

No More *Dilworth* Formalism After *Wayfair*

by Richard L. Cram



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In this article, Cram discusses the 1944 sales tax decision of *McLeod*

v. Dilworth, which held that a state could not impose a sales tax collection duty on an out-of-state seller using sales representatives to solicit interstate sales into that state, although the decision acknowledged that a state could impose a use tax collection duty on such a seller in similar circumstances. *South Dakota v. Wayfair*, in overruling the physical presence rule of *Quill* and *National Bellas Hess*, considered South Dakota's economic nexus statute that imposed a sales tax collection duty on the remote seller. Cram argues that because *Dilworth* was implicitly overruled in *Complete Auto Transit Inc. v. Brady*, states may impose either a use tax or a sales tax collection duty on a remote seller that has exceeded the state's economic nexus threshold, even though *Dilworth* was not raised in *Wayfair*.

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In overturning the *Quill*¹ physical presence rule, *South Dakota v. Wayfair*² determined that a remote seller³ can be required to remit sales tax based on its economic nexus with the state. Under the statute at issue, South Dakota Codified Law (SDCL) section 10-64-2, a remote seller of tangible personal property, electronically transferred products, or services for delivery into South Dakota is required to remit the state's sales tax "as if the seller had a physical presence in the state," if the seller's gross revenue from those sales exceeded \$100,000 or it had 200 or more transactions in the current or previous calendar year.

The U.S. Supreme Court did not rule on the constitutionality of SDCL section 10-64-2, remanding the case back to the South Dakota Supreme Court for that purpose.⁴ The case was thereafter settled, so no constitutionality ruling was made.⁵ After *Wayfair*, a business's in-state physical presence is no longer constitutionally required to determine commerce clause substantial nexus. Therefore, a state can obligate a remote seller to collect its sales or use tax if the seller's economic or virtual presence provides substantial nexus.⁶

¹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

² 585 U.S. ___, 138 S. Ct. 2080 (2018).

³ In this article, "remote seller" refers to an out-of-state seller with no physical presence in the taxing state.

⁴ 138 S. Ct. at 2099-2100.

⁵ See *South Dakota v. Wayfair*, No 32 Civ 16-92, Circuit Court of Sixth Judicial Circuit, Settlement Agreement and Stipulation of Dismissal (Oct. 31, 2018).

⁶ 138 S. Ct. at 2099.

Some have noted that SDCL section 10-64-2 concerned the remote seller's obligation to remit sales tax, not use tax.⁷ They further note that *Quill* and *National Bellas Hess*,⁸ the decisions overruled in *Wayfair*, both concerned the constitutionality of an obligation imposed on the remote seller to collect use tax, not sales tax.⁹ Therefore, they conclude that there is still doubt as to whether a state can impose a sales tax collection obligation on a remote seller, although neither the taxpayers nor the Court expressly raised or addressed this distinction in *Wayfair*.¹⁰

Professors David Gamage, Darien Shanske, and Adam Thimmesch point to the "sales tax formalism" created by a 1944 sales tax decision, *McLeod v. Dilworth*.¹¹ That decision held that Arkansas could not impose its sales tax on a Tennessee seller delivering product from Tennessee by common carrier to customers in Arkansas, although sales representatives of the seller solicited orders in Arkansas. *Dilworth* considered the sale to be consummated in Tennessee, so the Arkansas sales tax could not reach the transaction.¹² The professors identify a companion decision, *General Trading Co. v. Iowa*,¹³ which authorized Iowa to impose a use tax collection duty on an out-of-state seller using sales representatives to solicit sales in Iowa.¹⁴ Under the *Dilworth* formalism, a state could impose a use tax collection duty on an out-of-state seller shipping merchandise into the state and using sales representatives in the state — but not a sales tax collection duty.

The professors note that *Wayfair* did not explicitly overrule *Dilworth*.¹⁵ In view of that, they recommend that states enacting economic nexus provisions under *Wayfair* should "continue to abide by the *Dilworth* formalism and . . . enact their economic nexus standards through their use tax systems."¹⁶ For states wishing to follow the South Dakota model, the professors recommend that those states "ensure that their statutes impose the tax [on interstate sales] as a substantive matter."¹⁷

Professor Richard Pomp concurs that states considering adoption of economic nexus laws should draft them to impose on the remote seller the obligation to collect use tax, not sales tax.¹⁸ However, he disagrees that South Dakota statutes should serve as a model.¹⁹ Pomp warns that under *Dilworth*,²⁰ a state's attempt to impose sales tax on a transaction crossing state borders may still be unconstitutional, although imposing a use tax collection obligation on such a transaction has long been sanctioned.²¹

Well before *Wayfair*, professor John A. Swain pointed out that under the contemporary commerce clause analysis of *Complete Auto Transit Inc. v. Brady*,²² this "triumph of formalism"²³ in *Dilworth* has effectively been overruled.²⁴ He contended that a properly drawn sales tax statute would bring interstate sales within constitutional reach of the state's tax collection authority.²⁵ Swain suggested that it should be constitutionally

⁷ See, e.g., David Gamage, Darien Shanske, and Adam Thimmesch, "Wayfair: Sales Tax Formalism and Income Tax Nexus," *Tax Notes State*, Sept. 3, 2018, p. 975; and Richard D. Pomp, "Wayfair: Its Implications and Missed Opportunities," *Tax Notes State*, Apr. 2, 2019, p. 1035.

⁸ *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).

⁹ Pomp, *supra* note 7, at 1060. *National Bellas Hess* considered the constitutionality of imposing the use tax collection obligation in Ill. Rev. Stat. c. 120, section 439.3 (1965) on the remote seller. *Quill* considered the constitutionality of imposing a similar use tax collection obligation on the remote seller in N.D. Cent. Code section 57-40.2-07 (Supp. 1991).

¹⁰ Gamage, Shanske, and Thimmesch, *supra* note 7, at 976; Pomp, *supra* note 7, at 1060-1063.

¹¹ 322 U.S. 327 (1944).

¹² *Id.* at 330.

¹³ 322 U.S. 335 (1944).

¹⁴ Gamage, Shanske, and Thimmesch, *supra* note 7, at 975; Pomp, *supra* note 7, at 1060.

¹⁵ Gamage, Shanske, and Thimmesch, *supra* note 7, at 976.

¹⁶ *Id.*

¹⁷ *Id.*, citing SDCL sections 10-45-2, 10-45-108; S.D. Admin. R. section 64:06:01:62(1); and Streamlined Sales and Use Tax Agreement sections 310-311.

¹⁸ Pomp, *supra* note 7, at 1060.

¹⁹ *Id.* at 1063.

²⁰ *Id.* at 1061, discussing *McLeod v. Dilworth*, 322 U.S. 327 (1944).

²¹ *Id.*, discussing *General Trading*.

²² 430 U.S. 274 (1977).

²³ *Id.* at 281 (in reference to the rule in *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951) and *Freeman v. Hewitt*, 329 U.S. 249 (1946) that a state tax on the "privilege of doing business" is per se unconstitutional when applied to interstate commerce, overruled in *Complete Auto*).

²⁴ John A. Swain, "The Zombie Precedent: *Norton Co. v. Department of Revenue*," *Tax Notes State*, Apr. 17, 2017, p. 301, at n. 8 (citing *Complete Auto*, 430 U.S. at 281).

²⁵ *Id.*; see Swain, "The Sales and Use Tax Dichotomy and the Streamlining Movement," *Tax Notes State*, Jan. 15, 2007, p. 129.

permissible to merge the sales and use tax concepts.²⁶

Does the *Dilworth* formalism remain alive even after *Wayfair* as a “trap for the unwary draftsman,”²⁷ potentially invalidating a state’s imposition on the remote seller of a sales tax collection duty?

If the state’s sales tax imposition statute is properly drafted to reach interstate sales, a remote seller’s collection duty should not be invalid simply because it applies to sales tax instead of use tax. *Wayfair*’s failure to specifically address this question or expressly overrule *Dilworth* is most likely due not only to the fact that the taxpayers did not raise the issue, but also because the Court agreed that such formalism had been abandoned. This article explains why the *Dilworth* formalism is gone, describing briefly the sales and use tax structure and how the Court’s understanding in *Wayfair* of the states’ sales and use tax systems signals indifference to that formalism.

This article will show that South Dakota’s sales tax laws are properly drafted to reach interstate sales. Second, U.S. Supreme Court decisions leading up to and including *Dilworth* reveal that the *Dilworth* formalism rested on the state court’s interpretation that the subject sales were consummated out of state, as well as the “free trade” rule.²⁸ Under this now discredited rule, the commerce clause immunized from state taxation transactions in interstate commerce. Strong dissents in *Dilworth* questioned the validity of that formalism. Third, *Complete Auto*

rejected the free trade rule and adopted a four-part test for evaluating state taxation of interstate commerce, invalidating the *Dilworth* formalism.

Finally, *Wayfair* determined that the South Dakota sales tax was lawfully imposed on interstate transactions, with the sale being consummated upon delivery of the purchased product in the state. *Wayfair* recognized that the case concerned a remote vendor’s sales tax remittance obligation, not a use tax collection obligation, but remained indifferent to that distinction. *Wayfair* did not need to explicitly overrule the *Dilworth* formalism, because that formalism is a direct offshoot of a long-discredited view of the commerce clause.

South Dakota Sales and Use Tax Statutes

Sales tax and use tax are complementary yet different taxes. Sales tax functions as a consumption tax paid by the consumer.²⁹ States impose the sales tax on the transaction as a fixed percentage of the sales price in the retail sale of tangible personal property, some enumerated services, or digital products, to the extent included in the tax base.³⁰

The seller collects the sales tax from the purchaser at the time of the transaction, and periodically remits it to the state, along with a sales tax return.³¹ The seller remains liable to remit the sales tax, whether collected from the purchaser or not.³²

The sales tax is triggered by consummation of the sale, which under South Dakota law occurs upon delivery of the product to the purchaser in

²⁶ *Id.* at 131-132. Swain also warned that several legislative changes would be needed to accomplish that, such as making the sales tax base and use tax base uniform; sourcing sales to the destination, a proxy for where consumption takes place; and employing a seller collection mechanism, but recognizing that situations exist when consumer remittances need to be reconciled with seller remittances and credits allowed to prevent double taxation. These situations may include the purchaser making taxable use of an item in a jurisdiction other than the delivery jurisdiction, the purchaser claiming an exemption at the time of purchase but later making a taxable use of the item, or the purchaser providing a direct pay permit to the seller. *Id.*

In the case of software or remote access to software purchases, the item or service could be used in multiple jurisdictions. Also, use tax revenues may be dedicated to funding different governmental purposes than sales tax revenues, so merging would present tracking difficulties. The mechanics of merging sales and use tax are beyond the scope of this article, although certainly a topic worthy of further investigation.

²⁷ 430 U.S. at 281.

²⁸ See *Spector* and earlier cases embodying the rule cited in 430 U.S. at 279, n. 9.

²⁹ Jerome R. Hellerstein and Walter Hellerstein, *State and Local Taxation* (7th ed., 2001), at 836.

³⁰ SDCL sections 10-45-2, 10-45-2.4, 10-45-5.2 impose sales tax directly on the seller for the privilege of engaging in retail sales of tangible personal property, some services, and products transferred electronically.

³¹ Under South Dakota law, the seller has the right to collect the sales tax from the purchaser but no obligation to do so. SDCL section 10-45-22. Some states (“vendor tax” states), like South Dakota, impose the sales tax directly on the seller, while other states (“consumer tax” states) impose the sales tax on the purchaser, with an obligation on the seller to collect it. Still other states (“hybrid tax” states) may combine the features of both in their tax. See John F. Due and John L. Mikesell, *Sales Taxation* (2nd ed., 1994), at 28-29; and Walter Nagel, “State Business Taxes,” *Law Journal Press* (2012), section 4.01, at 4-4.

³² SDCL section 10-45-27.3. Wherever the legal incidence may lie, the economic incidence of the tax is viewed as resting upon the consumer. Hellerstein and Hellerstein, *supra* note 29, at 662.

the state.³³ South Dakota sources the sale to the destination where the purchaser receives the product (referred to as “destination sourcing”).³⁴ Under South Dakota administrative rules, sales tax is imposed on transactions originating outside the state when the seller ships the product from outside the state to the purchaser in the state, the product is for use or consumption in the state, and the seller “engages in business” in the state.³⁵ Also, South Dakota law requires remote retailers to remit sales tax on their sales into South Dakota exceeding the state’s economic nexus threshold.³⁶ Administrative rules also provide that if the sale originates in South Dakota, but the item is shipped out of state to the purchaser, then it is not considered a South Dakota sale and is not subject to the state’s sales tax.³⁷

The use tax complements the sales tax, discouraging purchasers from attempting to avoid the tax by buying items out of state rather than from in-state sellers. The use tax is also considered “compensatory” with the sales tax.³⁸ The use tax rate mirrors the sales tax rate and is imposed on the consumer for the “use, storage, or consumption” of tangible personal property, enumerated services, or digital products (depending on the scope of the state or local use tax base, which may be equal to or narrower than the corresponding sales tax base³⁹) in the taxing state.⁴⁰ The use tax applies when the consumer has not paid sales tax on the purchase. The taxpayer receives credit against the use tax for any other

state’s sales or use tax paid on the purchase transaction, up to the amount of use tax due.⁴¹ The credit protects against multiple states imposing sales or use taxes on the same transaction.

Although the use tax is imposed on the consumer, the state may impose a collection obligation on the seller when it is “maintaining a place of business in this state.”⁴² If the seller does not collect the use tax, the consumer remains liable to the administering state tax agency for the tax.⁴³ States have recognized that use tax collection by the vendor at the time of the transaction is the most effective means of tax compliance.⁴⁴ However, as will be discussed later, South Dakota relied on its remote vendor sales tax remittance statute — not its use tax collection statute — in *Wayfair*.

Use Tax Cases

The use tax received constitutional approval in *Henneford v. Silas Mason Co.*⁴⁵ Washington imposed use tax on tangible personal property used in the state and bought at retail outside the state, with no sales tax having been paid. The Washington Tax Commission notified specific contractors and subcontractors on the Grand Coulee Dam construction project that use tax was due on their equipment, materials, and supplies purchased at retail outside the state, brought into the state for use, and on which no Washington sales tax had been paid. The taxpayers challenged the tax under the commerce clause as a “tax upon the operations of interstate commerce or a discrimination against such commerce obstructing or burdening it unlawfully.”⁴⁶ *Henneford* upheld the use tax as constitutional, “not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end.”⁴⁷ *Henneford* observed:

³³ SDCL section 10-64-2. States generally follow the “destination rule” for sourcing sales tax. See Nagel, *supra* note 31, section 4.01, at 4-5.

³⁴ SDCL section 10-45-108.

³⁵ South Dakota Administrative Rule 64:06:01:25; see SDCL section 10-45-2.

³⁶ SDCL section 10-64-2.

³⁷ South Dakota Administrative Rule 64:06:01:24; see SDCL section 10-45-108.

³⁸ See *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 647 (1994) (“Under the compensatory tax doctrine, a facially discriminatory tax that imposes on interstate commerce the equivalent of an ‘identifiable and substantially similar tax on intrastate commerce does not offend the negative Commerce Clause.’” [Citation omitted]).

³⁹ Swain observed that in some states, the use tax applies only to tangible personal property and not services. “The Sales and Use Tax Dichotomy and the Streamlining Movement,” *supra* note 25, at 132. Also, use tax may be imposed at the state — but not local — level in some states.

⁴⁰ See SDCL sections 10-46-2, 10-46-2.1, 10-46-2.2, 10-46-4 for South Dakota’s imposition of use tax on the consumer for the use, storage, and consumption in the state of tangible personal property, services and products transferred electronically.

⁴¹ SDCL section 10-46-34.1. South Dakota requires that the other state provide a reciprocal credit.

⁴² SDCL sections 10-46-1 (12); 10-46-20; 10-46-23.

⁴³ SDCL section 10-46-33.

⁴⁴ 138 S. Ct. at 2088.

⁴⁵ 300 U.S. 577 (1937).

⁴⁶ 300 U.S. at 581.

⁴⁷ *Id.*

One of [the use tax's] effects must be that retail sellers in Washington will be helped to compete upon terms of equality with retail dealers in other states who are exempt from a sales tax or any corresponding burden. Another effect, or at least another tendency, must be to avoid the likelihood of a drain upon the revenues of the state, buyers being no longer tempted to place their orders in other states in the effort to escape payment of the tax on local sales.⁴⁸

Henneford characterized the Washington use tax as a property tax that is “non-discriminatory in its operation” when the properties acquired or transported in interstate commerce “have become part of the common mass of property within the state of destination.”⁴⁹ The Court also noted the use tax’s credit feature: “Every one who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.”⁵⁰ The in-state purchaser and the out-of-state purchaser are treated equally: One pays the sales tax, while the other pays a complimentary use tax — both at the same rate. However, the Court did not consider the credit feature as necessarily required for constitutional purposes.⁵¹

Henneford concerned the consumer’s direct liability for use tax. Later cases upheld states’ authority to impose a use tax collection duty on the seller.

In *Felt & Tarrant Co. v. Gallagher*,⁵² an Illinois manufacturer sold its products to customers in California, using sales agents to solicit orders. The manufacturer rented office space for the sales agents in California and approved the hiring of any subagents hired by those agents. For accepted orders, the manufacturer shipped the products directly to California purchasers, or to the sales agents in California, who then delivered them to purchasers. California sought to impose its use tax collection obligation on the

manufacturer, as a retailer “maintaining a place of business” in the state. Relying on *Henneford*, the Court upheld imposition of California’s use tax collection obligation on the manufacturer.⁵³

*Nelson v. Sears, Roebuck & Co.*⁵⁴ and *Nelson v. Montgomery Ward & Co.*⁵⁵ upheld Iowa’s use tax statute imposing a collection duty on retailers “maintaining a place of business” in the state. Iowa sought use tax from Sears and Montgomery Ward on their mail order sales to Iowa customers. Sears and Montgomery Ward conducted their mail order sales from locations outside Iowa, but also maintained retail stores in Iowa. Although Sears and Montgomery Ward collected and remitted Iowa sales tax on sales made or orders taken at their retail stores in Iowa, they did not collect any tax on the mail order sales to Iowa customers. Relying in part on *Henneford*, the Court upheld the Iowa use tax collection obligation imposed on the sellers.⁵⁶

*General Trading Co. v. Iowa*⁵⁷ upheld imposing Iowa’s use tax collection obligation on the seller located outside the state and using sales representatives to solicit orders from customers in Iowa. The seller had no stores or facilities in Iowa — only sales representatives.

Sales Tax Cases

In *McGoldrick v. Berwind-White Coal Mining Co.*,⁵⁸ New York City applied its sales tax on “consumption of tangible personal property”⁵⁹ to a Pennsylvania coal manufacturer’s sale of coal to consumers and dealers in New York City. The coal was mined in Pennsylvania, shipped to a Jersey City, New Jersey, dock, and then delivered by the coal manufacturer via barge to the New York City purchasers. The coal manufacturer maintained an office in New York City — at which it entered into contracts with its customers providing for the purchase and delivery of coal.

⁵³ *Id.* at 67.

⁵⁴ 312 U.S. 359 (1941).

⁵⁵ 312 U.S. 373 (1941).

⁵⁶ 312 U.S. at 363.

⁵⁷ 322 U.S. 335 (1944).

⁵⁸ 309 U.S. 33 (1940).

⁵⁹ 309 U.S. at 42.

⁴⁸ *Id.*

⁴⁹ *Id.* at 582-583 (citations omitted).

⁵⁰ *Id.* at 583.

⁵¹ *Id.* at 587.

⁵² 306 U.S. 62 (1939).

The coal manufacturer challenged the sales tax as a violation of the commerce clause. The New York Supreme Court agreed,⁶⁰ and the New York Court of Appeals affirmed.⁶¹ The state courts had construed the sales tax imposition statute as conditioning the tax on the transfer of possession or title to the purchaser occurring in the state, or consummation of the agreement for the transfer of possession or title occurring within the state.⁶² The U.S. Supreme Court reversed in a 6-3 decision. The majority opinion (delivered by Justice Harlan Stone) upheld the tax, observing:

Its only relation to the commerce arises from the fact that immediately preceding transfer of possession to the purchaser within the state, which is the taxable event regardless of the time and place of passing title, the merchandise has been transported in interstate commerce and brought to its journey's end. Such a tax has no different effect upon interstate commerce than a tax on the "use" of property which has just been moved in interstate commerce.⁶³

The majority opinion further stated:

We can find no adequate basis for distinguishing the present tax laid on the sale or purchase of goods upon their arrival at destination at the end of an interstate journey from the tax which may be laid in like fashion on the property itself.⁶⁴

Interpreting the New York City sales tax imposition statute consistently with the state courts, the *Berwind-White Coal Mining Co.* majority viewed the sales transactions as consummated at the place of delivery of the coal to the purchasers for consumption in New York City: destination sourcing.⁶⁵ The majority emphasized that "the

object of interstate shipment is a sale at destination."⁶⁶

Chief Justice Charles Evans Hughes's dissenting opinion (joined by Justices James Clark McReynolds and Owen Roberts) characterized the coal transactions at issue as "interstate commerce in its most obvious form"⁶⁷ — with the seller in Pennsylvania and the purchasers in New York City. The coal was mined in Pennsylvania, shipped from there, and delivered to the purchasers in New York City — with the tax imposed directly on the seller and "laid upon interstate sales."⁶⁸ The dissent disagreed that delivery of the coal to the customer in New York City constituted the "taxable event within the state,"⁶⁹ viewing delivery as only part of the interstate transaction, and finding "no ground for sustaining a tax upon the whole of the interstate transaction of which the delivery is only a part, as in the case of a tax upon the entire gross receipts."⁷⁰

McGoldrick v. Felt & Tarrant Manufacturing Co. was a companion case to *Berwind-White Coal Mining Co.*, with which it also shared an identical 6-3 split among the justices. The facts mirrored those in *Felt & Tarrant Manufacturing Co. v. Gallagher*, only New York City was the taxing jurisdiction rather than California. The Illinois manufacturer maintained a New York City office from which its agents solicited sales and took orders, sending those to the home office for acceptance. The manufacturer shipped ordered product to its New York City sales office, and the sales agents delivered the product to customers in the city. The manufacturer also shipped product directly to New York City customers from Illinois. New York City applied its sales tax to those transactions, seeking liability from the manufacturer, which challenged the tax as a violation of the commerce clause. Relying on *Berwind-White Coal Mining Co.*, the Court upheld application of the New York City sales tax on those transactions, noting that the orders were

⁶⁰ 255 App. Div. 961; 8 N. Y. S. 2d 668.

⁶¹ 309 U.S. at 41 (citing 281 N. Y. 610).

⁶² 309 U.S. at 42.

⁶³ 309 U.S. at 49 (citing *Henneford v. Silas Mason Co., Felt & Tarrant Manufacturing Co. v. Gallagher*, among other cases).

⁶⁴ *Id.* at 52.

⁶⁵ *Id.* at 43-44, 59. ("Here the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption." *Id.* at 59).

⁶⁶ *Id.* at 54.

⁶⁷ *Id.* at 59.

⁶⁸ *Id.* at 60.

⁶⁹ *Id.* at 64.

⁷⁰ *Id.* at 65.

taken in the city, and that the merchandise was delivered to customers there.⁷¹

Dilworth considered the validity under the commerce clause of imposing the Arkansas sales tax on a Tennessee vendor making retail sales to customers in Arkansas. The seller's sales representatives solicited orders in Arkansas. The retailer accepted in Tennessee orders from Arkansas customers by mail and telephone, and also transferred the merchandise to a common carrier in Tennessee for ultimate delivery to the Arkansas purchasers. The Arkansas revenue commissioner filed suit against the vendor, seeking tax on the transactions. The seller challenged the tax as violating the commerce clause and due process. The Chancery Court ruled for the seller, dismissing the suit, and the Arkansas Supreme Court affirmed,⁷² interpreting the tax imposition statute as a sales tax and determining that the sales took place in Tennessee, based upon title transferring from the retailer upon delivery of product to the common carrier. The U.S. Supreme Court affirmed in a 5-4 decision.⁷³

The *Dilworth* majority opinion, consistent with the Arkansas Supreme Court's interpretation of Arkansas law, viewed the sales transactions at issue as occurring in Tennessee, not Arkansas, so Arkansas could not impose its sales tax on them:

In this case the Tennessee seller was through selling in Tennessee. We would have to destroy both business and legal notions to deny that under these circumstances the sale — the transfer of ownership — was made in Tennessee. For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.⁷⁴

The *Dilworth* majority opinion acknowledged that Arkansas could have imposed a use tax collection duty on the seller.⁷⁵ In contrast to the

Berwind-White Coal Mining Co. majority opinion, the *Dilworth* majority opinion drew a sharp distinction between a sales tax on an interstate sale and a use tax for purposes of commerce clause analysis:

Arkansas has chosen not to impose such a use tax, as its Supreme Court so emphatically found. A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds. A sales tax is a tax on the freedom of purchase — a freedom which wartime restrictions serve to emphasize. A use tax is a tax on the enjoyment of that which was purchased. In view of the differences in the basis of these two taxes and the differences in the relation of the taxing state to them, a tax on an interstate sale like the one before us and unlike the tax on the enjoyment of the goods sold, involves an assumption of power by a State which the Commerce Clause was meant to end.⁷⁶

...

Though sales and use taxes may secure the same revenues and serve complementary purposes, they are, as we have indicated, taxes on different transactions and for different opportunities afforded by a State.⁷⁷

In reaching its determination, the *Dilworth* majority opinion distinguished the earlier sales tax cases, *Berwind-White Coal Mining Co.*⁷⁸ and *McGoldrick v. Felt & Tarrant Manufacturing Co.*⁷⁹

The *Dilworth* majority opinion found "relevant and controlling" the factual differences identified by the Arkansas Supreme Court

⁷¹ 309 U.S. at 77.

⁷² 205 Ark. 780, 171 S.W.2d 62 (1943), relying on *Mann v. Carroll*, 198 Ark. 628, 130 S. W. 2d 721 (1939).

⁷³ 322 U.S. at 332.

⁷⁴ *Id.* at 329.

⁷⁵ *Id.* at 330.

⁷⁶ *Id.*

⁷⁷ *Id.* at 331.

⁷⁸ 309 U.S. 33 (1940).

⁷⁹ 309 U.S. 70 (1940).

between the case at hand and *Berwind-White Coal Mining Co.*: The out-of-state seller in *Berwind-White Coal Mining Co.* maintained its sales office in New York City, took its contracts there, and made actual delivery in the city. These activities constituted retail sales in New York City.⁸⁰ In *Dilworth*, the majority opinion determined that the seller maintained offices in Tennessee and made the sale there, consummating the sale with delivery in the state or in interstate commerce to the carrier.⁸¹

Justice William Douglas's dissent in *Dilworth* (with Justices Hugo Black and Frank Murphy concurring) saw no distinction between a destination-sourced sales tax on an interstate sale and a use tax, for purposes of commerce clause analysis:

But a use tax and a sales tax applied at the very end of an interstate transaction have precisely the same economic incidence. Their effect on interstate commerce is identical.⁸²

...

In terms of state power, receipt of goods within the State of the buyer is as adequate a basis for the exercise of the taxing power as use within the State. And there should be no difference in result under the Commerce Clause where, as here, the practical impact on the interstate transaction is the same.⁸³

Similarly, Justice Wiley Blount Rutledge's dissent⁸⁴ in *Dilworth* compared the facts with those in the companion decision of *General Trading Co.*, finding "no difference but one of words" for "constitutional purposes,"⁸⁵ and concluding that "it is hard to see how one tax can be upheld and the other voided."⁸⁶ Application of the Arkansas sales tax to the out-of-state seller using agents to

solicit sales in Arkansas was held invalid in *Dilworth*, while application of the Iowa use tax collection obligation to the remote retailer using agents to solicit sales in Iowa was upheld in *General Trading Co.* His dissent added: "Other things being the same, constitutionality should not turn on whether one name [for the tax] or the other is applied by the state."⁸⁷

Rutledge found sufficient due process connections with Arkansas, the market state, to sustain the tax:

Thus, in the case from Arkansas . . . should there be [no] difficulty in finding due process connections with the taxing state sufficient to sustain the tax. . . . [T]he goods are sold and shipped to Arkansas buyers. Arkansas is the consuming state, the market these goods seek and find. They find it by virtue of a continuous course of solicitation there by the Tennessee seller.⁸⁸

Rutledge acknowledged that Tennessee, as the "origin state," would also have sufficient connections to tax the transaction, but that should not "deprive Arkansas of the same power."⁸⁹

Rutledge characterized the transaction at issue as "interstate," and suggested that because the commerce clause prohibits states from discriminating against interstate commerce, it should operate to prohibit both the origin state and market state from taxing that same interstate transaction. One of those taxes must give way. He clearly preferred giving priority to the market state's taxing authority:

If in this case it were necessary to choose between the state of origin and that of market for the exercise of exclusive power to tax, or for requiring allowance of credit in order to avoid the cumulative burden, in my opinion the choice should lie in favor of the state of market rather than the state of origin. The former is the state where the goods must come in competition with those sold locally. It is the one where the burden of the tax

⁸⁰ 322 U.S. at 329.

⁸¹ *Id.*

⁸² *Id.* at 333.

⁸³ *Id.* at 334.

⁸⁴ *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 349 (1944).

⁸⁵ *Id.* at 350.

⁸⁶ *Id.* at 351.

⁸⁷ *Id.*

⁸⁸ *Id.* at 353-354.

⁸⁹ *Id.* at 357.

necessarily will fall equally on both classes of trade.⁹⁰

Rutledge acknowledged the commerce clause risk of double taxation when both the origin state and destination state could attempt to tax the interstate sales transaction:

If in each case the state of origin were shown to impose a sales tax of three per cent and the state of market a use tax of the same amount, interstate transactions between the two obviously would bear double the local tax burden borne by local trade in each state.⁹¹

But Rutledge doubted “that the mere risk Tennessee may apply its taxing power to these transactions will have any substantial effect in restraining the commerce such as the actual application of that power would have.”⁹²

At the time of *Dilworth*, interstate commerce was deemed immune from state taxation under the so-called “free trade” rule:

The very purpose of the Commerce Clause was to create an area of free trade among the several States. That clause vested the power of taxing a transaction forming an unbroken process of interstate commerce in the Congress, not in the States.⁹³

If the tax was found to apply to transactions considered to be in interstate commerce (such as application of the Arkansas sales tax at issue in *Dilworth*), then it violated the commerce clause. If the tax applied at the point after interstate commerce had ended (such as application of the New York City sales tax at issue in *Berwind-White Coal Mining Co.* to the point of delivery), then it did not violate the commerce clause. Thus, determination of whether the tax at issue was applied to a “local event” or to interstate commerce was critical to its validity under the commerce clause.

The following two decisions, citing *Dilworth*, applied the free trade rule to invalidate state

taxes: *Freeman v. Hewit*,⁹⁴ (holding unconstitutional Indiana’s gross receipts tax as applied to the proceeds of securities sold on the New York Exchange for an Indiana broker on behalf of an Indiana trust) and *Spector Motor Service Inc. v. O’Connor*⁹⁵ (a 5-3 decision holding unconstitutional a Connecticut corporate income tax on the “privilege of doing business” imposed on a Missouri-incorporated multistate trucking company hauling product into and out of Connecticut). *Hewit* noted the precedent for states lawfully imposing consumption taxes on goods from out of state.⁹⁶ *Hewit* also distinguished the permissible “local” sales tax at issue in *Berwind-White Coal Mining Co.* from the impermissible direct sales tax on interstate commerce in *Dilworth*. Then, *Hewit* essentially articulated the *Dilworth* formalism as follows: “Taxes which have the same effect as consumption taxes are properly differentiated from a direct imposition on interstate commerce.”⁹⁷

Relying on *Hewit* as well as *Dilworth* and acknowledging that a state may appropriately impose a tax “as compensation for petitioner’s use of the highways,” the *Spector* majority opinion determined that the Connecticut tax violated the free trade rule as a tax placed on the “corporation’s franchise for the privilege of carrying on exclusively interstate transportation in the State.”⁹⁸ The opinion stated the *Dilworth* formalism in another way:

Even though the financial burden on interstate commerce might be the same, the question whether a state may validly make interstate commerce pay its way depends first of all upon the constitutional channel through which it attempts to do so.⁹⁹

The *Spector* majority opinion’s use of the free trade rule to compare a lawful tax on in-state highway use with a constitutionally barred direct

⁹⁰ *Id.* at 361.

⁹¹ *Id.* at 359.

⁹² *Id.* at 362.

⁹³ 322 U.S. at 330-331.

⁹⁴ 329 U.S. 249, 257 (1946).

⁹⁵ 340 U.S. 602, 608 (1951).

⁹⁶ 329 U.S. at 257.

⁹⁷ *Id.*

⁹⁸ 340 U.S. at 68

⁹⁹ *Id.*

tax on interstate transportation matches up well with the *Dilworth* formalism's comparison of a lawful use tax on out-of-state goods with the unlawful direct sales tax on interstate commerce.

In addition to the free trade rule, the *Dilworth* formalism also rested on the Arkansas Supreme Court's interpretation of Arkansas tax law that the sales transaction on which the tax was imposed was deemed consummated out of state. As noted, in *Berwind-White Coal Mining Co.* the transaction subject to tax was deemed consummated at the location of delivery to the purchaser, New York City.

Complete Auto

The rule that interstate commerce had free trade immunity from state taxation under the commerce clause remained effective until *Complete Auto* discarded it.¹⁰⁰ *Complete Auto* upheld against a commerce clause challenge Mississippi's sales tax on the privilege of doing business in the state. The tax was imposed on a Michigan-incorporated motor carrier's gross receipts from transporting new vehicles shipped by rail from the out-of-state factory to the state and then delivered by the motor carrier to car dealers within the state. *Complete Auto* rejected the free trade rule embodied in *Spector*, overruling that decision.¹⁰¹ Although the Court extensively discussed *Hewitt* in connection with the free trade rule, that decision was not explicitly overruled.¹⁰²

The Court observed that decisions succeeding *Hewitt* narrowed the free trade rule, upholding state taxes on income generated in interstate commerce but disallowing taxes on the "privilege" of engaging in interstate commerce. By the time of the *Spector* decision, the free trade rule had become merely a rule of

"draftsmanship."¹⁰³ *Complete Auto* replaced the *Spector* rule with the four-part test under which a state can tax interstate commerce if the tax:

[1] is applied 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 provided by the State.¹⁰⁴

After *Complete Auto*, the fictional determination of whether the tax applies to a sales transaction consummated either during or after interstate commerce has ended no longer has significance for commerce clause purposes.¹⁰⁵

Likewise, *Complete Auto*'s disposal of the free trade rule and replacement with the four-part test eliminated the need to distinguish between a destination-sourced sales tax imposed on a transaction in interstate commerce and a use tax imposed on the storage, use, or consumption of the purchased item after interstate commerce has ended. As Swain suggested,¹⁰⁶ after *Complete Auto*, states have the authority to impose sales tax on transactions in interstate commerce without regard to the *Dilworth* formalism. Subject to the *Complete Auto* four-part test, the commerce clause places no barrier against one state imposing a destination-based sales tax on a seller in another state. The imposition statute must, of course, source the sale to its destination and impose the tax on the point of delivery to the purchaser in the taxing state.¹⁰⁷ However, prior to *Wayfair* and

¹⁰³ 430 U.S. at 281-285, comparing *Memphis Gas Co. v. Stone*, 335 U.S. 80 (1948), upholding a Mississippi franchise tax imposed on the value of capital in a multistate pipeline going across the state, with *Spector*, finding unconstitutional a Connecticut tax on the "privilege of doing business" imposed on a Missouri-incorporated multistate trucking company hauling product into and out of Connecticut.

¹⁰⁴ *Id.* at 279.

¹⁰⁵ See Pomp, *supra* note 7, at 1061. Pomp contends that even after *Complete Auto*, the constitutional definition of where a sale takes place remains open.

¹⁰⁶ *Supra* note 24, at 301-302, n. 8.

¹⁰⁷ Pomp acknowledges that *Complete Auto* overturned that aspect of *Dilworth* relying on the free trade rule in *Spector* but contends that "still left open is the constitutional characterization of where a sale takes place." Pomp, *supra* note 7, at 1061. However, as previously discussed, *Dilworth* adopted the Arkansas Supreme Court's interpretation that under applicable state law, the transaction was consummated in Tennessee, whereas *Berwind-White Coal Mining Co.*, interpreting the sales tax imposition statute at issue, determined that the sale was consummated at the place of delivery to the purchaser. The location where a sale is deemed consummated appears to be a matter of statutory interpretation, not constitutional characterization.

¹⁰⁰ 430 U.S. 274, 288-89 (1977), overruling *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951). See Pomp, *supra* note 7, at 1061, n. 208.

¹⁰¹ 430 U.S. at 289.

¹⁰² 430 U.S. at 274-275. But see *Quill*, 504 U.S. at 310:

Complete Auto rejected *Freeman* and *Spector*'s formal distinction between "direct" and "indirect" taxes on interstate commerce because that formalism allowed the validity of statutes to hinge on "legal terminology," "draftsmanship and phraseology." [Citation omitted.]

under *Quill*, the seller needed to have a physical presence in the taxing state before that state could impose any tax collection obligation.

Wayfair

Wayfair considered three large online retailers' constitutional challenge to South Dakota's newly enacted economic nexus law and, as noted, overruled the *Quill* physical presence rule. South Dakota's economic nexus statute imposed a sales tax remittance obligation on the remote seller — not a use tax collection obligation. None of the parties in *Wayfair* raised any issue concerning that fact.¹⁰⁸ Respondents Wayfair Inc., Overstock.com Inc., and Newegg Inc. were the parties likely to raise it, but probably concluded that the issue was not worth litigating. *Complete Auto* had disposed of it, along with the fact that the South Dakota sales tax law imposed the tax upon interstate sales with delivery in the state.

The Court recognized that South Dakota's sales tax law was at issue, and referenced the state's use tax laws only regarding consumer use tax liability:

Like most States, South Dakota has a sales tax. It taxes the retail sales of goods and services in the State. S. D. Codified Laws [sections] 10-45-2, 10-45-4 (2010 and Supp. 2017). Sellers are generally required to collect and remit this tax to the Department of Revenue. [Section] 10-45-27.3. If for some reason the sales tax is not remitted by the seller, then instate consumers are separately responsible for paying a use tax at the same rate. See [sections] 10-46-2, 10-46-4, 10-46-6. Many States employ this kind of complementary sales and use tax regime.¹⁰⁹

¹⁰⁸ The amicus curiae brief of Washington State Tax Practitioners submitted in *Wayfair* emphasized that South Dakota was seeking to apply a sales tax remittance obligation on the remote seller, rather than a use tax collection obligation, attempting to raise the issue. However, *Wayfair* did not acknowledge those arguments.

¹⁰⁹ 138 S. Ct. at 2088.

The Court understood that the statute at issue imposed on the seller an obligation to remit sales tax — not collect use tax:¹¹⁰

When a consumer purchases goods or services, the consumer's State often imposes a sales tax. This case requires the Court to determine when an out-of-state seller can be required to collect and remit that tax. All concede that taxing the sales in question here is lawful. The question is whether the out-of-state seller can be held responsible for its payment, and this turns on a proper interpretation of the Commerce Clause, U. S. Const., Art. I, [section] 8, cl. 3.¹¹¹

The Court also recognized that both *Bellas Hess* and *Quill* concerned a remote seller's use tax collection obligation, not a sales tax remittance obligation,¹¹² but drew no such distinction in referencing those decisions.¹¹³

Although the Court referred to the seller's requirement to collect and remit the South Dakota sales tax, the South Dakota statute imposes the sales tax directly on the seller, giving the seller the right, but not the obligation, to collect it from the purchaser.¹¹⁴ The Court was indifferent to that distinction.¹¹⁵

Acknowledging agreement of the parties, the *Wayfair* majority opinion interpreted South Dakota's statute as lawfully sourcing the sales tax to the destination, with in-state delivery to the purchaser consummating the sale:

¹¹⁰ 138 S. Ct. at 2089 (“[T]he Act requires out-of-state sellers to collect and remit sales tax ‘as if the seller had a physical presence in the state.’ [section] 1.”).

¹¹¹ 138 S. Ct. 2087.

¹¹² *Id.* at 2091 (“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.”); *Id.* (“[*Quill*] presented a challenge to North Dakota’s ‘attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State.’ 504 U.S., at 301”).

¹¹³ *Id.* at 2088 (“Under this Court’s decisions in *Bellas Hess* and *Quill*, South Dakota may not require a business to collect its sales tax if the business lacks a physical presence in the State”).

¹¹⁴ SDCL section 10-64-2.

¹¹⁵ 138 S. Ct. at 2093 (“The central dispute is whether South Dakota may require remote sellers to collect and remit the tax without some additional connection to the State”).

All agree that South Dakota has the authority to tax these transactions. S.B. 106 applies to sales of “tangible personal property, products transferred electronically, or services for delivery into South Dakota.” [section] 1 (emphasis added). “It has long been settled” that the sale of goods or services “has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.”

Oklahoma Tax Comm’n v. Jefferson Lines, Inc., 514 U. S. 175, 184 (1995); see also 2 C. Trost & P. Hartman, *Federal Limitations on State and Local Taxation* 2d [section] 11:1, p. 471 (2003) (“Generally speaking, a sale is attributable to its destination”).¹¹⁶

The *Dilworth* formalism would certainly have been relevant to whether South Dakota had the authority to lawfully tax the transactions, if that formalism still had any validity.

The *Wayfair* majority opinion’s interpretation that the tax was lawfully imposed is consistent with the *Berwind-White Coal Mining Co.* majority opinion, which determined — consistent with the state courts — that the transactions subject to New York City’s sales tax were consummated upon delivery of the coal to the purchasers “for consumption.”¹¹⁷ South Dakota’s sales tax law imposed the tax on interstate sales transactions in which the product was delivered to the purchaser for consumption in the state.¹¹⁸

The *Wayfair* majority opinion’s determination that the transaction is consummated upon delivery of property to the purchaser contrasts with the *Dilworth* majority opinion, which — in reliance on the Arkansas Supreme Court’s interpretation — deemed the sales transaction to come to an end upon transfer of the purchased goods to the common carrier in Tennessee, not delivery to the purchaser.

The *Wayfair* majority opinion aligns with the rationales of the *Dilworth* dissents of Douglas and Rutledge. Both justices respected the strong interest of the market state, where the property was delivered to the purchaser, in taxing the transactions at issue. Like Douglas’s dissent in *Dilworth*,¹¹⁹ the *Wayfair* majority opinion drew no distinction for commerce clause purposes between a state imposing on the seller a destination-sourced sales tax and an obligation to collect use tax. In harmony with Rutledge’s emphasis on the importance of the market state having priority over the origin state in imposing a destination-sourced sales tax,¹²⁰ the *Wayfair* majority opinion focused on the benefits that the market state provides to the remote seller:

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,” *Quill*, 504 U. S., at 328 (opinion of White, J.); and help create the “climate of consumer confidence” that facilitates sales.¹²¹

In referencing the seller’s duty to collect tax from the purchaser as a “sanctioned device,” the *Wayfair* majority opinion quoted both *Berwind-White Coal Mining Co.* (considering a Pennsylvania coal manufacturer’s statutory obligation to collect sales tax on sales of coal to New York City consumers) and *Scripto Inc.* (considering a Georgia seller’s obligation to collect use tax on its sales of merchandise to Florida customers).¹²²

The *Wayfair* majority opinion blurred the distinction between a sales tax and use tax in discussing the flaws in the *Quill* physical presence rule:

¹¹⁶ *Id.* at 2092.

¹¹⁷ 309 U.S. at 59 (“Here the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption”).

¹¹⁸ SDCL section 10-64-2; Administrative Rule 64:06:01:25.

¹¹⁹ 322 U.S. at 334.

¹²⁰ 322 U.S. at 361.

¹²¹ 138 S. Ct. at 2096.

¹²² *Id.*

Quill's physical presence rule intrudes on States' reasonable choices in enacting their tax systems. And that it allows remote sellers to escape an obligation to remit a lawful state tax is unfair and unjust. It is unfair and unjust to those competitors, both local and out of State, who must remit the tax; to the consumers who pay the tax; and to the States that seek fair enforcement of the sales tax, a tax many States for many years have considered an indispensable source for raising revenue.¹²³

Wayfair's elimination of the *Quill* physical presence standard obviously affects how previous Court decisions concerning the remote seller's obligation to collect sales or use tax should be viewed. The seller's physical presence in the taxing state (such as the presence of agents soliciting sales as in *General Trading* or a sales office in which purchase contracts are executed as in *Berwind-White Coal Mining Co.*) is no longer required to support the remote seller's obligation to collect either sales or use tax, if the seller has economic nexus with the state.

As the *Wayfair* majority opinion stated in criticizing the physical presence rule: "*Quill* imposes the sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause precedents disavow."¹²⁴ The *Dilworth* formalism, indistinguishable from the *Freeman* and *Spector* formalism rejected in *Complete Auto*, likewise falls within that same distinction. Under *Dilworth*, two taxes that the Court has long recognized have the same economic effect — sales tax and use tax — were given different treatment under the commerce clause. The *Dilworth* formalism must be considered overruled by implication.

States with properly drafted sales tax imposition statutes that impose sales tax on interstate transactions and source the sale to the location where the purchaser receives the product, like South Dakota's, should face no constitutionality risk, simply because the remote

seller has a sales tax — not use tax — collection and remittance duty.

Conclusion

Wayfair did not expressly overrule the *Dilworth* formalism, which prohibited states from imposing a sales tax collection duty on remote sellers although recognizing that states could impose a use tax collection duty in similar circumstances. Some argue that this formalism remains part of commerce clause jurisprudence as a trap for the unwary. But *Dilworth* rested on the free trade rule that *Complete Auto* discarded in explicitly overruling *Spector*. *Wayfair* had no need to consider the *Dilworth* formalism; *Complete Auto* had already implicitly overruled it. *Wayfair*'s elimination of *Quill*'s physical presence rule clears the way for a state to impose a sales tax remittance duty on the remote seller meeting the state's economic nexus threshold, assuming the state imposes sales tax on interstate transactions and sources the tax to the delivery destination, as South Dakota does. ■

¹²³ *Id.* at 2095-2096.

¹²⁴ *Id.* at 2092. Ironically, in *Quill*, the Court rejected the argument that after *Complete Auto*, *Bellas Hess* fell with "*Freeman* and its progeny." 504 U.S. at 310-311. In *Wayfair*, *Quill* and *Bellas Hess* did so fall.