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INSIGHT: 'Wayfair': What Are the Practical Retroactivity Concerns?

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What is the practical risk that states would take in applying *Wayfair* retroactively? And should taxpayers rush to limit exposure for historical periods by entering into voluntary disclosure agreements with states that might assess tax retroactively under *Wayfair*?

Now that *Quill* is dead, clients have been asking whether states are free to go back in time and levy tax for the years in which their jurisdiction was restricted by the physical-presence requirement. Obviously, retroactive application of *Wayfair* would create massive exposure for retailers who never collected sales or use tax based on an eminently reasonable reliance on *Quill* and its predecessor, *National Bellas Hess*. The states appear, so far, willing to fall in line with the U.S. Supreme Court's guidelines issued through *Wayfair*, finding that the South Dakota law *likely* satisfies the Commerce Clause, in part, because the law would not be applied retroactively. On the other hand, while the Court's decision in *Wayfair* to overturn *Quill* was clearly animated by the South Dakota law's prospective-only application, *Wayfair* did not definitively state that retroactive application is prohibited.

In *Wayfair*, forty-one states joined to file an amicus curiae brief in support of South Dakota and provided assurances to the U.S. Supreme Court that retroactive application of any new decision would be unlikely and limited. The states assured the Court that ''there is no reason to suspect that the amici States will deviate from their normal administrative procedures—including advance notice—when implementing this Court's new post-*Quill* precedent.'' However, in a time when retroactive tax legislation has seemingly become commonplace where a state's fiscal health is concerned, companies are concerned that even the forty-one states' assurances may wash away with the legal sea change brought by *Wayfair*.

It's certainly plausible that a bold state could step forth, pound its chest to the celebratory shouts of ''kill *Quill*'' and assert that it will indeed apply *Wayfair* to taxpayers for periods prior to the opinion's June 21 release. In fact, some states already have sales tax economic nexus provisions in place with an effective date for periods prior to *Wayfair*. Mississippi, for example, has enacted a nexus threshold of $250,000 of in-state sales that is effective December 1, 2017.

However, for two reasons, the states would not prevail in an attempt to retroactively apply the Supreme Court's new law of the land.

First, *Wayfair* qualifies for purely prospective application under the *Chevron Oil* test.

Second, retroactivity risks a double tax burden in violation of *Complete Auto*.

These two reasons are analyzed below, but we also recommend that taxpayers read a law professor's article that wisely predicts the bases for the decision in *Wayfair*, *before* its release, and sets forth reasoning for why ''There Is No Retroactivity Concern With Overruling Quill.''

The 'Chevron Oil' Test

Generally, judicial decisions, unlike legislation, are presumed to apply retroactively to periods predating the judgment. This makes sense because typically the years at issue in any appeal are just that, in the past, and the decision of the court applies to the litigants as well as others impacted by its outcome on a retroactive basis. *Wayfair*, however, is unique in that the law in question was not effective until the Supreme Court decided the issue. As a result, *Wayfair* does not address

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tax assessed for past years, and the majority opinion expresses its clear preference that the holding be applied on a prospective basis. Under certain limited circumstances, like those presented in *Wayfair*, cases have been held by the Supreme Court and other courts to apply on a purely prospective basis.

The *Chevron Oil* test requires courts to consider three factors:

- whether the decision to be applied nonretroactively established a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed;
- whether retrospective operation would further the new rule's operation; and
- whether the equities cut in favor of prospective application.

Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07 (1971); *Kolkevich v. Att'y Gen.*, 501 F.3d 323, 338 n.9 (3d Cir.2007).

There is debate as to whether a majority of the justices agree that pure prospectivity is allowed. However, *Wayfair* would make a very strong case and is ideally situated to qualify for pure prospectivity under the three prongs of the *Chevron Oil* test. First, the decision to overrule *Quill* is a clear break from precedent. Second, past distortions in the market and consumer choices can't be corrected by retroactive application. Third, there would be substantial inequities if retailers are required to pay sales tax to the states during historical periods for which there's likely no practical way to collect those taxes from clients.

For those taxpayers concerned with leaving the fate of retroactivity to a three part test that not all justices agree is valid law, fear not because retroactive application of *Wayfair* is also prohibited by the test from *Complete Auto*.

The 'Complete Auto' Test

The *Complete Auto* test prohibits the retroactive application of *Wayfair*, likely for multiple reasons. The retroactive application of *Wayfair* would create double taxation of cross-border sales by imposing a sales tax on the retailer after a use tax was imposed on the buyer contemporaneous with the transaction. This would create a scenario where both parties to a single transaction, the seller and buyer, would be subject to a transaction-based tax that is only intended to apply once to each retail transaction.

Moreover, the Supreme Court left a breadcrumb in the *Wayfair* opinion for why, in their view, states would be prohibited from applying the holding retroactively. The majority opinion states that ''other aspects of the Court's Commerce Clause doctrine can protect against any undue burden on interstate commerce . . .'', referencing that ''[o]thers have argued that retroactive liability risks a double tax burden in violation of the Court's apportionment jurisprudence because it would make *both the buyer and the seller legally liable for collecting and remitting the tax on a transaction intended to be taxed only once*'' (emphasis added).

The risk of double taxation by making both the buyer and seller liable for the tax is a real and practical risk of applying *Wayfair* to past periods during which the buyer was previously solely responsible for remitting the tax. The low incidence of use tax compliance by buyers would not make the potential for double taxation constitutionally permissible under the tests used by the Supreme Court to determine whether a tax violates *Complete Auto*.

The Practical Realities

States should not be so brazen as to ignore the justices' endorsement of a purely prospective application of the *Wayfair* opinion. And taxpayers should be confident that a state's retroactive application of *Wayfair* would not withstand constitutional scrutiny by an independent court of law. As a result, taxpayers that have taken no-nexus positions based solely on a lack of physical presence can be confident that historic exposure will not result from *Wayfair* and, therefore, should be reluctant to rush to voluntarily remit taxes for past periods. However, the issue becomes less clear where a taxpayer's no-nexus position is more complicated because it implicates affiliate or agency nexus issues where third parties have potentially contributed to the maintenance of a market for in-state sales. Taxpayers with uncertain nexus positions under *Quill* should carefully consider their strategic options relating to historical tax periods in light of the impact of *Wayfair* on a go-forward basis.

Taxpayers will also want to tailor their strategic approach to the various circumstances of each states' economic nexus law. Some states, like Mississippi, have already enacted South Dakota-style sales tax nexus rules for remote sellers that are effective prior to the law change brought about by the issuance of the *Wayfair* opinion. These states will need to take action to address the effective date of their South Dakota-style economic nexus laws. Other states have previously enacted laws prior to the *Wayfair* opinion that intended to circumvent rather than directly contradict the *Quill* physical presence requirement. Massachusetts, for example, enacted a ''cookie nexus'' law effective in October 2017 that creatively defines ''physical presence'' for purposes of the *Quill* standard to include a web-based presence for remote sellers. Such states may consider modifications to their laws to achieve a less creative and less controversial nexus rule that more closely aligns with the South Dakota rule endorsed by the Supreme Court in *Wayfair*.

Pennsylvania and Rhode Island also both have economic nexus laws that are effective prior to the change in law promulgated by *Wayfair*. Significantly, both states' laws also include an option to comply with various information and notice reporting requirements for purchases by in-state buyers in lieu of collecting tax. As a result, these states may take the view that the notification option provides a release valve for forced tax collection in violation of *Quill* that allows the state to enforce an effective date for its legislation prior to *Wayfair*.

It's also noteworthy that some states' economic nexus laws are constitutionally dubious even under *Wayfair*. Pennsylvania and Washington, for example, both purport to assert jurisdiction over companies with as little as $10,000 of in-state sales, which is a considerably lower ''safe harbor'' threshold than the South Dakota threshold of $100,000 endorsed by the Supreme Court. Thus, these states' laws may not withstand judicial scrutiny even if they are applied on a purely prospective basis. Accordingly, sellers should carefully

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consider the constitutional validity of each state's economic nexus rules as applied to their facts and circumstances in addition to the potential for retroactive imposition prior to the law change promulgated by *Wayfair*.

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