tax>.

²⁰ James S. Brady Press Briefing Room, *Press Briefing by Treasury Secretary Steven Mnuchin on North Korea Sanctions*, WHITEHOUSE.GOV (Feb. 23, 2018, 11:40 AM), <https://www.whitehouse.gov/briefings-statements/press-briefing-treasury-secretary-steven-mnuchin-north-korea-sanctions/> (noting that “the President is focused on the idea of Internet sales tax” and that “the President wants to make sure that the states are getting the money that they deserve and that they can spend on infrastructure”).

²¹ *Direct Mktg. Ass’n v. Brohl*, 135 S.Ct. 1124 (2015).

²² See Adam B. Thimmesch, *Online Shopping and Tax Privacy*, THE SURLY SUBGROUP (July 13, 2017), <https://surlysubgroup.com/2017/07/13/online-shopping-and-tax-privacy/>.

The *Direct Marketing* case went to the U.S. Supreme Court on a procedural matter unrelated to tax collection on online sales, but Justice Kennedy used the occasion to write a concurring opinion excoriating *Quill*. He noted that the case was “questionable even when decided” and said that “*Quill* now harms States to a degree far greater than could have been anticipated earlier.”²³ He called it a “continuing injustice” and called for the “legal system [to] find an appropriate case for this Court to reexamine *Quill* and *National Bellas Hess*.”²⁴

South Dakota responded and enacted a statute that requires out-of-state vendors to collect the state’s use tax based on their economic connections with the state.²⁵ The South Dakota statute requires collection of that tax by vendors who, during the current or prior year, have generated over \$100,000 of sales to, or have engaged in 200 or more transactions with, South Dakota customers.²⁶ The South Dakota legislature understood that its statute was inconsistent with the Court’s physical-presence rule, and it included provisions in the law that would allow the case to travel expeditiously through the courts. Litigation quickly followed the enactment of the law, led by Wayfair and Overstock. South Dakota chose not to even defend its law, but instead focused solely on getting the U.S. Supreme Court to take the case.²⁷ Its strategy worked. On January 12th, the Supreme Court granted certiorari on the question of whether the physical-presence rule of *Quill* should be abrogated.

²³ *Direct Mktg. Ass’n*, 135 S.Ct. at 1135 (Kennedy, J., concurring).

²⁴ *Id.*

²⁵ The statute may have a technical error related to its application to the state’s sales tax instead of its use tax, but the plain intent is to have use tax collected on online sales into the state. See Hayes R. Holderness & Matthew C. Bock, *Did South Dakota Neglect Transactional Nexus in its Bill to Kill Quill?*, BLOOMBERG BNA DAILY STATE TAX REPORT (Dec. 7, 2017).

²⁶ S.B. 106 § 1, 91st Sess. (S.D. 2016).

²⁷ *Id.* at § 7; see also Adam B. Thimmesch, *Winning By Losing? Getting the Supreme Court to Review Quill*, THE SURLY SUBGROUP (Aug. 31, 2017), <https://surlysubgroup.com/2017/08/31/winning-by-losing-getting-the-supreme-court-to-review-quill/>.

No one can say for certain what the Court will do in *Wayfair*. We seem to know what Justice Kennedy would do. Justice Thomas has also long expressed an unwillingness to strike down any state laws under the dormant Commerce Clause, so his vote seems as certain as it can be.²⁸ That leaves seven other Justices. Vote counting is difficult and fraught with peril, so I will not go further than that in this essay. In another essay, I suggest that the Court's best, and most likely, course in *Wayfair* will be to eliminate the nexus requirement altogether and leave it to Congress to sort out any problems that result, if any.²⁹ I'll start from that proposition here. The next question, then, is what a reversal would mean for Nebraska.

III. ONLINE TAXES AND NEBRASKA

Nebraska has imposed a general tax on consumption since 1967.³⁰ That tax is actually composed of two separate taxes, a "sales tax" and a "use tax." The state's sales tax is imposed under Nebraska Revised Statutes section 77-2703(1), which imposes tax upon sales that occur "in this state." Subsection (2) of that section imposes the state's use tax "on the storage, use, or other consumption in this state of property purchased, leased, or rented from any retailer and on any transaction the gross receipts of which are subject to tax under subsection (1)." The two taxes are necessary because the State lacks the authority to impose taxes on sales that occur in other states.³¹ That means that Nebraskans could avoid the state's consumption tax by purchasing taxable items out of the state or from "remote" vendors via catalog or the internet. That is where the state's use

²⁸ *United Haulers Ass'n Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 349–55 (Thomas, J., concurring); *Ky. v. Davis*, 553 U.S. 328, 361–62 (2008) (Thomas, J., concurring) (2007) ("I would entirely discard the Court's negative Commerce Clause jurisprudence.").

²⁹ Adam B. Thimmesch, *A Unifying Approach to Nexus under the Dormant Commerce Clause*, __ MICH. LAW REVIEW ONLINE __ (forthcoming 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3122709.

³⁰ See Nebraska Legislature, *Nebraska Sales and Use Tax History and Program Description*, TAXES IN NEBRASKA https://nebraskalegislature.gov/app_rev/source/narrative_salestaxhistory.htm.

³¹ *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944) (holding that "to impose a tax on such transactions would be to project [a state's] powers beyond its boundaries and to tax an interstate transaction").

tax comes into play. When Nebraskans purchase taxable property or services and use them here, they owe the state’s tax on “use.”

Without more, this system of sales and use taxation could impose a duplicative tax burden on Nebraskans. They could be forced to pay sales tax at the point of sale *and* a use tax on their later use. That result is avoided, however, because Nebraska law also grants residents a credit against their use tax for any sales tax that they paid on the purchase of the taxable good or service.³² The problem with the sales and use tax system is therefore not one of double taxation, but one of non-taxation. The state does not, and cannot, require vendors that don’t have physical presences in the state to collect the state’s sales or use tax.³³ Consumption from many online vendors thus goes without any tax collected at the time of sale. Of course, that is where consumers should be paying their use tax, but few do.³⁴ The state also cannot economically pursue each Nebraskan for what they owe.

The resulting revenue loss to the state is difficult to estimate, but the GAO estimates that it is currently somewhere between \$67 and \$95 million a year.³⁵ That is substantial at a time when the State faces a current budget deficit hovering around \$200 million. And that is after last year’s deficit of nearly \$1 billion.

Last year, Senator Watermeier introduced LB44,³⁶ which would have imposed two different obligations on remote vendors. The first was an information-reporting requirement like

³² NEB. REV. STAT. § 77-2704.31.

³³ To that end, Nebraska Revised Statutes section 77-2703(2)(b) requires the collection of use tax only by vendors “engaged in business in th[e] state,” and that term is defined to include only retailers that have some physical operations in the state, either directly or through an agent.

³⁴ Nebraskans are supposed to self-report use tax either on a sales and use tax return or on their state income tax return. Take a look at Line 38 of the Nebraska Form 1040N.

³⁵ See *supra* note 2.

³⁶ LB 44 § 5, 105th Leg., 1st Sess. (Neb. 2017), available at <https://nebraskalegislature.gov/FloorDocs/105/PDF/Intro/LB44.pdf>.

that enacted by Colorado and litigated in *Direct Marketing Association v. Brohl*.³⁷ The second was a provision modeled after the South Dakota law³⁸ that would require remote vendors to collect the state's use tax if they exceeded the statute's quantitative thresholds.³⁹ The bill stalled in the legislature. This standstill followed opposition by Governor Ricketts and the issuance of an opinion by Attorney General Doug Peterson that called the bill unconstitutional as in conflict with *Quill*.⁴⁰

In this legislative session, Senator Watermeier has introduced an amended LB44 that solves many of the issues raised by opponents of the bill.⁴¹ It makes small changes to the information-reporting provisions, but most importantly expressly conditions the imposition of its tax-collection obligations on the Supreme Court or Congress abrogating the physical-presence limitation of *Quill*.⁴² That change means that the bill is on as solid footing as it could be. If the *Wayfair* Court does not overrule *Quill*, LB44 would impose only information reporting requirements on remote vendors. If it did overrule *Quill*, the state's tax-collection obligations would kick in on July 1.⁴³

There seems to be no legal reason for the state to not enact LB44, as amended, but some have raised other potential concerns. These include (1) the potential privacy issues raised by an information-reporting system; (2) whether the state can condition the effectiveness of a state law on an act of the Supreme Court or Congress; and (3) why the state would enact a statute before the Supreme Court or Congress affirmatively allows it to do so. These questions are all addressed below. None merit the legislature waiting to act.

³⁷ 135 S.Ct. 1124 (2015); LB 44 § 5.

³⁸ *See supra* note 26.

³⁹ LB 44 § 4.

⁴⁰ *Constitutionality of LB44 – The Remote Seller Sales Tax Collection Act*, Neb. Op. Att'y Gen. No. 17-002, 2017 WL 1424168 (Apr. 18, 2017).

⁴¹ LB 44 (AM 1822), 105th Leg., 2d Sess. (Neb. 2018), *available at* <https://nebraskalegislature.gov/FloorDocs/105/PDF/AM/AM1822.pdf>.

⁴² *Id.* at § 9.

⁴³ Technically, the requirements under the bill are effective on the later of July 1 or the first calendar quarter following a reversal of *Quill*. *Id.* However, the Court has scheduled oral arguments in *Wayfair* for April 17th and should issue its opinion by the end of its term in June.

A. The Privacy Aspects of Information Reporting

Under LB44, as introduced last year, remote vendors would have been required to provide the State with an annual report listing the amount of money that each Nebraskan spent with the retailer over the last year. That reporting requirement raises privacy concerns. Namely, should the state have a database of where every Nebraskan shops?

Privacy is a tough concept to define, so people will have different opinions on this. However, it seems clear that such a database might not be particularly problematic when the vendor is a general retailer like Amazon or Wal-Mart, but that the calculus would be very different where the vendor sells a narrower range of items—perhaps those of a sensitive political, medical, or sexual nature. People could legitimately be concerned about the privacy implications of a reporting requirement that disclosed purchases from a retailer of that type.

The version of LB44 introduced in the legislature this year addresses that concern in a simple, effective way. Instead of requiring remote vendors to report on each Nebraska consumer, it requires them to report the aggregate amount of commerce that it engaged in with *all* Nebraska consumers.⁴⁴ The individual privacy concern is thus alleviated.

B. Unconstitutional Delegation of Power?

Another critical amendment made to LB44 is that it makes the effectiveness of its tax-collection obligation contingent upon the Supreme Court or Congress eliminating the physical-presence restriction of *Quill*. This type of provision is not typical for a state law, but it is perfectly appropriate. The State Constitution vests legislative power in the Unicameral, and it is that body that should make our laws, but the legislature can make its law conditioned on outside events.⁴⁵

⁴⁴ LB 44 (AM 1822 § 6).

⁴⁵ See *Lennox v. Hous. Auth. of Omaha*, 290 N.W. 451, 457-58 (1940) (“The legislature cannot delegate its powers to make a law, but it can make a law to become operative on the happening of a certain contingency or on an ascertainment of a fact upon which the law intends to make its own action depend.”).

The Nebraska Supreme Court has long held that this is proper, even when the condition is an act of a branch of the federal government.

The critical case in this regard is *State v. Padley*.⁴⁶ That case involved a challenge to the state's speed limit on the freeway. At the time, state law fixed the speed limit at 55 miles per hour, but provided that the limit would go up to 75 miles per hour if the President or Congress eliminated a federal restriction on state speed limits.⁴⁷ The Nebraska Supreme Court specifically addressed this aspect of the law and whether it was an unconstitutional delegation of the legislature's authority, and it said that it was not. Here's what it said:

It may also be noted that after fixing a definite speed limit presently effective, the statute proceeds to fix an alternative speed limit to become effective when the federal conservation act is nullified. In so doing the Legislature has not delegated its power to make the law but has designed its alternative provision to become effective on the happening of a certain contingency. It is a well-recognized rule of law that: 'The legislature cannot delegate its powers to make a law, but it can make a law to become operative on the happening of a certain contingency or on an ascertainment of a fact upon which the law intends to make its own action depend.'⁴⁸

This opinion has not been overruled and has been cited by the State Attorney General in a number of opinions since that time.⁴⁹ It also just makes sense. Conditioning the effectiveness of a state law on an outside event is qualitatively different than delegating the ability to make substantive law.

⁴⁶ 237 N.W.2d 883 (1976).

⁴⁷ *Id.* at 359.

⁴⁸ *Id.* at 360 (quoting *Lennox*, 137 Neb. 582, 290 N.W. 451).

⁴⁹ *See, e.g.*, Neb. Op. Att'y Gen. No. 92064, 1992 WL 473439 (April 27, 1992); Neb. Op. Att'y Gen. No. 91014, 1991 WL 496785 (March 1, 1991); Neb. Op. Att'y Gen. No. 87066, 1987 WL 248462 (May 4, 1987).

C. Why Act Now?

The biggest question that Senators and Nebraskans might raise with respect to LB44 is why the state should act now. If the effectiveness of the legislation is delayed unless and until the Court abrogates *Quill*, why not just wait to see what the Court does in *Wayfair*? The answer to this is multifaceted. First, LB44 would immediately impose information reporting requirements on remote vendors who do not collect the state's tax. That would immediately help the state to collect the taxes that are owed by Nebraskans on their online commerce regardless of what the Court does in *Wayfair*.

More fundamentally, the legislature should act now to be prepared for the Court's decision in that case. This year's legislative session ends on April 18, which means that the legislature will not be in session when the Court hands down its opinion. If the Court were to overrule *Quill*, and the state did not have LB44 in place, it would have to wait until 2019 to even introduce another bill. Taking into account the legislative process, that means that it would be at least nine months before the state could get any legislation in place, and maybe a year before it would be collecting revenue. That could result in up to \$100 million of lost revenue. Whether you think the state needs that revenue to fund things like our prisons, our schools, or our social workers—or to fund property tax relief—that is big money.

This is also a matter of fairness to Nebraska retailers. As it currently stands, Nebraska law gives our residents a tax incentive to give their business to online retailers. That just does not make sense. It also encourages out-of-state businesses to stay out of Nebraska. If those businesses come into the state to hire employees, store inventory, or open a location, they are hit with a tax collection obligation. Our laws thus undercut business expansion into the state. Finally, other states are enacting these types of laws, which will impact Nebraska retailers. If *Quill* is overturned, our

retailers will be required to collect tax for South Dakota and any other state that does act.⁵⁰ Failing to pass LB44 would mean that the legislature would protect those out-of-state businesses while putting our own businesses at a disadvantage.

IV. CONCLUSION

The Supreme Court is poised to make a significant change to how it regulates states and their exercise of taxing autonomy under our federal structure. The Court's current position has severely limited Nebraska's ability to conform its tax system to the modern economy and undercuts its ability to raise funds to support its operations. Nebraska is also otherwise at an important point in its history. Changes in the farm economy and ongoing budget issues have undercut the state's ability to provide the public services necessary for a state to compete and thrive in the modern world. The State should be following *Wayfair* very closely, and the legislature should carefully consider enacting LB44 so that it is poised to act if the Court removes the physical-presence limitation on its inherent power to tax.

⁵⁰ Apropos of this, the Governor of Iowa recently proposed adopting a package of tax provisions, including an expansion of its tax-collection requirements, that would impact Nebraska businesses selling into the state. *Iowa Tax Reform Proposal Introduced*, EY TAX NEWS UPDATE (Feb. 22, 2018), <https://taxnews.ey.com/news/2018-0399-iowa-tax-reform-proposal-introduced-includes-sales-tax-nexus-expansion-taxation-of-digital-products-individual-income-tax-changes>.