Wayfair and the Retroactivity of Constitutional Holdings

David Gamage
*Indiana University Maurer School of Law*, dgamage@indiana.edu

Adam Thimmesch
*University of Nebraska - Lincoln*

Darien Shanske
*University of California, Davis*

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Wayfair and the Retroactivity of Constitutional Holdings

by Adam Thimmesch, Darien Shanske, and David Gamage

The primary issue that the U.S. Supreme Court will address in South Dakota v. Wayfair Inc. is whether the Court should overturn its long-standing physical presence rule. However, if the Court were to overturn this rule, it may also choose to resolve a second question — whether its reversal would apply retroactively or prospectively only. If the holding were to apply retroactively, that would mean that remote vendors could be liable for years of back taxes, with no real opportunity to collect those taxes from their customers. The impact of that could be highly problematic.1

The retroactivity issue is of critical importance, and it did receive attention from both parties in their merits briefs, as well as in the briefs of many amici.2 But the issue was not nearly as fleshed out as the substantive issue in the case, and the retroactivity issue deserves more discussion to make clear that the Court is not bound to reverse Quill on a retroactive basis either now or later (if it is to repeal Quill at all). This article elaborates by evaluating the doctrinal foundation of the Court’s retroactivity doctrine and by analyzing why Wayfair differs from cases in which the Court required its decisions to be applied retroactively. To summarize the argument, a prospective-only application of a new rule in Wayfair would be more than justified and would be consistent with the Court’s doctrine in this area of law.

The Supreme Court’s Retroactivity Doctrine

One of the foundational elements of the rule of law and American jurisprudence is that people should have an opportunity to understand what the law is before being held

1 That is, assuming that any states would act to collect retroactive tax liabilities, an eventuality that 40 states argue is unlikely in their amicus brief. States’ Amicus Brief at 19-20, South Dakota v. Wayfair Inc., No. 17-494 (U.S. Mar. 5, 2018).

accountable for violations of its mandates.\(^1\) One aspect of this principle is that we generally disfavor retroactively punishing conduct based on new laws. This is reflected in various places in our legal system, including the U.S. Constitution, which prohibits ex post facto laws, and in a general judicial presumption that legislation is applied only prospectively.\(^2\)

That general rule gives way in the realm of judicial pronouncements, however, where there has developed a norm of retroactivity. This arises from a prominent theory of judicial power that reasons that judges have the power to issue retroactive decisions because their role is to announce what the law “is” or “was,” not what it “shall be.”\(^3\) A statute that is held to be inconsistent with the Constitution, for example, is not inconsistent only from that point on or only regarding the parties involved in the particular case. The statute was always inconsistent with the Constitution. Any other approach would allow Courts to be the writer of laws rather than the interpreter of laws, according to this philosophy.

The Supreme Court has struggled with this issue and with other issues that retroactivity can cause. Applying a constitutional holding retroactively could impose significant costs on parties who have relied on the Court’s prior precedent or on the law as it was enacted. That cost might outweigh the benefits of a retroactive application, and a prospective ruling might provide greater net benefits. The Court addressed this tension with its 1971 decision in *Chevron Oil v. Huson*\(^4\) in which it pulled together three factors from its prior cases for evaluating whether a prospective-only ruling is appropriate. Under the *Chevron Oil* framework, the Court looks to (1) whether the Court’s decision establishes a new principle of law, either by overruling prior law or by deciding a question of first impression that was not “clearly foreshadowed”; (2) whether retroactive application would undermine the operation of the new rule, given its purpose and effect; and (3) whether retroactive application would cause injustice or hardship.\(^5\)

**Chevron Oil and Tax Statutes**

The *Chevron Oil* factors suggest that the Court could easily justify applying a reversal of *Quill* on a prospective-only basis only. The Court clearly would be overruling prior law. Retroactive application would undermine the purpose of the Court’s dormant commerce clause doctrine, which is to protect interstate commerce while respecting state autonomy.\(^6\) And a retroactive holding would clearly cause injustice or hardship on remote vendors — they could be liable for years of past taxes that they otherwise could have collected from their customers. Retroactive liability wouldn’t just place them in the same position as if the physical presence rule were never imposed by the Court, it would make them worse off.

Why does Wayfair argue that a reversal of *Quill* would have to apply retroactively? That position stems from a gradual erosion of the *Chevron Oil* test that can be seen in the Court’s cases since the 1970s. Key among those are three state tax cases from the early 1990s.\(^7\) The first, *American Trucking Associations v. Smith,*\(^8\) was a case involving a flat highway tax identical to one the Court had struck down as unconstitutionally discriminatory during pendency of that dispute.\(^9\) The issue presented to the Court was whether that intervening decision would be applied to the case at hand. Justice Sandra Day O’Connor applied *Chevron Oil* and answered that question in the negative, but her opinion on

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\(^1\) Lon L. Fuller, “The Morality of Law,” 51-53 Yale U.S. Press 1969


\(^3\) See Kay, id. at 49-50 (describing this judicial philosophy and likening it to a “Blackstonian view of adjudication”); and American Trucking Association, 496 U.S. 167, 201 (1990) (Scalia, J., dissenting) (“[p]rospective decisionmaking is incompatible with the judicial role, which is to say what the law is, not to prescribe what it shall be”).


\(^6\) Id. at 106-107.

\(^7\) Id. at 105-107.

\(^8\) Id. at 106-107.


\(^10\) The Court had, at that time, already retreated from its willingness to apply its decisions on a prospective-only basis in criminal procedure matters. See *Griffith v. Kentucky*, 479 U.S. 314, 328 (1986).


\(^12\) See American Trucking Associations v. Scheiner, 483 U.S. 266 (1987).
that issue garnered the support of only a plurality of the justices. That year, the Supreme Court decided James B. Beam Distilling Co. v. Georgia, which involved the question whether the decision in Bacchus Imports Ltd. v. Dias \(^{13}\) would apply retroactively. Bacchus was another discrimination case, and the Court determined that it did apply retroactively notwithstanding Chevron Oil, but it could not muster a majority opinion on why. O'Connor's dissent, which Chief Justice William Rehnquist and Justice Anthony M. Kennedy joined, applied Chevron Oil and mentioned the "potentially devastating liability" that retroactivity can cause. \(^{15}\) The majority opinion did not apply Chevron Oil at all.

James Beam left the status of the Chevron Oil doctrine unclear, but the Court struck a much deeper blow to that doctrine very shortly thereafter in Harper v. Virginia. \(^{16}\) That case again involved the retroactivity of a court’s decision that a state statute was unconstitutionally discriminatory. Justice Clarence Thomas wrote the majority opinion in Harper and all but closed the opportunity for prospective-only decisions. After reviewing Chevron Oil and its progeny, he noted that:

> When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule. \(^{18}\)

For many, that seems to have marked the end of the retroactivity debate.

**Prospective Rulings After Harper**

Thomas’s opinion in Harper certainly did not seem to leave a great amount of room for prospective-only judgments. But it didn’t entirely foreclose them either. The precise issue addressed by the Harper Court was whether lower courts could reject retroactivity when the Court had not done so itself. \(^{19}\) This says nothing of whether the Court can issue a prospective-only judgment of its own accord.

The real takeaway from Harper is about the Court’s desire for consistency of application between parties. The Court was critical of “selective prospectivity,” which is when “a court applies the new rule to the parties before it but not to other conduct predating the court’s judgment.” \(^{20}\) That is inconsistent with many justices’ views of how courts and the rule of law should operate. But it does not mean that Chevron Oil is bad law or that the Court cannot issue prospective-only rulings in appropriate circumstances. The Court still has that option, and Wayfair presents the precise fact situation for which that is proper. We base this conclusion on several factors.

To start, much judicial action under the dormant commerce clause is quasi-legislative in nature. The dormant commerce clause represents the Court’s attempt to protect the negative implications of the commerce clause, which directly grants Congress an affirmative power to regulate interstate commerce. \(^{21}\) It is only when Congress does not act under the commerce clause

\(12\) American Trucking Associations v. Smith, 496 U.S. at 179-183. Notably, Justice O’Connor justified prospectivity based, in part, on the inequity of potentially retroactively imposing taxes on previously “favored taxpayers.” Id. at 182-183. Justice Scalia joined the majority in denying relief to the taxpayer, but he did not agree with the plurality opinion on retroactivity.Id. at 201 (Scalia, J., concurring in the judgment) (noting that “the notion that our interpretation of the Constitution in a particular decision could take prospective form does not make sense”).


\(15\) James B. Beam, 501 U.S. at 558 (O'Connor, J., dissenting).

\(16\) 509 U.S. 86 (1993). Note that this is the first of these cases that occurred after Quill was handed down in 1992.

\(17\) This case was a bit different in that the statute at issue was not discriminatory under the dormant commerce clause, but in violation of the principles of intergovernmental tax immunity. See Harper, 509 U.S. at 89-91; see also Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989).

\(18\) Harper, 509 U.S. at 97.

\(19\) Id. at 97-98 (rejecting the Virginia Supreme Court’s application of Chevron Oil “when this Court does not ‘reserve the question of whether its holding should be applied to the parties before it’”; and id. at 98 (noting that state courts have a “legal imperative to apply a rule of federal law retroactively after the case announcing the rule has already done so”) (emphasis added). Lower courts have latched on to that language to preserve some room for prospective-only rulings. See Daniel Hemel, “There Is No Retroactivity Concern With Overruling Quill,” Whatever Source Derived (Jan. 28, 2018).

\(20\) Kay, supra note 4, at 48 (internal quotations omitted).

\(21\) U.S. Const. Art. I, section 8, cl. 3.
that the Court has a role under the negative or dormant commerce clause. If the Court acts, though, it does so to some extent by exercising federal legislativelike power to proscribe some state conduct; this is of course why the clause remains controversial among some justices. As noted above, the Court’s default position regarding legislative enactments is that they apply prospectively only. The table is flipped, and so if there is any area of the law where the presumption in favor of retroactivity should be relaxed it is regarding the dormant commerce clause. The special role of the dormant commerce clause is further indicated by the fact that, unlike in other areas of constitutional law, this is an area in which Congress can overturn a constitutional ruling of the Supreme Court.

Of course, much of the erosion of *Chevron* in the early 1990s occurred in dormant commerce clause cases. However, all those cases raised the issue of unlawful discrimination, an aspect of the dormant commerce clause that even Justice Antonin Scalia embraced. The states involved had collected taxes in unconstitutional ways, and issuing a retroactive ruling meant that the states had to provide relief to all parties affected by those actions — not just to the litigant who brought the challenge. To hold to the contrary would allow states to act in a discriminatory way with no real downside. They would get to keep the resulting revenue.

The analysis here could be put another way. Though surely the Court did not rely on *Chevron* in these cases, we might say that these cases should have gone the same way even if the Court had applied *Chevron*’s three factors. In a discrimination case, the Court is applying well-established old rules, and injustice would be caused by prospective-only application, as opposed to retroactive application.

Thus, a ruling for South Dakota in *Wayfair* would be fundamentally different from these other post-*Chevron* Oil cases because the issue in this case is not about state discrimination. This observation has several implications. First, ruling prospectively would not permit the states to retain any ill-gotten gains. Second, and conversely, ruling prospectively would protect remote vendors who relied on a prior ruling by the Court. These vendors did not trench upon the polestar of the dormant commerce clause, namely the anti-discrimination principle, nor commit any other wrong, and so placing the burden of the Court’s mistake on these vendors goes to exactly the concern with injustice that animates *Chevron* Oil’s third prong. Returning to our alternative framing, the Court has not encountered a case in which prospectivity is so important as in *Wayfair*, and should return to application of *Chevron* Oil.

Taken together, the legal issue and the factual posture presented in *Wayfair* are sufficiently different from the traditional cases that have come before the Court that a prospective-only ruling is more than justified on those grounds.

**Retroactive Application Would Unduly Burden Interstate Commerce**

Even if most of the justices do not agree that *Chevron* Oil is still valid or that a prospective-only ruling is otherwise proper, the Court could still effectively prohibit states from imposing retroactive liabilities on vendors post-*Quill*. That is because the application of retroactive liabilities would violate the dormant commerce clause by imposing undue burdens on interstate commerce.

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22 Landgraf v. USI Film Production, 511 U.S. 244, 265, (1994) (“the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic”).

23 See Quill, 504 U.S. at 318 (noting that “Congress has the ultimate power to resolve” dormant commerce clause issues).

24 Not necessarily enthusiastically. See, e.g., West Lynn Creamery Inc. v. Healy, 512 U.S. 224, 265, (1994) (“I will, on stare decisis grounds, enforce a self-executing, ‘negative’ Commerce Clause in two situations: (1) against a state law that facially discriminates against interstate commerce, and (2) against a state law that is indistinguishable from a type of law previously held unconstitutional by this Court. Applying this approach — or at least the second part of it — is not always easy, since once one gets beyond facial discrimination our negative-Chevron-Clause jurisprudence becomes (and long has been) a ‘quagmire.’”) (Scalia, J., concurring) (internal citations omitted).

25 States could alternatively seek to collect tax from the previously favored class of in-state taxpayers, but that could obviously prove to be difficult. See Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, para. 4.17 (3d ed. 2017) (discussing potential remedies for state tax statutes determined to be unconstitutionally discriminatory).

26 Of course, concern with the reliance interest of vendors might lead one to the conclusion that *Quill* should not be overturned at all, but this can’t be correct. Mistakes that generate reliance cannot become unassailable, though rule of law considerations clearly indicate the Court must proceed with care.
Understanding this argument starts with first appreciating that the Court’s current nexus doctrine serves as nothing more than a proxy for assessing when a state tax collection requirement burdens interstate commerce in a way that is not justified by the local interest in tax collection.\footnote{See Thimmesch, supra note 8, at 106-108; see also Amicus Curiae Brief of Four U.S. Senators in Support of Petitioner at 15-16, South Dakota v. Wayfair Inc., No. 17-494 (U.S. Mar. 5, 2018); and Brief of the United States as Amicus Curiae Supporting Petitioner at 18-19, South Dakota v. Wayfair Inc., No. 17-494 (U.S. Mar. 5, 2018).} This type of balancing is not a tax-specific task; it is something the Court does regarding all types of state regulations. In nontax situations, the Court does not use a nexus test though. It applies something referred to as *Pike* balancing.\footnote{This stems from the application of that balancing test in *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970).} The *Pike* formulation is as follows:

Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.\footnote{Id. (internal citation omitted).}

That balancing approach is intended to identify state regulations that go “too far” and that thus unduly burden interstate commerce.\footnote{See South Pacific Co. v. Arizona, 325 U.S. 761, 781 (1945).} The Court has found it difficult to apply this test to particular facts,\footnote{See Kentucky v. Davis, 553 U.S. 328, 353 (2008) (noting the “institutional difficulty” of doing *Pike* balancing); see also Dan T. Coenen, “Where United Haulers Might Take Us: The Future of the State Self-Promotion Exception to the Dormant Commerce Clause,” 95 Iowa L. Rev. 541, 568-569, 624-627 (2010) (questioning *Pike’s* balancing test); Brannon P. Denning, “Reconstructing the Dormant Commerce Clause Doctrine,” 50 Win. & Mary L. Rev. 417, 453-458 (2008) (noting common critiques of *Pike’s* balancing test); and Donald H. Regan, “The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause,” 84 Mich. L. Rev. 1091, 1092 (arguing that “[d]espite what the Court has said, it has not been balancing”).} but the imposition of retroactive liabilities only on vendors engaged in interstate commerce could easily be characterized as a state action that unduly burdens interstate commerce using this approach.

That conclusion stems from first identifying the burden that retroactive liabilities would impose on vendors. In this situation, the burden of a retroactive statute would be that vendors who relied on the physical presence rule would find themselves liable for years of back taxes. And those back taxes wouldn’t be taxes they would have paid from their own funds in any event. They otherwise would have collected the tax from their customers — and maybe even have received compensation for doing so under states’ vendor-compensation programs. Retroactive liability in this context would be an incredibly high burden.

If current estimates are to be believed, we are talking about liabilities in the tens of billions of dollars per year.\footnote{Donald Bruce, William F. Fox, and LeAnn Luna, “E-Tailer Sales Tax Nexus and State Tax Policies,” 68 Nat’l Tax J. 735, 736 (2015); and U.S. Government Accountability Office, “States Could Gain Revenue From Expanded Authority, but Businesses Are Likely to Experience Compliance Costs,” GAO-18-114 (Nov. 2017).} Multiply that by many years, or decades, of non-collection, and we are talking about a huge potential liability for remote vendors. That burden could bankrupt many online vendors.

That burden is also particularly *undue* because it would arise from retailers’ reliance on the Court and its prevailing constitutional interpretation and not from their own ignorance of the law or from aggressive tax positions. States also had the opportunity to collect this revenue in past years from their state residents or by challenging *Quill* themselves.\footnote{See Hemel, supra note 19.} They had mechanisms available to collect this tax without imposing this burden on vendors who relied on the Court’s prevailing constitutional interpretation. The imposition of retroactive liabilities would thus fairly be called into question under *Pike*.

**Resolving Wayfair Without a Retroactivity Problem**

The foregoing analysis reveals that the Court could resolve *Wayfair* (or a post-*Wayfair* case) in several ways without permitting retroactive liabilities for remote vendors who relied on *Quill*. First, it could explicitly make its reversal of *Quill*

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\footnote{See Thimmesch, supra note 8, at 106-108; see also Amicus Curiae Brief of Four U.S. Senators in Support of Petitioner at 15-16, South Dakota v. Wayfair Inc., No. 17-494 (U.S. Mar. 5, 2018); and Brief of the United States as Amicus Curiae Supporting Petitioner at 18-19, South Dakota v. Wayfair Inc., No. 17-494 (U.S. Mar. 5, 2018).}
prospective only, based on *Chevron Oil*. The equities certainly lay with this option and it is not foreclosed by existing law.

The facts in *Wayfair* also present a particularly favorable case for the Court to issue a prospective-only ruling — based on *Chevron Oil* without undermining the adjudicatory principle that the law should apply equally to all similarly situated parties. Prospective-only judgments arguably violate that principle because they allow the parties to a particular case to be governed by the “new law” while other parties who engaged in the same activity during the same period are not. Justice John Marshall Harlan II offered a direct critique of that aspect of prospective-only judgments, labeling the issuance of such a ruling as “[s]imply fishing one case from the stream of appellate review, using it as a vehicle for pronouncing new constitutional standards, and then permitting a stream of similar cases subsequently to flow by unaffected by that new rule.”

If this is a concern of the current justices, it is not one that is implicated by *Wayfair*. There are several features of this litigation that permit the justices to avoid this “selective prospectivity” worry. First, South Dakota is not trying to collect taxes from remote vendors for any prior period; the state drafted its law so that it imposed tax collection obligations only for periods after the law is upheld in court. Second, because of the procedural posture of the case, there are not specific litigants who would be subject to a different rule. This case came to the courts as an action for declaratory judgment. Thus, the Court could overrule *Quill* on a prospective basis and uphold the South Dakota law without giving rise to any inconsistent application of the law to other parties. This is also not a situation in which South Dakota would benefit from the Court’s ruling to the exclusion of other states. To the contrary, a prospective-only ruling would put all states — and all vendors — in the same position for all periods of time. None could impose tax collection obligations based on economic nexus concepts before the Court’s decision. Prospectively applying a reversal of *Quill* in *Wayfair* would not involve “selective prospectivity.”

Alternatively, the Court could apply its holding prospectively but narrow *Chevron Oil* further. The Court might take note, for instance, of the special common law nature of the dormant commerce clause or the federalism implication if retroactivity concerns are to prevent the Court from overturning incorrect limitations on state power.

There are more options. The Court could uphold the South Dakota law but clarify in dicta that a retroactive statute would have posed serious constitutional concerns. Alternatively, the Court could explain in dicta that a state seeking to impose a use tax collection obligation retroactively would likely face an uphill battle under *Pike*. Or the Court can say nothing and instead rely on the lower courts to apply *Pike* and the presumption against retroactive legislation in the first instance.

In the end, this discussion shows that a reversal of *Quill* would not necessarily mean a world where vendors could face retroactive liability because they relied on the physical presence rule of *Quill*. A more rational result can easily be obtained. The Court should not be swayed by arguments to the contrary.

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35 The law allowed the state to file a declaratory judgment action to determine the permissibility of the statute’s economic nexus provisions. S.B. 106 section 2. Also, the filing of such an action operated as an injunction against the state from enforcing the legislation’s tax collection obligations. Id. at section 3. Section 5 of the law provides that “[n]o obligation to remit the sales tax required . . . may be applied retroactively.” Id. at section 5.
36 See supra note 20.