AMERICAN CONSTITUTIONALISM

VOLUME I: STRUCTURES OF GOVERNMENT

Howard Gillman • Mark A. Graber • Keith E. Whittington

Supplementary Material

Chapter 11: The Contemporary Era – Federalism/States and the Commerce Clause

**South Dakota v. Wayfair, Inc., \_\_\_ U.S. \_\_\_** (2018)

*Wayfair, Inc. sells home goods and furniture online. When selling to South Dakota residents, Wayfair was not required to collect the state sales tax because the Supreme Court in* National Bellas Hess, Inc. v. Department of Revenue of Ill. *(1967) and* Quill Corp. v. North Dakota *(1992) had ruled that requiring companies with no physical presence in a state to collect state sales taxes unconstitutionally burdened interstate commerce. State residents were expected to pay the tax on their initiative. South Dakota in 2016 nevertheless passed a law requiring online sellers who did substantial business in the state to collect the state sales tax. South Dakota then filed a lawsuit in state court seeking a declaratory judgment that the act was constitutional. The trial court gave summary judgment to Wayfair on the ground that* Bellas Hess *and* Quill Corp. *remained good law. That decision was affirmed by the South Dakota Supreme Court. South Dakota appealed to the Supreme Court of the United States.*

*The Supreme Court by a 5-4 vote overruled* Bellas Hess *and* Quill Corp. *Justice Anthony Kennedy’s majority opinion declared that prohibiting states from requiring out of state online businesses to collect state sales taxes gave those businesses an unfair advantage over state businesses required to collect sales taxes. The justices unanimously agreed that* Bellas Hess *and* Quill Corp. *were wrongly decided and imposed burdens on intrastate commerce. Why do the justices then dispute whether those decisions should be overruled? To what extent do Kennedy and Chief Justice John Roberts dispute the standards to be used when overruling dormant commerce clause cases? To what extent do they think that courts or legislatures are more competent to figure out the governing rules. Note that Justice Ruth Bader Ginsburg joined four conservative justices in the majority while Roberts joined three liberal justices in the minority. Such shifts rarely occur in Roberts Court cases. What explains this shift? Might this reflect some penchant for judicial restraint on the part of the Chief Justice and some penchant for activism on the part of Ginsburg.*

JUSTICE [KENNEDY](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0243105201&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) delivered the opinion of the Court.

. . . .

Under this Court's decisions in *National Bellas Hess, Inc. v. Department of Revenue of Ill.* (1967) and *Quill Corp. v. North Dakota* (1992), South Dakota may not require a business to collect its sales tax if the business lacks a physical presence in the State. Without that physical presence, South Dakota instead must rely on its residents to pay the use tax owed on their purchases from out-of-state sellers. “[T]he impracticability of [this] collection from the multitude of individual purchasers is obvious.” . . . It is estimated that *Bellas Hess* and *Quill* cause the States to lose between $8 and $33 billion every year.

. . . .

The Constitution grants Congress the power “[t]o regulate Commerce ... among the several States.” . . . Although the Commerce Clause is written as an affirmative grant of authority to Congress, this Court has long held that in some instances it imposes limitations on the States absent congressional action. . . . [T]his Court has observed that “in general Congress has left it to the courts to formulate the rules” to preserve “the free flow of interstate commerce.”

. . . .

. . . . Modern precedents rest upon two primary principles that mark the boundaries of a State's authority to regulate interstate commerce. First, state regulations may not discriminate against interstate commerce; and second, States may not impose undue burdens on interstate commerce. State laws that discriminate against interstate commerce face “a virtually per se rule of invalidity.” State laws that “regulat[e] even-handedly to effectuate a legitimate local public interest ... will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”

These principles also animate the Court's Commerce Clause precedents addressing the validity of state taxes. . . . [A] State “may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause.” After all, “interstate commerce may be required to pay its fair share of state taxes.” The Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides.

. . . . The Court [in *Bellas Hess*] held that a mail-order company “whose only connection with customers in the State is by common carrier or the United States mail” lacked the requisite minimum contacts with the State required by both the Due Process Clause and the Commerce Clause. Unless the retailer maintained a physical presence such as “retail outlets, solicitors, or property within a State,” the State lacked the power to require that retailer to collect a local use tax. . . . In 1992, the Court reexamined the physical presence rule in *Quill*. Despite the fact that *Bellas Hess* linked due process and the Commerce Clause together, the Court in Quill overruled the due process holding, but not the Commerce Clause holding; and it thus reaffirmed the physical presence rule.

. . . .

*Quill* is flawed on its own terms. First, the physical presence rule is not a necessary interpretation of the requirement that a state tax must be “applied to an activity with a substantial nexus with the taxing State.” Second, *Quill* creates rather than resolves market distortions. And third, *Quill* imposes the sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause precedents disavow.

. . . .

This nexus requirement is “closely related,” to the due process requirement that there be “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” It is settled law that a business need not have a physical presence in a State to satisfy the demands of due process. Although physical presence “‘frequently will enhance’” a business' connection with a State, “‘it is an inescapable fact of modern commercial life that a substantial amount of business is transacted ... [with no] need for physical presence within a State in which business is conducted.’” . . .

When considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels. The reasons given in *Quill* for rejecting the physical presence rule for due process purposes apply as well to the question whether physical presence is a requisite for an out-of-state seller's liability to remit sales taxes. Physical presence is not necessary to create a substantial nexus.

. . . .

. . . . *Quill* puts both local businesses and many interstate businesses with physical presence at a competitive disadvantage relative to remote sellers. Remote sellers can avoid the regulatory burdens of tax collection and can offer de facto lower prices caused by the widespread failure of consumers to pay the tax on their own. . . . In effect, Quill has come to serve as a judicially created tax shelter for businesses that decide to limit their physical presence and still sell their goods and services to a State's consumers—something that has become easier and more prevalent as technology has advanced. Worse still, the rule produces an incentive to avoid physical presence in multiple States. Distortions caused by the desire of businesses to avoid tax collection mean that the market may currently lack storefronts, distribution points, and employment centers that otherwise would be efficient or desirable. . . .

The Court's Commerce Clause jurisprudence has “eschewed formalism for a sensitive, case-by-case analysis of purposes and effects.” *Quill*, in contrast, treats economically identical actors differently, and for arbitrary reasons.

Consider, for example, two businesses that sell furniture online. The first stocks a few items of inventory in a small warehouse in North Sioux City, South Dakota. The second uses a major warehouse just across the border in South Sioux City, Nebraska, and maintains a sophisticated website with a virtual showroom accessible in every State, including South Dakota. By reason of its physical presence, the first business must collect and remit a tax on all of its sales to customers from South Dakota, even those sales that have nothing to do with the warehouse. But, under *Quill*, the second, hypothetical seller cannot be subject to the same tax for the sales of the same items made through a pervasive Internet presence. This distinction simply makes no sense. . . .

. . . .

Modern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*. The “dramatic technological and social changes” of our “increasingly interconnected economy” mean that buyers are “closer to most major retailers” than ever before—“regardless of how close or far the nearest storefront.” Between targeted advertising and instant access to most consumers via any internet-enabled device, “a business may be present in a State in a meaningful way without” that presence “being physical in the traditional sense of the term.” A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores. Yet the continuous and pervasive virtual presence of retailers today is, under *Quill*, simply irrelevant. This Court should not maintain a rule that ignores these substantial virtual connections to the State.

The physical presence rule as defined and enforced in *Bellas Hess* and *Quill* is not just a technical legal problem—it is an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions. . . . In essence, respondents ask this Court to retain a rule that allows their customers to escape payment of sales taxes—taxes that are essential to create and secure the active market they supply with goods and services. An example may suffice. Wayfair offers to sell a vast selection of furnishings. Its advertising seeks to create an image of beautiful, peaceful homes, but it also says that “‘[o]ne of the best things about buying through Wayfair is that we do not have to charge sales tax.’” . . . State taxes fund the police and fire departments that protect the homes containing their customers' furniture and ensure goods are safely delivered; maintain the public roads and municipal services that allow communication with and access to customers; support the “sound local banking institutions to support credit transactions [and] courts to ensure collection of the purchase price,” and help create the “climate of consumer confidence” that facilitates sales. Helping respondents' customers evade a lawful tax unfairly shifts to those consumers who buy from their competitors with a physical presence that satisfies *Quill*—even one warehouse or one salesperson—an increased share of the taxes. It is essential to public confidence in the tax system that the Court avoid creating inequitable exceptions. This is also essential to the confidence placed in this Court's Commerce Clause decisions. Yet the physical presence rule undermines that necessary confidence by giving some online retailers an arbitrary advantage over their competitors who collect state sales taxes.

. . . . If it becomes apparent that the Court's Commerce Clause decisions prohibit the States from exercising their lawful sovereign powers in our federal system, the Court should be vigilant in correcting the error. While it can be conceded that Congress has the authority to change the physical presence rule, Congress cannot change the constitutional default rule. It is inconsistent with the Court's proper role to ask Congress to address a false constitutional premise of this Court's own creation. Courts have acted as the front line of review in this limited sphere; and hence it is important that their principles be accurate and logical, whether or not Congress can or will act in response. It is currently the Court, and not Congress, that is limiting the lawful prerogatives of the States.

Further, the real world implementation of Commerce Clause doctrines now makes it manifest that the physical presence rule as defined by *Quill* must give way to the “far-reaching systemic and structural changes in the economy” and “many other societal dimensions” caused by the Cyber Age. The Quill Court did not have before it the present realities of the interstate marketplace. . . . The Internet's prevalence and power have changed the dynamics of the national economy. . . . Last year, e-commerce grew at four times the rate of traditional retail, and it shows no sign of any slower pace. See ibid.

This expansion has also increased the revenue shortfall faced by States seeking to collect their sales and use taxes. In 1992, it was estimated that the States were losing between $694 million and $3 billion per year in sales tax revenues as a result of the physical presence rule. Now estimates range from $8 to $33 billion. . . .

. . . .

Reliance interests are a legitimate consideration when the Court weighs adherence to an earlier but flawed precedent. But even on its own terms, the physical presence rule as defined by *Quill* is no longer a clear or easily applicable standard, so arguments for reliance based on its clarity are misplaced. And, importantly, stare decisis accommodates only “legitimate reliance interest[s].” Here, the tax distortion created by *Quill* exists in large part because consumers regularly fail to comply with lawful use taxes. Some remote retailers go so far as to advertise sales as tax free. A business “is in no position to found a constitutional right on the practical opportunities for tax avoidance.”

 Respondents argue that “the physical presence rule has permitted start-ups and small businesses to use the Internet as a means to grow their companies and access a national market, without exposing them to the daunting complexity and business-development obstacles of nationwide sales tax collection.” . . . Congress may legislate to address these problems if it deems it necessary and fit to do so. . . . 

. . . . For these reasons, the Court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court's decisions in *Quill Corp. v. North Dakota* (1992), and [*National Bellas Hess, Inc. v. Department of Revenue of Ill.* (1967)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1967129499&pubNum=0000708&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), should be, and now are, overruled.

JUSTICE [THOMAS](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0216654601&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), concurring.

. . . . A quarter century of experience has convinced me that *Bellas Hess* and *Quill* “can no longer be rationally justified.” The same is true for this Court's entire negative Commerce Clause jurisprudence.

JUSTICE [GORSUCH](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0183411701&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), concurring.

. . . .

My agreement with the Court's discussion of the history of our dormant commerce clause jurisprudence, however, should not be mistaken for agreement with all aspects of the doctrine. The Commerce Clause is found in Article I and authorizes Congress to regulate interstate commerce. Meanwhile our dormant commerce cases suggest Article III courts may invalidate state laws that offend no congressional statute. Whether and how much of this can be squared with the text of the Commerce Clause, justified by stare decisis, or defended as misbranded products of federalism or antidiscrimination imperatives flowing from Article IV's Privileges and Immunities Clause are questions for another day. . . .

CHIEF JUSTICE ROBERTS, with whom JUSTICE [BREYER](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0254766801&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), JUSTICE [SOTOMAYOR](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0145172701&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), and JUSTICE [KAGAN](https://1.next.westlaw.com/Link/Document/FullText?findType=h&pubNum=176284&cite=0301239401&originatingDoc=Ic60a706c752611e89d59c04243316042&refType=RQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) join, dissenting.



I agree that *Bellas Hess* was wrongly decided, for many of the reasons given by the Court. The Court argues in favor of overturning that decision because the “Internet's prevalence and power have changed the dynamics of the national economy.” But that is the very reason I oppose discarding the physical-presence rule. E-commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical-presence rule. Any alteration to those rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress. The Court should not act on this important question of current economic policy, solely to expiate a mistake it made over 50 years ago.

This Court “does not overturn its precedents lightly.” . . . The bar is even higher in fields in which Congress “exercises primary authority” and can, if it wishes, override this Court's decisions with contrary legislation. . . . We have applied this heightened form of stare decisis in the dormant Commerce Clause context. In *Quill*, this Court emphasized that the decision to hew to the physical-presence rule on stare decisis grounds was “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.” . . .

. . . .

Congress has in fact been considering whether to alter the rule established in *Bellas Hess* for some time. Three bills addressing the issue are currently pending. . . .States and local governments are already able to collect approximately 80 percent of the tax revenue that would be available if there were no physical-presence rule. . . . To the extent the physical-presence rule is harming States, the harm is apparently receding with time.

. . . . “[T]he present realities of the interstate marketplace” include the possibility that the marketplace itself could be affected by abandoning the physical-presence rule. . . . The Court, for example, breezily disregards the costs that its decision will impose on retailers. Correctly calculating and remitting sales taxes on all e-commerce sales will likely prove baffling for many retailers. Over 10,000 jurisdictions levy sales taxes, each with “different tax rates, different rules governing tax-exempt goods and services, different product category definitions, and different standards for determining whether an out-of-state seller has a substantial presence” in the jurisdiction. . . . The burden will fall disproportionately on small businesses. One vitalizing effect of the Internet has been connecting small, even “micro” businesses to potential buyers across the Nation. People starting a business selling their embroidered pillowcases or carved decoys can offer their wares throughout the country—but probably not if they have to figure out the tax due on every sale. . . .

A good reason to leave these matters to Congress is that legislators may more directly consider the competing interests at stake. Unlike this Court, Congress has the flexibility to address these questions in a wide variety of ways. . . . Here, after investigation, Congress could reasonably decide that current trends might sufficiently expand tax revenues, obviating the need for an abrupt policy shift with potentially adverse consequences for e-commerce. Or Congress might decide that the benefits of allowing States to secure additional tax revenue outweigh any foreseeable harm to e-commerce. Or Congress might elect to accommodate these competing interests, by, for example, allowing States to tax Internet sales by remote retailers only if revenue from such sales exceeds some set amount per year. . . .

The Court is of course correct that the Nation's economy has changed dramatically since the time that *Bellas Hess* and *Quill* roamed the earth. I fear the Court today is compounding its past error by trying to fix it in a totally different era. The Constitution gives Congress the power “[t]o regulate Commerce ... among the several States.” I would let Congress decide whether to depart from the physical-presence rule that has governed this area for half a century.