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Michael T. Dillon • Mar. 12, 2018



Accountants are being pulled in to the trend of the online marketplace. The ease offered by online ecommerce platforms means even small clients can suddenly be mired in complexities of multistate tax rules from their very first sale. The following article is the first in a six-part series discussing policy changes brought on by the growth of ecommerce sales.

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dormant Commerce Clause prohibit a State from requiring catalog retailers to collect sales taxes on sales into the State unless the retailer is “physically present” there. [*Nat’l Bellas Hess v. Dep’t of Rev. of Ill.*, 386 U.S. 753 (1967)] The Court stated that “the Court has 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.” [386 U.S. at 758]

The Commerce Clause of U.S. Constitution reserves to Congress the power to regulate commerce among the states, with foreign nations, and with Indian tribes. [U.S. Const. Sec. 8, Cl. 3, Art. I]. The dormant Commerce Clause, also known as the negative Commerce Clause, refers to the authority judicially inferred to Congress by virtue of the exclusive power of Congress to regulate interstate commerce. This dormant authority is a restriction prohibiting a state from passing legislation that improperly discriminates against interstate commerce. In *Complete Auto Transit, Inc. v. Brady*, the U.S. Supreme Court established the following four-part test to determine the constitutionality of a tax on multistate transactions:

- (1) the tax is applied to an activity having substantial nexus with the taxing state,
- (2) the tax is fairly apportioned,
- (3) the tax does not discriminate against interstate commerce, and
- (4) the tax is fairly related to services provided by the taxing state. [430 US 274 (1977)]

The purpose of the four-part test established by the U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady* is to determine when *non-resident* businesses conducting interstate commerce in a State may be asked to contribute their “just share” to collecting that State’s taxes. The operative issues in most cases involving remote sellers (e.g., e-commerce retailers) concerns the first part of the test: the “substantial

nexus” between the taxing State and the activity taxed. As such, for sales tax nexus

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substantial nexus required by the dormant Commerce Clause.

Notably, the Court indicated that in light of *Complete Auto Transit, Inc. v. Brady*, “contemporary Commerce Clause jurisprudence might not dictate the concurring same result” as the Court had reached in *Bellas Hess*. [504 U. S., at 311]. However, believing that it was bound by principles of *stare decisis* (respecting the precedent established in *National Bellas Hess*) the Court noted that the bright-line rule of *National Bellas Hess* “furthers the ends” of the dormant Commerce Clause.

Since *Quill*, it has been clear that a business must have a physical presence in a state for that state to require it to collect sales taxes. However, the Court in *Quill* explicitly stated that Congress can overrule the decision through legislation. Furthermore, the Court did not indicate a clear set of guidelines for what activities, and what level of activities, may establish the “physical presence” substantial nexus required by the dormant Commerce Clause.

Obviously, despite numerous efforts of federal legislators to put forth legislation that might enable states to impose sales tax collection obligations on remote sellers, none of these measures have passed. [see most recently, [Marketplace Fairness Act \(S.976\)](#); [Remote Transaction Parity Act \(HR 2193\)](#)]

In [Part 2 of this article](#), we will discuss the tests of physical presence in more detail.

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