LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
MONDAY, JUNE 25, 2018
PERSPECTIVE

Law is mightier than the *Quill*

By Mark R. Yohalem and C. Hunter Hayes

The wayfarer, / perceiving the pathway to truth, / was struck with astonishment. / It was thickly grown with weeds.

— Stephen Crane, "The Wayfarer"

For over half a century, America's retail economy has been distorted by a judicially erected "tax shelter" given to absentee retailers, i.e., retailers not "physically present" in a state. Such retailers were exempt from the otherwise universal requirement that retailers collect and remit any sales taxes owed by their customers. When the Supreme Court established this exception in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U. S. 753 (1967), the only absentee retail was carried out through catalog-based mail order, but almost immediately after the exception was reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), internet-based e-commerce exploded, in part because online stores held themselves out as "tax-free." In *South Dakota v. Wayfair, Inc.*, 2018 DJDAR 5927 (June 21, 2018), a decision authored by Justice Anthony Kennedy and joined by Justices Clarence Thomas, Ruth Bader Ginsburg, Samuel Alito and Neil Gorsuch, the Supreme Court finally dismantled that tax shelter, thereby correcting a legal error, leveling the retail playing field, and ensuring the sustainability of state and local sales taxes.

Thanks to *Wayfair*, the collection of sales taxes online will now be a consistent experience. Just as when one purchases a product in a store — or on many online sites — the *retailer* will calculate, collect, and remit any sales tax owed on the transaction. Previously, that was not true. Online-only retailers could pretend to be duty-free (e.g., "One of the best things about buying through Wayfair is that we do not have to charge sales tax."), while in fact shifting the burden of calculating and remitting the taxes owed to the customer. Many customers failed to pay these so-called "use" taxes, either through ignorance or willfulness. But that did not mean the transactions were tax-free, merely — as the *Wayfair* decision put it — that absentee online retailers were "helping [their] customers evade a lawful tax." Now, such retailers will no longer being able to "offer to assist in tax evasion" in order to edge out their competitors.

As the *Wayfair* decision explains, *Quill*'s tax shelter for physically absent retailers was inflicting a fourfold harm. First, it was distorting the retail sector by giving favored absentee retailers an apparent price advantage against retailers that were physically present in the community. Second, it was discouraging absentee retailers from taking economically efficient steps (such as locating distribution centers nearer to customers) that would create a physical presence and eliminate the tax shelter. Third, it was harming the public sector by depriving state and local governments of billions of dollars in much-needed sales tax receipts. Fourth, it required courts, states, and retailers to make increasingly difficult judgments as to what constituted "physical presence" (space on a third-party cloud-storage server in the state? pop-up runways? virtual showrooms? cookies and apps on customers' devices?).

The Supreme Court was able to address these harms by bringing its dormant commerce clause jurisprudence into harmony. *Wayfair* holds that the same "nexus" requirement applies across the board when analyzing state taxes under the commerce clause. The aberrant, artificial, and harmful physical-presence requirement, applicable only to the collection of sales tax, no longer exists as a narrow exception to the practical and nuanced rules that has long applied to all other state taxes with an interstate effect. There is no serious dispute that this is the correct interpretation of the commerce clause.

Nevertheless, despite *unanimous agreement* among the justices that there was no basis in the Constitution for the purportedly constitutional physical-presence requirement, *Wayfair* produced a 5-4 split. In dissent, Chief Justice John Roberts — joined by Justices Stephen Breyer, Sonia Sotomayor, and Elena Kagan — began by conceding that "*Bellas Hess* was wrongly decided." Nevertheless, he reasoned that "[w] hatever salience the adage 'third time's a charm' has in daily life, it is a poor guide to Supreme Court decisionmaking." Thus, because the wrong constitutional rule had been created and then reaffirmed by the court in *Bellas Hess* and *Quill*, the physical-presence requirement was beyond the court's disapproval ever after. To the dissenters, it hardly mattered how much legal doctrine and economic reality had changed since *Bellas Hess*; the law and the world might change, but the physical- presence requirement would not unless Congress intervened. The dissenters rested this cry to inaction on stare decisis, a rule of institutional conservatism.

Thanks to *Wayfair*, the collection of sales taxes online will now be a consistent experience. Just as when one purchases a product in a store — or on many online sites — the *retailer* will calculate, collect, and remit any sales tax owed on the transaction.

To have applied stare decisis here would have been judicial abdication, not conservative restraint. The most famous analogy for such restraint is G.K. Chesterton's "fence … erected across a road" in the countryside. Chesterton chastised reformers who, coming upon the fence, merely say, "I don't see the

use of this; let us clear it away." And he credited conservatives with warning those reformers, "If you don't see the use of it, I certainly won't let you clear it away. Go away and think. Then, when you can come back and tell me that you do see the use of it, I may allow you to destroy it." Rather than reforming the physical-presence requirement in *Quill*, the Supreme Court went away and thought for 25 years; in the interim, the reformers — including state governments, retail businesses, tax professionals, lawyers and legal academics, think tanks, and advocacy groups — carefully evaluated the requirement's many, waxing demerits and few, waning merits. By this point, everyone knows the fence is doing nothing but leading retailers, states, and courts astray, regardless of the shelter it might provide to tax-evading highwaymen. Moreover, doing nothing is particularly unconservative (and illiberal) here, where the physical-presence requirement is a federal-judge-made restriction, untethered from constitutional text or common law, on the ability of democratically elected state governments to raise revenue for public services through even-handed taxation. To leave that "fence" up in those circumstances is an abdication of the court's responsibility to make sure it has not blighted the countryside with its past mistakes.

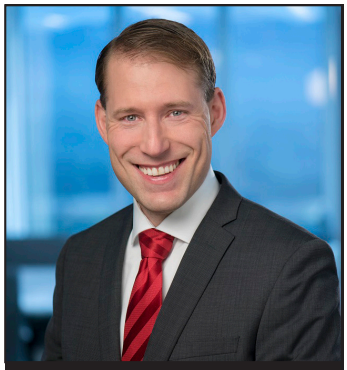
The truly Chestertonian opinion is not the chief justice's dissent, but Justice Thomas' concurrence. In *Quill*, Justice Thomas voted to uphold *Bellas Hess*' physical-presence requirement, failing to join the lone dissent of Justice Byron White, who had been in the *Bellas Hess* majority. In his concurrence in *Wayfair*, Justice Thomas wrote: "I should have joined his opinion. Today, I am slightly further removed from *Quill* than Justice White was from *Bellas Hess*. And like Justice White, a quarter century of experience has convinced me that *Bellas Hess* and *Quill* 'can no longer be rationally justified.' … [I]t is never too late to 'surrende[r] former views to a better considered position.' I therefore join the Court's opinion."

We are lucky that the Supreme Court as an institution also followed this wiser path.

Mark R. Yohalem *is a partner with Munger, Tolles & Olson, where he works in appellate and complex business litigation.*

C. Hunter Hayes *is a litigator at Munger, Tolles & Olson, specializing in complex civil matters.*

Munger, Tolles & Olson represented the Retail Litigation Center, Inc. as an amicus curiae in Wayfair. The RLC's brief in support of petitioner South Dakota was joined by 21 other retail and wholesale trade associations and was repeatedly cited in the Supreme Court's decision.


YOHALEM


HAYES