What Will the First Post-*Wayfair* Litigation Look Like?

by Amy Hamilton

In a petition filed one day after the U.S. Supreme Court decided *Wayfair*, law firm Mayer Brown argued that one back-office employee not related to establishing or maintaining a market in the state is no longer sufficient for income tax nexus.

According to Leah Robinson, the leader of Mayer Brown's State and Local Tax group, the team rewrote a client's draft petition — which was due June 22 in a Southern state — after members read the Court's June 21 decision in *South Dakota v. Wayfair Inc*. "Maybe that will be the next round of litigation," Robinson said during a July 25 panel discussion at the Multistate Tax Commission's annual conference in Boston.

Robinson initially predicted that the next major round of post-*Wayfair* litigation would involve a state that has neither enacted South Dakota-type thresholds nor codified a physical presence nexus standard, but is seeking to retroactively assert an economic presence nexuslike statute or rule that the state had let go dormant during the *Quill Corp. v. North Dakota* era.

But as Robinson talked through this potential type of state assertions of nexus, she said the sellers in that scenario would likely fall below the South Dakota law's thresholds of $100,000 in sales into the state or 200 in-state transactions. This means that many of the sellers would probably just pay the tax rather than attempt to mount a legal challenge, she said. Robinson added that while she still expects such state assertions of nexus to be a problem, any such cases also would be unlikely to attract national attention because the amounts involved would likely be relatively small.

A question from panelist Nancy Prosser, general counsel at the Texas Comptroller of Public Accounts, prompted Robinson to bring up the argument that one back-office employee is no longer sufficient for income tax nexus.

The Discussion

Prosser asked her fellow panelists what the first major round of lawsuits after *Wayfair* might look like and what the issues are likely to involve. In response, Robinson said, "If a state came to me and asked for advice, I would absolutely say, 'Do not do anything below South Dakota's thresholds.'"

"Even if they have a physical presence, if the company doesn't meet those thresholds, I would say, 'Walk away,'" Robinson added.

This piqued the interest of Robinson's fellow panelists. Prosser asked Robinson to describe the fact pattern in which a company could have a physical presence in a state but not have nexus because it falls below South Dakota-type economic presence thresholds.

Craig Johnson, executive director of the Streamlined Sales Tax Governing Board, also sought clarification of Robinson's position: Was she really saying that even with physical presence in a state, a company might no longer have substantial nexus? "What if I'm an in-state business?" he asked. "I'm there every day of the year, and I only sell $50,000 a year in sales — is that not substantial nexus?"

Robinson said that before the Court decided *Wayfair*, those considering whether a seller had substantial nexus in a state for sales tax or income tax purposes needed to conduct both a quantitative and a qualitative analysis. The quantitative analysis considers things like physical presence, she said. The qualitative analysis looks to whether those activities are significantly associated with establishing and maintaining the company's market in the state, Robinson said, quoting language from *Scripto Inc. v. Carson* and *Tyler Pipe Industries Inc. v. Washington*.

Whether there is physical presence isn't the relevant question post-*Wayfair*, Robinson said. "Now we forget about the physical presence question," she said. "We just say, are there activities that are substantially related to establishing and maintaining the in-state market?"

Addressing Johnson's hypothetical, Robinson said that an in-state seller who falls below the South Dakota-type economic presence nexus thresholds but who is establishing and maintaining an in-state market should collect sales tax.

Robinson then segued into discussing an income tax consideration that she said is perfectly valid. There are cases across the nation in which a company has one in-state employee working from home — "purely back office, not market-facing," she said. Before *Wayfair*, that one full-time employee was a physical presence that created nexus both for income and for sales tax purposes. "Now, though, I think we would revisit that," Robinson said, adding, "I'm not sure you have substantial nexus anymore." She argued that the question now tracks the *Scripto* and *Tyler Pipe* inquiry into whether the employee's activities are related to establishing and maintaining the company's in-state market.

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"I think that should be the new standard, and I think you can get there from *Wayfair*," Robinson said. She argued that even for income tax purposes, the idea that that one telecommuting employee who isn't client-facing creates nexus "went out with *Quill*."

"I think there's actually a little bit of a sword aspect to *Wayfair*," Robinson said. The Court said physical presence is not the standard, which Robinson said means forgetting about the quantitative analysis and focusing on the qualitative analysis to determine whether a seller has substantial nexus with a state.

From the audience, Michael Fatale, deputy general counsel for the Massachusetts Department of Revenue, disagreed. "All *Wayfair* is doing is addressing a fact pattern that's above and beyond the historic due process jurisprudence," Fatale said. He said the Court in *Wayfair* accepted that the physical presence standard of *Quill* had been a misstep in the context of the overall doctrine. "They didn't reformulate the doctrine," he added.

"They overruled *Quill*. They threw out *Quill*," Robinson countered, adding that most states have said *Quill* wasn't the standard for income tax purposes anyway. "So now taxpayers are going to take that argument and turn it around."

"Good luck," said Joe Garrett Jr., Alabama's deputy revenue commissioner, from the audience.

Prosser, however, agreed that these issues will bubble up when revenue departments try to define what "substantial nexus" means post-*Wayfair* and start floating their first draft regulations. ■