New Alabama Regulation to Require Out-of-State Sellers to Collect Sales and Use Tax Contrary to Supreme Court Precedent

Alabama recently promulgated a controversial regulation requiring certain out-of-state retailers to collect sales and use tax on sales made in Alabama, even though the out-of-state retailers may not have physical presence in Alabama.¹ This regulation appears to contradict the U.S. Supreme Court’s conclusion in *Quill Corp. v. North Dakota*,² a decision based on the Commerce Clause of the U.S. Constitution requiring out-of-state retailers to have physical presence in a state before a state can require the retailer to collect and remit sales and use tax.

**Regulation Utilizes Substantial Economic Presence Standard**

Effective January 1, 2016, certain out-of-state sellers making retail sales into Alabama will be required to collect and remit sales and use tax even though such sellers do not have a physical presence in the state. Specifically, the regulation requires out-of-state sellers to collect sales and use tax if they have substantial economic presence in the state. The substantial economic presence standard is satisfied for purposes of the regulation for sellers that meet two conditions: (a) prior calendar year retail sales of tangible personal property in the state are greater than $250,000; and (b) certain activities are performed within the state. These activities are described in Alabama Code Section 40-23-68(b),³ and generally include the following:

- Maintaining, occupying or using an Alabama place of business (by itself or through a subsidiary or agent).
- Qualifying to do business or registering with the state to collect the sales and use tax.
- Utilizing employees, agents, salesmen or other personnel operating in Alabama to sell, deliver or take orders for the sale of tangible personal property or services taxable under the Alabama sales and use tax law, or otherwise soliciting and receiving purchases or others by agents or salesmen.
- Soliciting orders for tangible personal property by mail if substantial and recurring, and if the retailer benefits from banking, financing, debt collection,

¹ ALA. ADMIN. CODE r. 810-6-2-.90.03.
³ The regulation actually references ALA. CODE § 40-23-68 in its entirety, but the only list of activities in this statute are contained in subsection (b).
telecommunication or marketing activities occurring in Alabama, or benefits from authorized installation, servicing or repair facilities located in Alabama.

- Using a franchisee or licensee operating under its trade name.
- Soliciting orders for tangible personal property through advertising disseminated primarily to Alabama customers; advertising transmitted or distributed over an Alabama cable television system; or through a telecommunication or television shopping system intended for broadcast to Alabama customers.
- Maintaining any contract with Alabama that would allow Alabama to require collection and remittance of sales and use tax under the U.S. Constitution.
- Distributing catalogs or other advertising matter resulting in orders from Alabama residents.

**Commentary**

The U.S. Supreme Court held in 1992’s *Quill* decision that for Commerce Clause nexus purposes, out-of-state retailers must have physical presence in a state before a state can require the retailer to collect sales tax. *Quill* also distinguished this Commerce Clause nexus standard from Due Process nexus, which does not require physical presence. This new Alabama regulation appears to be the first instance in which a regulation promulgated by a state tax authority contradicts the *Quill* decision by requiring out-of-state sellers to collect and remit sales taxes even though they may not have actual physical presence in the state.

It may not be surprising that Alabama (and potentially other states) would look to overcome the *Quill* physical presence standard through novel means, given the significant amount of money that states do not collect due to the inability to force remote sellers to collect and remit sales taxes on sales made to in-state customers, and lack of Congressional action in this area since *Quill*. The uncertain vitality of *Quill* was specifically highlighted by Justice Kennedy in a concurring opinion to the Supreme Court’s recent *Direct Marketing Association* decision. Justice Kennedy indicated that the Court may be willing to reconsider the *Quill* case in light of how drastically technology and sales have changed since 1992. In fact, instead of simply commenting that the case may be outdated, he went a step further and requested that the “legal system should find an appropriate case for this Court to re-examine *Quill* and *Bellas Hess*.”

Many experts predicted that cash-strapped states looking to bring in additional revenue would take this as an invitation to pass a law that could provide the basis for a test case to challenge the long-standing *Quill* decision. Alabama’s use of a regulation to address these issues rather than engaging in an effort to enact legislation may reflect the difficulty that proponents of this policy would have had using the legislative process. But by promulgating a regulation, the Department risks having the regulation overturned by a court as overreaching beyond the bounds of the current Alabama sales and use tax statutes.

On that point, it is likely someone will file a lawsuit challenging this new regulation when the impact of such regulation becomes significant, but it may take several years before a test case arises that may be heard before the U.S. Supreme Court. Once the regulation

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4 ALA. CODE § 40-23-68(b)(1)-(10).
6 *Id.*
goes into effect, a lawsuit would need to be filed and litigated in a trial court, go through the appellate process, and then be appealed to the Supreme Court. Even if a case were to reach that level, it is uncertain whether the Supreme Court would agree to hear it. Beginning next year, this regulation may create a situation whereby out-of-state sellers are forced to collect Alabama sales and use taxes even though the requirement appears contrary to Supreme Court precedent, while companies and taxpayers alike wait for a viable challenge to work its way through the court system.

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