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Connecticut's 'Kill Quill' Bet Seems To Pay Off

By **Marc Finer** (July 25, 2018, 1:44 PM EDT)

In the highly anticipated decision, *South Dakota v. Wayfair Inc.*,^[1] the United States Supreme Court overturned the long-standing “physical presence” standard, which previously served as a prerequisite to the collection of state sales tax by out-of-state retailers. In *Wayfair*, the court analyzed the constitutionality of a South Dakota “economic nexus” law that required out-of-state retailers to collect and remit sales tax “as if the seller had a physical presence in the state” if the retailer, on an annual basis, delivered more than \$100,000 of goods or services into South Dakota or engaged in 200 or more separate transactions for the delivery of goods or services into South Dakota.



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In its analysis, the court reviewed the framework under which the constitutional validity of state taxes will be sustained. Under this framework, a state tax — including sales tax — will be sustained as long as it:

- Applies to an activity with a substantial nexus to the taxing state;
- Is fairly apportioned;
- Does not discriminate against interstate commerce; and
- Is fairly related to the services the state provides (e.g., police and fire protection, road access, municipal services).

The question before the court was whether a retailer must satisfy the “physical presence” standard enunciated in *Quill Corp. v. North Dakota*^[2] to satisfy the “substantial nexus” prong of this framework. With respect to the South Dakota law, the court concluded that a retailer who met the law’s dollar amount or sales volume threshold availed itself of the substantial privilege of carrying on business in South Dakota. Such a retailer thus, satisfied the “substantial nexus” prong of the framework notwithstanding the absence of any physical presence in the state. As a result, online retailers, such as the respondents in the *Wayfair* matter, would be required to collect and remit sales tax to South Dakota even though they have no physical presence in the state. In arriving at its conclusion, the court noted that the South Dakota law had several attributes that prevented it from running afoul of commerce clause protections:

- The law is not retroactive;
- The law affords a reasonable degree of protection to small merchants in that it requires a merchant to collect the sales tax only if it transacts a considerable amount

of business in South Dakota; and

- South Dakota is a party to the Streamlined Sales and Use Tax Agreement which standardizes taxes to reduce administrative and compliance costs.

In anticipation of the Wayfair decision, Connecticut recently enacted "An act concerning the department of revenue services' recommendations regarding state taxation and collection." The act, in part, changes the sales tax nexus standard for determining whether an out-of-state retailer regularly or systematically solicits sales of tangible personal property in Connecticut and is therefore required to collect and remit Connecticut sales tax. Under the act, online retailers without a physical presence in the state are required to collect and remit Connecticut sales tax if they have at least \$250,000 of gross receipts from sales to Connecticut residents and at least 200 separate retail sales from outside Connecticut to destinations within the state during the preceding 12-month period. To expand the types of retailers required to collect and remit Connecticut sales tax, the act broadens the definition of "retailer" to include "market facilitators" and persons who make retail sales from outside Connecticut to a destination within Connecticut by the internet. For purposes of the act, market facilitators include out-of-state companies that facilitate the sale of goods and services in an electronic forum such as an internet website, dedicated sales software applications or other forms of electronic delivery. The portion of the act relating to the sales tax provisions becomes effective Dec. 1, 2018.

In light of the Wayfair decision, it is likely that the \$250,000 gross receipts and 200 separate transactions thresholds in the act would satisfy the "substantial nexus" prong in considering the constitutional validity of the sales tax provisions in the act. An open question, however, is whether Connecticut's failure to be a member of the Streamlined Sales and Use Tax Agreement would prove fatal to the validity of these provisions notwithstanding its incorporation of gross receipts and separate transaction thresholds that meet or exceed those in the South Dakota economic nexus law. Also, one has to wonder whether Connecticut will consider changing its sales tax nexus provisions of the act to match the South Dakota law by reducing the \$250,000 gross receipts threshold to a \$100,000 threshold and by changing the gross receipts and separate transaction thresholds to a disjunctive test (i.e., "or" test) rather than conjunctive test (i.e., "and" test). These changes would clearly broaden the Connecticut sales tax base.

Other states may also need to re-examine their sales tax laws to ensure that they comply with Wayfair. In addition, states may begin to consider changes to existing gross receipts and separate transactions thresholds in their sales tax "economic nexus" laws to parallel those in the South Dakota law and an expansion of the category of retailers covered by their law. For example, to incorporate the physical presence standard of Quill into its sales tax regime, Massachusetts has a regulation that defines physical presence to include making use of software (e.g., "apps") available to be downloaded by in-state residents and placing cookies on in-state web browsers. The argument is that these digital footprints represent a "physical presence" in Massachusetts. These out-of-state internet retailers are required to collect and remit Massachusetts sales tax if they have in excess of \$500,000 in online sales in Massachusetts or have at least 100 transactions to in-state residents during the preceding calendar year. With the Wayfair decision and similar to Connecticut's response, one has to wonder whether Massachusetts will remove the physical presence standard in its regulation, adjust the sales or transaction thresholds to match those in the South Dakota law, expand the category of retailers covered by the regulation, or some combination of the foregoing.

In any event, with the "substantial nexus" standard replacing the "physical presence" standard as a result of the Wayfair decision, businesses should expect a prompt and rapid expansion of sale tax nexus assertions by the states. Online retailers and other e-commerce companies need to examine their business operations to determine whether

they are now required to collect and remit sales tax to Connecticut and other states. They will need to also consider the additional compliance burden such obligation will entail. Online retailers should consult their tax advisors to better understand the implications of the Wayfair decision and how it may affect their business.

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[1] [South Dakota v. Wayfair Inc.](#) , 585 U.S. ____ (2018).

[2] [Quill Corp. v. North Dakota](#) , 504 U.S. 298 (1992).

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