UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH DAKOTA
CENTRAL DIVISION

STATE OF SOUTH DAKOTA, Plaintiff, v. WAYFAIR INC. OVERSTOCK.COM, INC. NEWEGG INC. Defendants.	))))))))))))	3:16-CV-03019-RAL BRIEF IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

Defendants Wayfair Inc., Overstock.com, Inc., and Newegg Inc., submit this brief in support of their motion for summary judgment on the Complaint for declaratory relief filed by the Plaintiff, the State of South Dakota ("the State"). The State seeks a declaration that it may impose sales tax collection obligations upon the Defendants under a new South Dakota statute, Senate Bill 106, "An Act to provide for the collection of sales taxes from certain remote sellers," 91st Sess., S.D. Legis. (2016) ("S.B. 106"or "the Act"). The Act represents an unprecedented attempt, in contravention of the Commerce Clause of the United States Constitution, to expand the State's taxing jurisdiction beyond its borders to reach companies located anywhere in the United States based solely on their having a minimum level of sales to, or transactions with, customers in South Dakota. Because the Act's novel "economic nexus" standards are directly at odds with established United States Supreme Court precedent and seek to usurp the proper role of Congress in regulating interstate commerce, the Defendants' motion for summary judgment should be granted.

INTRODUCTION

Under the Commerce Clause, every state tax must satisfy the "substantial nexus" requirement of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Under this test, an interstate business "must have a substantial nexus with the State before *any* tax may be levied on it." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981) (emphasis in original).

Consistent with the substantial nexus requirement for state taxes recognized in *Complete Auto*, it has been established by the United States Supreme Court for at least 50 years that a state lacks the power to impose a sales or use tax[1] collection obligation on a company located outside the state that has no "physical presence" in the taxing state and communicates with its customers there solely via the instrumentalities of interstate commerce (*e.g.*, United States mail, common carrier, and, today, the Internet). *See National Bellas Hess, Inc. v. Illinois Dep't of Revenue*, 386 U.S. 753, 758-60 (1967). The Supreme Court reaffirmed the physical presence, substantial nexus requirement for sales and use taxes in *Quill Corp. v. North Dakota*, 504 U.S. 298, 313-19 (1992). Since its decision in *Quill*, the Supreme Court has never held, or even suggested, that any different or lesser "substantial nexus" standard applies for determining the validity of a state sales tax, while reaffirming *Quill's* basic principles in decisions issued as recently as 2015.

Nevertheless, by its express terms, S.B. 106 imposes sales tax collection and reporting obligations upon any remote seller of tangible personal property, products transferred electronically, or services for delivery into South Dakota, "*who does not have a physical presence in the state*," so long as the seller meets one of two different economic thresholds during the prior or current calendar year: realizing at least $100,000 of gross revenue from, or

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[1] South Dakota law imposes a sales tax on retailers of taxable tangible personal property, services, and goods transferred electronically. A parallel use tax applies to South Dakota consumers when sales tax is not paid on a taxable transaction. *See* South Dakota Department of Revenue Fact Sheet, "Use Tax" (March 2011), available at https://dor.sd.gov/Taxes/Business_Taxes/Publications/PDFs/usetax315.pdf. Because they are complementary taxes, the "substantial nexus" standard under the Commerce Clause is the same for both sales tax and use tax.

completing at least 200 separate transactions with, customers in South Dakota. *See* S.B. 106, § 1 (italics added).

In enacting S.B. 106, and in bringing its declaratory judgment action against the Defendants, the State acknowledged that the Act's requirements are unconstitutional under applicable Supreme Court precedent, *i.e., Quill*. The South Dakota legislature expressly found that: (a) established constitutional doctrine "prevents states from requiring remote sellers to collect sales tax;" (b) the Court's substantial nexus doctrine would need to be changed "to permit the collection obligations of this Act;" and (c) "a decision from the Supreme Court of the United States abrogating its existing doctrine" would be necessary for S.B. 106 to be enforced. *Id.* § 8(7), (10), (11). In its Complaint, the State again acknowledged that "a change in federal constitutional doctrine will be necessary for the State to prevail in this case" and that "a declaration in its favor will require the abrogation of the United States Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)." Complaint ¶¶ 1, 51. The State's admission that S.B. 106 violates the "substantial nexus" standard for sales taxes under *Quill* should alone be sufficient for this Court to enter summary judgment for the Defendants. Indeed, it is fundamentally improper for the State even to request (Complaint, Prayer for Relief ¶ (1)) that this Court validate statutory provisions that the State admits are at odds with existing Supreme Court precedent.

The legislative findings of S.B. 106, and the extended narrative of the State's Complaint, decry in exaggerated terms the state revenue losses supposedly caused by the physical presence standard affirmed in *Quill*. The State fails, however, to explain the wildly complex and burdensome system of state sales taxes in the United States that led the Supreme Court to adopt, and then reaffirm, the physical presence standard of nexus.

Instead of simplifying the burdensome sales tax system after *Quill*, the states collectively have made it even more complex. At the time the Court decided *Quill*, it cited in support of its decision the diverse and potentially conflicting sales tax obligations that would be imposed on remote sellers (in the absence the "physical presence" doctrine) by "the Nation's 6,000-plus taxing jurisdictions," explaining that they would unduly burden interstate commerce in violation of the Commerce Clause. *Quill*, 504 U.S. at 313 n.6. Since 1992, the number of state and local taxing jurisdictions imposing a sales tax has *increased* by several thousand to 10,000 or more such jurisdictions. *See* "State Sales Tax Jurisdictions Approach 10,000," Tax Foundation (Mar. 24, 2014), available at http://taxfoundation.org/blog/state-sales-tax-jurisdictions-approach-10000. Today, more than ever, the excessively complicated U.S. sales tax system, with its "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [remote sellers] in a virtual welter of complicated obligations," *Bellas Hess,* 386 U.S. at 759-60 (brackets added), that would dwarf the complications envisioned by the Supreme Court when it first recognized, and then upheld, the physical presence requirement.

Furthermore, striking the proper balance between a free-flowing national marketplace, on the one hand, and the interest of the States in burdening such commerce in order to secure the collection of revenue ultimately due from its residents, on the other hand, is a role assigned by the Constitution to Congress, through the Commerce Clause, and not to the States, let alone an individual State such as South Dakota. U.S. Const., Art. I, Sec. 8, Cl. 3 (Congress shall have the power "[t]o regulate commerce … among the several States"); *Quill*, 504 U.S at 318-19 (in light of Congress' role in regulating interstate commerce, including whether to permit the imposition of sales/use tax collection obligations on remote sellers, "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.") It is only Congress,

and not the States or the courts, that has the institutional expertise to weigh the national implications of expanded state taxing authority and to craft legislation that will simplify and make more uniform state sales tax systems, to assure that state tax obligations do not unduly burden interstate commerce. South Dakota's unprecedented jurisdictional and regulatory power grab contravenes such fundamental principles of the Constitution and cannot stand.

For these reasons and the other reasons set forth below, this Court should fulfill the most basic obligation of a lower federal court by following existing Supreme Court precedent. The Court should grant the Defendants' motion for summary judgment because the declaration requested by the State is plainly unconstitutional under established Commerce Clause principles and the clear holding of *Quill*.

PROCEDURAL BACKGROUND

In March 2016, the South Dakota legislature enacted, and Governor Dennis Daugaard signed into law, S.B. 106. The Act on its face requires any retailer that sells tangible personal property, products transferred electronically, or services for delivery into South Dakota, and that does not have a physical presence in the state, to collect South Dakota sales taxes if, during the current or previous calendar year either:

(1) The seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeds one hundred thousand dollars; or

(2) The seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in two hundred or more separate transactions.

S.B. 106, § 1. The legislature further authorized the State to bring a declaratory judgment action in state court against any person the state believes meets the criteria of section 1, in order to "establish that the obligation to remit sales tax is applicable and valid under state and federal

law." *Id.* The statute also directed the court to "presume that the matter may be fully resolved through a motion to dismiss or a motion for summary judgment." *Id.*

Three days after the Act was signed into law, the South Dakota Department of Revenue ("Department") sent notices to the Defendants that the Department believed they met the requirements of S.B. 106 for sales tax collection, but lacked physical presence in South Dakota and were not collecting sales tax. *See* Complaint, ¶¶ 35, 37. The notices directed the Defendants to register with the Department by April 25, 2016, or face possible suit under the Act.

The Defendants did not register to collect sales tax, because the provisions of the Act requiring sales tax collection by retailers with no physical presence in the State violate the limitation on the State's taxing power under the Commerce Clause, as reaffirmed in *Quill*.

On April 28, 2016, the State filed suit against the Defendants in state Circuit Court. *State of South Dakota v. Wayfair Inc. et al.*, Docket No. 32CIV16-00092 (Sixth Judicial Circuit, Hughes County). The State acknowledged that "a declaration in its favor will require the abrogation of the United States Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)." Complaint ¶ 1. Nevertheless, in its Complaint, the State sought a declaration that the requirements of Section 1 of the Act are valid and applicable with respect to the Defendants. *Id.*, Prayer for Relief, ¶ (1).[2]

On May 25, 2016, the Defendants timely filed with this Court their Notice of Removal (Doc. 1), transferring the action from the state Circuit Court. Removal was proper because this Court has jurisdiction under 28 U.S.C. § 1331 over the State's affirmative suit. The action raises an express question of federal law under the Constitution of the United States that is "actually disputed and substantial" and which the Court may resolve without disturbing the proper balance

[2] It is remarkable that the State acknowledges the absence of any existing constitutional authority to impose the sales tax obligations of S.B. 106 upon companies located in remote jurisdictions (here, Massachusetts (Wayfair), Utah (Overstock), and California (Newegg)), and yet has elected to haul such remote sellers into court in order to seek, at their considerable expense, a unilateral expansion of the State's taxing authority via declaratory judgment.

between federal and state judicial responsibilities. *See Grable & Sons Metal Prods., Inc. v. Darue Engineering & Mfg.*, 545 U.S. 308, 314 (2005). On the same day, the Defendants filed their Joint Answer (Doc. 7).

On June 22, 2016, the parties filed a Joint Motion for Entry of Briefing Schedule (Doc. 18), in which they proposed to the Court that the parties file concurrent dispositive motions on July 22, 2016. The Defendants sought to file a motion for summary judgment based on the Act's failure to satisfy the "substantial nexus" requirement for state sales taxes, and the State indicated that it planned to file a motion to remand the case to state court. On June 29, 2016, the Court entered an order granting the parties' Joint Motion (Doc. 19).

The Defendants now move for summary judgment.

SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate when there is no genuine dispute of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a); *United States v. Tolin*, -- F.3d --, 2016 WL 3606648 at * 2 (July 5, 2016). Where the parties have no genuine dispute as to the facts and the law is clear, summary judgment is "properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed 'to secure the just, speedy and inexpensive determination of every action.'" *Torgerson v. City of Rochester*, 643 F.3d 1031, 1043 (8th Cir.2011) (en banc) (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986)).

FACTS

The parties are in agreement that this case presents no genuine dispute of fact that would prevent the entry of judgment as a matter of law. *See* Joint Motion for Entry of Briefing Schedule (Doc. 18) at 2 ("The parties agree that this matter turns on pure questions of law and that no discovery is necessary so that an early motion for judgment as a matter of law is

appropriate."); Form 52 Report (Doc. 20) at 3 ("There is no dispute that each of the Defendants is a retailer with no physical presence in South Dakota and that each meets the requirements for sales tax reporting under S.B. 106, § 1.")

The facts set forth in the Defendants' Statement of Material Facts ("DSMF") establish only those facts necessary to show that the Act applies to the Defendants. *See* DSMF, ¶¶ 1-9 (confirming that each of the Defendants has no physical presence in South Dakota, does not report South Dakota sales tax, and had either $100,000 in gross revenues and/or 200 sales transactions for products delivered to customers in the State of South Dakota in 2015). No other facts are required to support the Defendants' right to judgment as a matter of law that the State's attempt to require them to collect South Dakota sales tax under S.B. 106 violates the Commerce Clause.[3]

ARGUMENT

I. THE COMMERCE CLAUSE LIMITS THE AUTHORITY OF A STATE TO IMPOSE TAX OBLIGATIONS ON SELLERS THAT LACK A SUBSTANTIAL NEXUS WITH THE STATE.

The Commerce Clause delegates to Congress the power "[t]o regulate commerce . . . among the several States." U.S. Const., Art. 1, Sec. 8, Cl. 3. It is well-established that the Commerce Clause has a corresponding "negative" or "dormant" aspect that expressly restricts the authority of a state to impose undue burdens on interstate commerce. *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 98 (1994). Under contemporary dormant Commerce Clause analysis, a state tax must satisfy the four-part test of *Complete Auto Transit* to withstand a challenge that the tax is unconstitutional. *E.g., Comptroller of the Treasury v.*

[3] The Defendants note that numerous assertions regarding the impact of the physical presence standard on state tax revenues contained in the legislative findings for S.B. 106, and in the State's Complaint seeking a declaration of its enforceability against the Defendants, are both immaterial and incorrect. Because such "factual" assertions are more in the nature of argument, they are refuted later in the Defendants' brief. *See, infra*, Section II.B.

Wynne, -- U.S. --, 135 S.Ct. 1787, 1793 (2015) (citing *Complete Auto,* 430 U.S. at 279). This case concerns the first prong of the *Complete Auto* test—substantial nexus—which is designed to "limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." *Quill Corp*., 504 U.S. at 313.

A. Substantial Nexus For State Sales Tax Requires That A Retailer Must Have A "Physical Presence" In The State.

For nearly 50 years, it has been established by the United States Supreme Court that, under the Commerce Clause, a state has no authority to impose a sales or use tax collection obligation on a company located outside the state that has no "physical presence" in the taxing state. In *Bellas Hess,* decided in 1967, the Supreme Court held that the State of Illinois lacked the power to impose a sales/use tax collection obligation on a company located outside the state whose only connection to the taxing state was communications with customers in the state via the instrumentalities of interstate commerce (*e.g*., United States mail, common carrier, and, today, the Internet). *See Bellas Hess*, 386 U.S. at 758–760. The company had no facilities, property, employees, or representatives in the state. *Id.* at 754. It did, however, mail catalogs and advertising flyers to recipients in the state, and sold goods via mail order to Illinois residents that were delivered to the purchasers via common carrier and the U.S. mail. *Id.* at 754–755. In striking down the Illinois tax provision, the Supreme Court upheld the "sharp distinction" established in prior cases between sellers with a physical presence in the state, and those without a presence who reached customers only via interstate commerce. *Id.* at 758.

Twenty-five years later, the Supreme Court reaffirmed the physical presence requirement of *Bellas Hess* and again held that, under the Commerce Clause, a retailer with no physical presence in the state cannot be obligated to collect a state's use tax. *Quill,* 504 U.S. at 313-19. Like the retailer in *Bellas Hess,* the remote seller in *Quill* had no outlets or salespeople in the taxing state, but sent catalogs and flyers to customers in the state via mail. North Dakota had

sought to require Quill to collect use tax on its sales to North Dakota consumers, based on Quill's distribution of catalogs and delivery of products into the state. 504 U.S. at 302-04. In finding the statute violated the Commerce Clause's substantial nexus requirement, the Supreme Court reaffirmed that a vendor "whose only connection with customers in the [taxing] State is by common carrier or United States mail" lacks a physical presence in the state for purposes of the "substantial nexus" requirement of the Commerce Clause. *Id.* at 315.

The Supreme Court emphasized that the "bright line" rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause:

> Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. *Bellas Hess* followed the latter approach and created a safe harbor for vendors "whose only connection with customers in the [taxing] State is by common carrier or United States mail."

Id. at 314-15 (brackets added). The Court further noted that any "artificiality" at the edges of the "bright line," physical presence test is more than offset by a rule that "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes" and encourages settled expectations among companies potentially subject to state tax obligations. *Id.* at 315-16.

Quill has never been called into question by any decision of the Supreme Court. To the contrary, the Court has continued to cite *Quill* favorably with regard to the limitations on state taxing authority under the Commerce Clause. For example, in *Hemi Group, LLC v. City of New York*, the Court rejected an effort by the City to find a creative way to "end-run its lack of authority" under *Quill*. 559 U.S. 1, 17 (2010) (Roberts, J., majority) (City improperly sought to impose civil liability on company for lost taxes "it had no obligation to collect, remit, or pay") and 559 U.S. at 18 (Ginsburg, J., concurring) (noting that the Commerce Clause prohibits the

imposition of a use tax collection obligation on an out-of-state seller with no physical presence in the jurisdiction, citing *Quill* and *Bellas Hess*).

Moreover, in its most recent term, the Court cited *Quill* favorably in reviewing the constitutionality of Maryland's individual income tax, including for the proposition that the Commerce Clause places limits on the authority of a state to regulate interstate commerce, even where the requirements of the Due Process Clause are satisfied. *Wynne*, 135 S.Ct. at 1798-99 ("while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause").[4] The economic nexus provisions of S.B. 106 clearly overstep those fundamental limitations on state taxing power under the Commerce Clause, by imposing sales tax obligations on out-of-state companies based solely on their gross revenues, or minimum number of transactions, from the sale of products delivered to South Dakota customers via common carrier.

B. The Court is Required To Follow *Quill*.

Even if there was reasonable speculation that the Supreme Court may eventually decide to reverse the physical presence standard, this Court must still follow the rule established in *Quill* in adjudicating the State's Complaint. As the Supreme Court has made clear, if the "precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions," lower courts "should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989); *see also Citizens United v. Fed. Election Comm'n,* 558

[4] The State relies heavily on the concurring opinion filed by Justice Kennedy in *Direct Marketing Assn. v. Brohl*, -- U.S. --, 135 S.Ct. 1124 (2015), in which he suggested that the holding of *Quill* should be reexamined. 135 S.Ct. at 1135. No other member of the Court joined Justice Kennedy's concurrence, and a few weeks later the Court issued its decision in *Wynne*, citing *Quill* favorably. 135 S.Ct. at 1798-1799; *see also id.* at 1818 (Ginsburg, J., dissenting) (citing *Quill* for the "obvious" proposition that the Commerce Clause imposes more stringent restrictions on state taxing power than the Due Process Clause). For the reasons discussed herein, the physical presence standard of *Quill* embodies the most basic principles of the Commerce Clause and fully retains its vitality in the Internet era.

U.S 310, 330 (2010) (Kennedy, J.) (noting with approval the District Court's adherence to Supreme Court precedent because "[o]nly the Supreme Court may overrule its decisions") (citing *Rodriguez de Quijas*, 490 U.S. at 484). The strength of this principle is illustrated by *Tenet v. Doe,* 544 U.S. 1 (2005). In *Tenet*, the Court reviewed the continuing viability of a rule established in a Civil War era case. *See id.* at 3 (discussing *Totten v. United States*, 92 U.S. 105 (1876)). The Court of Appeals read an intervening decision as limiting *Totten*, but the Supreme Court disagreed. *Tenet*, 544 U.S. at 8-9. Citing *Rodriguez de Quijas*, the Supreme Court chastised the lower court for failing to apply directly controlling precedent, in favor of related authority the lower court construed as undermining it. *Id.* at 10-11. This Court should summarily decline the State's invitation to issue a declaration that the requirements of S.B. 106 are valid and applicable to the Defendants, in violation of existing precedent — indeed, a violation of *Quill* that the State itself acknowledges in its Complaint.[5]

Adherence to settled precedent is particularly important in the area of Commerce Clause jurisdiction. When deciding whether to overrule the physical presence standard for state sales and use taxes established in *Bellas Hess*, the *Quill* Court noted that, even if it were convinced that the prior decision was incorrect under the Commerce Clause, the very fact that it was a Commerce Clause case counselled against overruling the decision because Congress has the power to change the result. As the Court explained, "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government" and defer to Congress. *Quill*, 504 U.S. at 318-19 (quoting *Commonwealth Edison Co*., 453 U.S. at 638); *see also id.* at 320 (Scalia, J., concurring) ("Congress has the final say over regulation of interstate commerce, and

[5] In its most recent term, the Supreme Court in a series of *per curiam* decisions presenting a variety of different legal issues reversed lower court rulings that failed to follow its precedents. *See, e.g., Johnson v. Lee,* -- U.S. --, 136 S.Ct. 1802, 1806 (2016) (*per curiam*), ("The Ninth Circuit's contrary reasoning is unpersuasive and inconsistent with this Court's precedents."); *James v. Boise,* -- U.S. --*,* 136 S.Ct. 685, 686 (2016) (*per curiam*) (State Supreme Court bound to follow U.S. Supreme Court precedent interpreting federal law).

it can change the rule of *Bellas Hess* by simply saying so. We have long recognized that the doctrine of *stare decisis* has 'special force' where 'Congress remains free to alter what we have done.'") (internal citation omitted).

C. Fundamental Principles Regarding The Regulation Of Interstate Commerce Require Rejection Of South Dakota's Statutory, Economic Nexus Thresholds.

1. The Physical Presence Standard of Substantial Nexus Is Grounded in the Core Principles of the Commerce Clause.

In *Quill*, the Supreme Court explained, at length, how the physical presence rule of *Bellas Hess* is consistent with, and grounded in, the principles that underlie the "substantial nexus" requirement of the Commerce Clause. 504 U.S. at 311-14 (the physical presence standard "furthers the ends of the dormant Commerce Clause"). The substantial nexus test derives from the core objectives of the dormant Commerce Clause and is informed "by structural concerns about the effects of state regulation on the national economy," rather than concerns about fairness to any individual company. *Id.* at 312.

As the Court recognized in *Quill*, the danger of inconsistent state laws across the many thousands of state and local taxing jurisdictions in the United States implicates fundamental principles of the Commerce Clause and justifies the "bright line" physical presence standard adopted by the Court. *Id.* at 313 n.6.[6] The potential burdens on retailers doing business in multiple states with differing tax laws are enormous, from initial registration and determination of a company's taxable products and services, to rate tracking and tax collection, to determining the proper taxable "sales price" and accounting for exemptions/exclusions, to obtaining the proper documentation from purchasers and maintaining the proper records, to monthly tax reporting and responding to revenue department audits, to identify only some of the complexities

[6] The number of state and local taxing jurisdictions in the United States has grown dramatically since the Supreme Court first recognized the physical presence requirement in 1967. The Court noted then that there were over 2,300 such jurisdictions. *Bellas Hess*, 386 U.S. at 759 n.12. At the time *Quill* was decided in 1992, there were over 6,000. *Quill*, 504 U.S at 313 n.6. Now there are 10,000 state and local taxing jurisdictions.

involved. Absent a rule that places clear and meaningful limits on state taxing authority, interstate businesses are faced with the substantial and, for small and medium-sized business, potentially crippling burdens of tax reporting and administration across multiple jurisdictions.

The very same "structural concerns" that support the physical presence requirement of *Quill* apply with equal force to the nexus thresholds of S.B. 106. If South Dakota is free to impose tax obligations on remote sellers based on nothing more than making sales to customers in the state, then "so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes," resulting in precisely the kinds of "local entanglements" and burdens on interstate commerce that the Commerce Clause is designed to prevent. *Bellas Hess*, 386 U.S. at 759-760.

Indeed, allowing states and localities to set their own, arbitrary sales thresholds to purportedly satisfy the Commerce Clause's substantial nexus requirement—and, necessarily, to adjust them as they choose—would render business planning for companies engaged in interstate commerce impossible. The State ignores the fact that a *different threshold* could apply in *every jurisdiction* having a sales or use tax, and that those thresholds could change at the whims of each new legislature, city council, or board of county commissioners.[7] For these reasons, the Commerce Clause requires a national perspective, taking into account the potential burdens on the national marketplace of tax policies that may be implemented across the country, not a focus

[7] Other states have already acted to adopt different sales thresholds. Under Alabama Department of Revenue Rule 810-6-2-.90.03(1), a retailer with no physical presence in the state is required to register for sales tax if the retailer makes at least $250,000 in annual sales to Alabama customers. The Tennessee Department of Revenue has advanced yet another threshold, proposing a rule that would require retailers with no physical presence in the state and more than $500,000 in annual sales to Tennessee consumers to collect sales tax. *See* Notice of Rulemaking Hearing (June 16, 2016), http://share.tn.gov/sos/rules_filings/06-12-16.pdf (proposed DOR Rule 1320-05-01-.129).

upon the requirements of a single state's law.[8] South Dakota's arbitrary "economic nexus" thresholds are a non-starter. [9]

2. The States Have Failed Since *Quill* to Simplify Their Sales Tax Systems.

The system of state and local sales taxes in the United States is highly complex. There are 45 states, plus the District of Columbia, and another 10,000 local taxing jurisdictions that impose a sales or use tax. This results in thousands of different tax rates, taxable and exempt products and services, exempt purchasers, shipping tax treatment, specialized tax rules (such as sales tax "holidays" and "thresholds" for different products), statutory definitions, registration and reporting regimes, documentation and record keeping requirements, and filing systems. In addition to the compliance burdens of such a system, companies are exposed to potential audit by every state and locality with a self-administered sales or use tax. Remote sellers are only shielded from such inordinate burdens by the physical presence substantial nexus requirement for state taxes under *Quill*.

South Dakota's own state and local sales tax regime contributes to the overall complexity of the United States sales tax system. South Dakota has 142 city, county, and special district taxes in addition to the state sales tax. *See* Tax Rates.org, 2016, South Dakota Sales Tax by Zip Code, available at http://www.tax-rates.org/south_dakota/sales-tax-by-county. A leading industry provider of sales tax software reports that "since South Dakota sales tax has numerous local taxing levels that must be monitored and maintained on a regular basis, compliance is complex and time consuming." *See* Avalara TaxRates, South Dakota, available

[8]What all of these problems highlight is precisely why the Framers assigned to Congress the responsibility for regulating interstate commerce under the Commerce Clause. Validation of South Dakota's self-selected "economic nexus" thresholds would obliterate the most basic principles of the dormant Commerce Clause and allow state and local legislators and tax officials to usurp congressional authority for regulating the national marketplace. *See infra*, Section II.

[9] In *Quill*, the Court expressly rejected an "economic presence" test as sufficient to meet the requirements of the Commerce Clause for state sales and use taxes. 504 U.S. at 304, 311-312 (describing state supreme court's endorsement of "economic presence" for Commerce Clause purposes, and rejecting it).

at http://www.taxrates.com/state-rates/south-dakota. Among the special districts are several Native American tribal areas with which the State has tax collection agreements. *See* South Dakota Department of Revenue Fact Sheet, "Tribal" (November 2012). In addition, unlike most states, South Dakota not only taxes tangible personal property, but also broadly taxes services as well as products transferred electronically.

While this very kind of complexity and disparity in state tax regimes is what led the Supreme Court to first adopt, and then reaffirm, the "physical presence" nexus standard for sales tax collection, the States have only exacerbated the problem since *Quill* was decided, with there now being over 10,000 different sales/use tax jurisdictions in the United States. Despite their demands for increased authority to impose sales tax collection and reporting obligations on interstate commerce, the States have simply been unwilling to meaningfully simplify a "crazy quilt" system that would inordinately burden interstate commerce, if all states and localities were permitted to export their tax requirements to out-of-state companies based solely on the remote seller communicating with and selling to a minimal number of customers in the jurisdiction.[10]

D. A Ruling That Customer Transactions Alone Are Sufficient To Support South Dakota's Taxing Authority Would Result In Nationwide Nexus For Any Internet Seller.

[10] To further illustrate the point, one need only look to the recent experience of the European Union. In a common market of only 28 member state VAT tax jurisdictions and only 75 different tax rates, the European Commission concluded that the administrative burden of complying with the varying member state VAT regimes in connection with cross-border consumer sales was one of the primary factors in suppressing the growth of electronic commerce on the continent. European Commission – Fact Sheet, "Action Plan on VAT: Questions and Answers" (Apr. 7, 2016), § 17 ("Businesses cite VAT obligations as one of the biggest barriers to cross-border ecommerce."), available at http://europa.eu/rapid/press-release_MEMO-16-1024_en.htm. In addition, it has been reported that the aggregate annual cost of compliance with EU VAT tax reporting obligations is estimated to be 80 billion euros. *See* Startup Europe, *Digital Single Market Strategy: European Commission agrees to areas for action* (March 25, 2015), available at http://startupeuropeclub.eu/digital-single-market-strategy-european-commission-agrees-areas-for-action/. To remove this impediment, the EU has decided to switch to a single home-jurisdiction VAT administration system. It would be ironic for this court, or any court, to require electronic merchants to comply with the rules of 10,000 tax jurisdictions, thereby imposing a failed and abandoned European model on American businesses. Indeed, a U.S. system of 10,000 transactional tax jurisdictions would be far worse than the 28-jurisdiction European VAT system.

The substantial nexus requirement is designed to "limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." *Quill*, 504 U.S. at 313 and n.6. An "economic nexus" standard, however, like the arbitrary thresholds of S.B. 106, that depends solely on earning revenue or completing a minimum number of transactions for products or services delivered to customers in the State would remove all limitations on state taxing authority over companies doing business in interstate commerce. If gross revenue—the very objective of interstate commerce—itself could serve as the basis for a state's power to tax (or regulate) persons engaged in such commerce, then the Commerce Clause would be no restriction on state authority, at all.

Moreover, it is no answer to claim that S.B. 106 sets a "sufficiently high" threshold of $100,000 in annual gross revenue as the basis for registration for South Dakota sales tax by a retailer with no presence in the state. The minimum level of required gross revenue or transactions set by the statute is simply a matter of state legislative choice. The Legislature might reduce the level of required revenues or transactions at any time if it concludes, for example, that state budget difficulties require an extension of sales tax liability to even smaller companies. There is, moreover, nothing to prevent another state or locality that chooses to follow South Dakota's lead from selecting a lower threshold for purported "presence" in the state. The amount of sales chosen by the State itself cannot validate the nexus standard as a matter of constitutional requirements. A decision upholding a standard of "substantial nexus" based on gross revenues or transactions would, therefore, be fundamentally at odds with the principles of the dormant Commerce Clause.

E. S.B. 106's "Economic Nexus" Principles Are Inconsistent With The Separate Nexus Standards Under The Commerce Clause And The Due Process Clause.

Finally, the statutory nexus thresholds of S.B. 106 must also be rejected because they would obliterate the established distinction between a State's jurisdiction to tax under the Due

Process Clause, and the limitations on a state's power over interstate commerce under the Commerce Clause. In *Quill*, the Court expressly found that "while a state may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." 504 U.S. at 305. In *Wynne*, the Court reaffirmed the *Quill* principle that the Commerce Clause sets a higher standard than does the Due Process Clause for state authority to tax interstate commerce. *See* 135 S.Ct. at 1799 ("the fact that a State has the jurisdictional power to impose a tax says nothing about whether that tax violates the Commerce Clause").

In this case, S.B. 106's nexus standards require only that an out-of-state company have customers in the state, a standard akin to the "minimum contacts" analysis applicable to the Due Process Clause. *See Quill*, 504 U.S. at 306-08 (solicitation of sales from outside the state may be adequate to satisfy the Due Process standard). The Supreme Court, however, has expressly rejected such a formulation of an "economic presence" standard as sufficient to meet the requirements of the Commerce Clause. *Id.* at 304, 311-12 (describing the lower court's conclusion that Quill's "economic presence" was sufficient to require use tax collection, and rejecting the lower court's analysis regarding the Commerce Clause). S.B. 106's expansive nexus standards likewise fail to survive scrutiny under the Commerce Clause.

II. CHANGES IN STANDARDS FOR REQUIRING TAX REPORTING BY REMOTE SELLERS ARE PROPERLY THE PURVIEW OF CONGRESS, NOT A STATE LEGISLATURE.

A. The Framers Entrusted The Regulation Of Interstate Commerce To The Congress.

The need to safeguard the national economic interests secured by the Commerce Clause and inherent to remote sales transactions has only increased in the years since *Quill* was decided, with the growth of electronic commerce conducted over the Internet. The physical presence requirement adopted in *Bellas Hess* and reaffirmed in *Quill* was based in part on the Supreme

Court's conclusion that "it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." *See Bellas Hess*, 386 U.S. at 759. Today, the majority of remote sales are conducted online, an even more intensely interstate environment.

The goal of a single national marketplace is precisely why the Framers reserved for Congress the power to regulate commerce "among the several States." *See Wynne,* 135 S.Ct. at 1794 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325-326 (1979) (the underlying concern for adoption of the Commerce Clause was the "immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.")) As *Quill* makes clear, Congress, rather than individual states or the courts, is "better qualified to resolve" the underlying tension between the states' interest in requiring tax collection by remote sellers and the potential burdens imposed by such tax obligations on interstate commerce. 504 U.S. at 318.

Balancing the competing interests of the free flow of interstate commerce against state and local taxing prerogatives in the area of Internet and other direct marketing sales requires careful analysis. By viewing the issue on a national scale, Congress can properly determine whether, and in what manner, to require a more uniform tax base, tax rate simplification, single-form reporting, etc. Any changes in the established standards defining the limits of state taxing authority over interstate commerce are legislative judgments to be made by Congress, not by a single state's general assembly or state tax department. For example, if the test, ultimately, were to be based on sales levels, federal legislators could debate and agree to a uniform national standard—rather than leaving state and local legislative bodies to adopt independently their own differing "bright line" sales levels, each of which would be subject to Commerce Clause review.

Indeed, Congress is actively considering legislation that prescribes the requirements a state must meet in order to be granted the authority to impose use tax collection obligations on retailers with no physical presence in the state, including Internet retailers. There are multiple bills and proposals currently before Congress. For example, the Marketplace Fairness Act, a version of which passed the Senate in an earlier session, has again been introduced in the Senate. *See* S. 698, 114th Cong. (2015-2016), https://www.congress.gov/bill/114th-congress/senate-bill/698. In the House, the Judiciary Committee (the committee charged with reviewing the Marketplace Fairness Act and other proposals for authorization of state taxation of remote sales transactions) has issued its *Basic Principles on Remote Sales Tax*, setting forth the fundamental tenets the Committee leadership view as important to guide congressional action on the issue. *See* http://judiciary.house.gov/index.cfm/press-releases?ID=3828FF47-4BE7-4D44-895A-EDB9E27198D8. The Chairman of the Judiciary Committee also released a discussion draft of a proposal based on these principles, "The Online Sales Simplification Act," in January 2015. *See* draft available at http://www.subnet.nga.org/downloads/1501HybridOriginDiscussionDraft.pdf. All of the proposals being actively considered by Congress include some measure of required sales tax simplification, to alleviate the burdens associated with differing requirements across thousands of state and local taxing jurisdictions. Since Congress is considering the issue, "the better part of both wisdom and valor is to respect the judgment of [Congress]" with regard to state taxation of interstate commerce generally, and remote sellers in particular. *Quill*, 504 U.S. at 318-19 (internal citation omitted).

B. The State Drastically Exaggerates The Alleged Harm Done To State Tax Revenues By The *Quill* Rule.

The amount of allegedly lost sales tax revenue purportedly associated with the "physical presence" standard of nexus is immaterial to the merits of the case and has no bearing on whether these Defendants are subject to the collection requirements of S.B. 106. Nevertheless,

the figures used in the State's Complaint are grossly inaccurate and overblown. The 2009 University of Tennessee Study on which the State's exaggerated estimates are based has been discredited by competing analyses and, moreover, does not take account of the considerable changes in the marketplace since 2009. For example, a more recent study showed that the Tennessee study overstated the uncollected use tax on Internet sales by approximately three-hundred percent (300%). *See* Jeffrey A. Eisenach and Robert E. Litan, "Uncollected Sales Tax on Electronic Commerce: A Reality Check," (Feb. 2010), available at https://netchoice.org/wp-content/uploads/eisenach-litan-e-commerce-taxes.pdf.

In fact, current U.S. Census Bureau data quickly demonstrates that the problem has nowhere near the magnitude projected by the State. Retail online sales—those ecommerce sales that may actually be subject to sales tax[11]—are reported by the Commerce Department to have reached $341 billion nationally in 2015. *See* "Quarterly Retail E-Commerce Sales 4th Quarter 2015," U.S. Census Bureau News (Feb. 17, 2016), available at http://www2.census.gov/retail/releases/historical/ecomm/15q4.pdf. Of that, industry reports indicate that on the order of 45 percent, or about $155 billion in sales, are made by Amazon.com, which now collects sales tax on the great majority of its sales, and the large "multi-channel" retailers that sell both in retail stores and online, and thus collect state and local sales tax. *See* "Amazon, Wal-Mart Lead Top 25 E-commerce Retail List," WWD (Mar. 7, 2016) available at http://wwd.com/business-news/financial/amazon-walmart-top-ecommerce-retailers-10383750/.

Of the remaining $186 billion, sales tax is also collected on some portion, because many smaller online retailers also have stores, and because almost every retailer, including "pure"

[11] The over $3 trillion figure often cited by critics of *Quill* represents all ecommerce, including manufacturing and wholesaling amounts which are not subject to sales tax. *See, e.g., Direct Marketing Ass'n v. Brohl*, 135 S.Ct. at 1135 (Kennedy, J., concurring). Retail ecommerce is much lower, as U.S. Census Bureau data shows.

online retailers, are required to collect sales tax in their home states. (Only 5 smaller states (AK, DE, MT, NH, and OR) do not have a sales tax.) If we conservatively assume that sales tax is collected on only one-fifth of the remainder, or another $37 billion, that leaves $149 billion of sales as to which the retailer does not collect the tax. Even if we ignore, entirely, self-reporting of use tax by consumers, the remaining $149 billion in national sales, divided proportionally by population for South Dakota (at 0.267% of the total U.S. population), would result in approximately $398 million in "untaxed" sales in the State annually. *See* "Quick Facts, South Dakota," U.S. Census Bureau (estimates of South Dakota and U.S. populations as of July 1, 2015), available at http://www.census.gov/quickfacts/table/PST045215/46,00. South Dakota's average state and local tax rate is 5.43%. *See* Sales Tax Handbook, South Dakota, Local Sales Tax Rates, available at https://www.salestaxhandbook.com/south-dakota/rates. Applying that average tax rate, the annual "lost" sales tax revenue in South Dakota would be on the order of $21 million, not the excessive $48 million to $58 million annually claimed by the State. *See* Complaint, ¶ 44. This is less than one-half of one percent of the South Dakota budget for 2016 of $4.4 billion. *See* Total State Government Budget (Revised Budgeted FY 2016), available at https://bfm.sd.gov/budget/rec17/SD_Total_Recommended_2017.pdf.

In addition, dramatic changes in online sales tax collection have occurred since 2009. Internet behemoth Amazon.com collected sales tax in only five states as of 2009, but now collects sales tax in 28 states comprising 84 percent of the population of the United States, and will begin collecting tax in an additional state (Alabama) on November 1, 2016. *See* "Amazon.com to Collect Sales Tax from Roughly 84 Percent of its US Customers," Tax Justice Blog (Jan. 28, 2016), available at http://www.taxjusticeblog.org/archive/2016/01/amazoncom_to_collect_sales_tax.php#.V4aMz_krKUk; "Major online retailers to begin collecting sales tax for Alabama," Birmingham Business Journal (June 6, 2016), available

at http://www.bizjournals.com/birmingham/news/2016/07/06/amazon-sales-tax-alabama.html. Because Amazon's Internet sales alone exceed, by some estimates, the total combined sales of the next 18 largest Internet retailers (most of which also collect sales tax), its change in tax collection practices reflects a drastic reduction in the amount of so-called "uncollected" sales tax revenues. *See* "Amazon, Wal-Mart Lead Top 25 E-commerce Retail List," *supra,* available at http://wwd.com/business-news/financial/amazon-walmart-top-ecommerce-retailers-10383750/

The State further points to the continued growth of retail electronic commerce, but 60 percent of that growth is now also attributable to Amazon.com alone, a company that collects state sales taxes. *See* "Amazon accounted for 60% of US online sales growth in 2015," MarketWatch (May 3, 2016), available at http://www.marketwatch.com/story/amazon-accounted-for-60-of-online-sales-growth-in-2015-2016-05-03 . The purported problem the State complains about is, therefore, substantially smaller than alleged and largely self-correcting.

Moreover, because most larger online retailers, like Amazon, already collect sales tax, the real victims of an "economic presence" nexus regime will be small and medium-sized Internet and catalog businesses that lack the resources of their larger competitors. Access to a national marketplace, via the Internet, is crucial for new and emerging business to grow and thrive in the modern economy. Excessive burdens placed on such business by inordinately complex state and local tax regimes will effectively close access to the electronic "super highway" for many start-ups and small businesses, stunting their potential for growth. The traditional backbone of the American economy—small and medium-sized businesses—will suffer, while the primary economic engine of the "new" economy—the Internet—will drive the success of only the largest retailers and service providers.

Nor can the State defend its thresholds as being set "high enough" to protect truly small businesses from overreaching state taxing authority. As an initial matter, the threshold of S.B.

106 based on a minimum number of 200 transactions will, in most cases, render irrelevant the Act's gross revenue threshold. In 2015, the average order value for online retailers was $78. *See* Statista, Average Order Value Graph (indicating $78.30 in first quarter 2015 and $77.90 in third quarter 2015), available at http://www.statista.com/statistics/304929/us-online-shopping-order-value/. At that level, an average retailer with 200 transactions would have only $15,600 in South Dakota sales. A retailer selling lower value items, such as digital downloads for $14.95 per product, would be required to collect South Dakota sales tax after making only $2,990 in sales.

In addition, the thresholds set by a state are a matter of pure legislative prerogative. If the State's "economic nexus" principle were upheld, the South Dakota legislature could then lower its thresholds to an even more modest level. Other states and localities could also choose lower thresholds. If 200 transactions are adequate to require tax reporting for a state, then 20 transactions would seem to be adequate for a municipality, or county, or taxing district to require sales tax collection. After all, there is nothing constitutionally significant about a particular number of transactions or one level of gross revenues as compared with another. Remote sellers could be confronted with the obligation to collect and remit tax in every jurisdiction where they make any sales at all. Economic nexus "thresholds" are an illusion proposed to conceal a regime of nearly unlimited state taxing authority.[12]

CONCLUSION

For the foregoing reasons, the Court should grant the Defendants' Motion for Summary Judgment.

[12] Nor is the judicial branch suited, either by its powers or its processes, to make quasi-legislative distinctions about what sales level causes a business to "cross the line" from constitutionally-protected to being subject to the jurisdiction's tax obligations (as South Dakota would have it, at the $100,000 gross revenue or 200 transaction threshold). Indeed, if there were some constitutional "de minimis" floor, at what level would it be set and on what principled basis? Is it the same for all businesses, or does it vary according to the nature of the business? Courts are not well-equipped to draw such policy-driven distinctions.

CERTIFICATE OF COMPLIANCE

I hereby certify that this Brief in Support of Defendants' Motion for Summary Judgment complies with the Type-Volume requirements under D.S.D. Civ. LR 7.1(B)(1). The Brief was prepared using Microsoft Word 2010 and contains proportionately-spaced 12-point Times New Roman font and, according to the software's word and character count feature, contains 8,451 words.

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CERTIFICATE OF SERVICE

The undersigned, one of the attorneys for Defendants, hereby certifies that on July 22, 2016, the foregoing Brief in Support of Defendants' Motion for Summary Judgment was electronically filed with the Clerk of Court using the ECF system which will send notification of such filing to the following:

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