

MEETING THE NEXUS REQUIREMENT FOR THE TAXATION OF INTERSTATE
E-COMMERCE – SALES AND USE TAX RULES AS APPLIED TO ELECTRONIC
COMMERCE IN THE UNITED STATES.

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The Commerce Clause and the Due Process Clause of the United States Constitution govern the taxation of interstate commerce. With evolving technology and the Internet in particular, the landscape of sales and use tax is evolving. E-Commerce is more than simply a new twist on an old idea. With the advent of the Internet and E-Commerce, technology is pushing the envelope of our current tax system. Since the United States has been a country, there has been interstate commerce. However, the Internet is unique in the nature of how it works, who uses it, compliance issues, as well as the overall framework of E-Commerce.

The Internet connects somewhere between 817 million¹ to one billion people² worldwide, with some 31+ million domain names registered³. E-Commerce utilizes cutting-edge technology which has caused lawmakers to reconsider the traditional rules of taxation. Consider that the internet has remote servers located throughout not only across the nation, but the world, and the rules governing taxation of E-Commerce suddenly lose clarity. There is no longer a clearly defined border. The Internet can be accessed nearly anywhere in the world, payments can be made using electronic cash as well as by every other form of electronic payment. The current US tax system is ill-equipped to accommodate the various administrative and compliance issues associated with the proliferation of E-Commerce, as there are currently over 7,500 sales and use tax jurisdictions in the United States.⁴

Among the various concerns of E-Commerce is the issue of whether a company must collect sales tax for an out of state purchase that was transacted online. Conversely, when does a state have the right to collect use tax on an item that was purchased online from an out-of-state vendor? The particular focus of this paper is on the various requirements that must be met to collect the sales and use taxes on e-commerce transactions, as well as the ever-evolving legal landscape which governs interstate commerce.

The United States Supreme Court has held that a physical presence is required to establish the nexus requirement for the collection of state sales tax.⁵ Without this nexus requirement a state is

¹ Internet World Stats at <http://www.internetworldstats.com/stats.htm>.

² ITFacts.biz at <http://www.itfacts.biz/index.php?id=P2502>.

³ NETFACTUAL.COM at <http://www.netfactual.com/>.

⁴ UMKC Bloch School, *E-Commerce Tax Policy Project* at <http://www.bloch.umkc.edu/e-commerce/domestic.html>.

⁵ Law of the Internet § 9.03. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), at <http://www.lexis.com/reserach>.

not required to collect sales tax on that particular purchase. However, the state to where the item is being sent to for storage, usage or consumption may impose a use tax which is typically equal to what the sales tax would have been had the item been purchased in the destination state.

Nexus is of paramount concern to online retailers and purchasers. The US Supreme Court has determined that in order to be Constitutional that the act of imposing the burden of collecting a state's use tax must conform to the Due Process and Commerce Clause of the US Constitution.

The case of *Quill Corporation v. North Dakota* is the crux of the current sales and use tax collection issue as it pertains to interstate commerce. Yet, while the US Supreme Court decision on *Quill Corporation v. North Dakota* is the basis for our current interstate sales and use tax laws, many feel that there must be a better way of dealing with this issue.

In order for a state to require a vendor to collect sales tax the state must abide by the Due Process and the Commerce Clauses of the US Constitution. Under the Due Process Clause there must be some minimum connection between the taxing state and the person, property, or transaction it seeks to tax. In order to satisfy the Commerce Clause of the US Constitution the US Supreme Court has devised a four-part test.⁶ Under this test, a tax affecting interstate commerce will survive a challenge based on the Commerce Clause if: 1) substantial nexus exists with the taxing state, 2) the tax is fairly apportioned, 3) the tax does not discriminate against interstate commerce and 4) the tax is fairly related to the services provided by the state.⁷ The first and fourth prongs are intended to ensure that a tax does not unduly burden commerce.⁸ The second and third prongs of the test relate to the goal of preventing discrimination against out-of-state businesses.⁹

The new Streamlined Sales Tax Program is taking form and has the potential to dramatically change the rules for collection of use taxes by out-of-state vendors. Something to consider is that even though the Streamlined Sales Tax Program has the official support of several states and several major retailers we do not yet know how it will stand up in the courts. It stands in defiance of the United States Constitution and two major United States Supreme Court Rulings.

The Internet has effectively eliminated not only state, but national borders on the information superhighway. As a result, many transactions are at risk of being subjected to tax in more than one jurisdiction—sometimes even in more than one country!¹⁰

Because of the complexities of the Internet and the fact that technology has outpaced the current tax code, taxation of e-commerce is rarely as simple as it may seem. Additionally, there are a host of other taxes that may or may not be imposed on companies doing business on the Internet.

⁶ Doing Business on the Internet § 9.03, at <http://www.lexis.com/research>.

⁷ *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1976). A state tax affecting foreign commerce must satisfy two additional requirements: the tax must not create a substantial risk of multiple international taxation; and the tax must not prevent the federal government from “speaking with one voice” when regulating commercial relations with foreign governments. *See: Japan Line, Ltd. V. County of Los Angeles*, 441 U.S. 434 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979).

⁸ *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 1913, 113 L.Ed.2d 91 (1992).

⁹ *Id.*

¹⁰ Law of the Internet § 9.01, at <http://www.lexis.com/research>.

These in turn affect the overall price structure of e-commerce transactions, which in turn further affect the taxation of e-commerce. The World Wide Web is a tangled a web of legal jurisdictions and tax compliance and enforcement issues.

I. Development of the Internet and Electronic Commerce

A. “*El Camino Real*,” How roads came to be

Nearly every major city has a street named “*El Camino Real*”, or some such variation. At first glance, especially to non-Spanish speakers, this would seem trivial at best. What exactly does “*El Camino Real*” mean? More importantly, what is the significance that there is such a large number of streets bearing the name? “*El Camino Real*” translates to “The Royal Highway”, or more commonly “The King’s Highway”.

Throughout history there have been various references to the King’s Highway. Initially it was the name attributed to the trade route dating back to antiquity that began in Egypt, wound across the Sinai Peninsula to Aqaba and then turned northward continuing on to Damascus, Aleppo and the Euphrates River.¹¹ One of the earliest references to the King’s Highway can be found in the Book of Numbers when the Israelites requested safe passage through Edom¹²: “Let us pass, I pray thee, through thy country: we will not pass through the fields, or through the vineyards, neither will we drink of the water of the wells: we will go by the king's highway, we will not turn to the right hand nor to the left, until we have passed thy borders.”¹³ This particular “King’s Highway” was later taken over by the Romans who remodeled the road to accommodate troop transport. It was subsequently called the *Via Nova Traiana*¹⁴, and it was eventually extended past Rome into Southern Italy.¹⁵

Interestingly enough it was the King’s Highway, later the *Via Nova Traiana*, which strongly influenced the usage of coinage.¹⁶ History takes us to the Book of Matthew, whose events occurred while under Roman control; we find reference to not only coinage, but also to one of the most noted quotes on taxation: “Tell us therefore, what do you think? Is it lawful to pay taxes to Caesar, or not?” But Jesus perceived their wickedness, and said, ‘Why do you test me, you hypocrites? Show me the tax money.’ They brought to him a denarius. He asked them, “Whose is this image and inscription?” They said to him, ‘Caesar’s.’ Then he said to them, ‘Give therefore to Caesar the things that are Caesar’s, and to God the things that are God’s.’”¹⁷

El Camino Real de Tierra Adentro “The King’s Highway of the Interior” is the New World’s

¹¹ Luma Khalaf & Integrated Business Solutions, *King’s Highway, Baptism Land 2000 - Amman, Jordan*, (1999), at <http://holysites.com/highway.htm>.

¹² Id.

¹³ *Numbers* 20:17 (King James Version).

¹⁴ *Via Nova Traiana* is Latin meaning New Traiana Street; Traiana being a member of the ruling class of Rome.

¹⁵ Dr. Tom J. Buggey, *Ancient Coins: In Praise of Celators!*, at <http://tjbuggey.ancients.info/viatraj.html>.

¹⁶ Dr. Tom J. Buggey, *Ancient Coins: In Praise of Celators!*, *The Rapid Spread of Coin Use*, at *Ancient Coins: In Praise of Celators!*, at <http://tjbuggey.ancients.info/spread.html>.

¹⁷ *Matthew* 22:17-21 (World English Version).

version of *El Camino Real*. *El Camino Real de Tierra Adentro* was a route of trade, cultural exchange and interaction among Spaniards and other Europeans, American Indians, Mexicans, and Americans, which shaped individual lives and communities and affected settlement and development in the greater Southwest.¹⁸ The trail extended from the colonial Spanish capitol of Mexico City and the Spanish provincial capitols at San Juan de Los Caballeros, San Gabriel and Santa Fe. *El Camino Real de Adentro* was added to the National Trails System in October 2000, with the national historic trail extending 404 miles from El Paso, Texas, to San Juan Pueblo, New Mexico.¹⁹ While yet another *El Camino Real*, *El Camino Real de los Tejas* “The King’s Highway of Texas” is also situated in the New World. *El Camino Real de los Tejas* was used for more than 150 years as the principal route between Mexico City, Saltillo, Monclova, and respective presidios, and the missions near the present Guerrero, Coahuila, Mexico, on the Rio Grande and Los Adaes in what is now northwestern Louisiana.²⁰ And California, as well, has its’ own *El Camino Real* which as per the official state definition²¹ is as follows: State highway routes embracing portions of I-280, Route 82, Route 238, US 101, I-5, Route 72, Route 12, Route 37, Route 121, Route 87, Route 162, Route 185, Route 92, and Route 123 and connecting city streets and county roads thereto, and extending in a continuous route from Sonoma southerly to the international border and near the route historically known as *El Camino Real* shall be known and designated as "*El Camino Real*."²²

B. The Information Super Highway

For millennia roads and taxes have had an intimate intertwining around the central theme of commerce. A brief look at history and it quickly becomes clear that roads played a pivotal role in the furtherance of commerce and urban development. Early in history kings discovered that if they would build roads to the marketplace that more people would buy and sell in the markets and the more tax revenue could be generated. Furthermore, usage of the roads themselves could be taxed, yet again increasing the royal purse.²³ The development of roads has had a huge influence on the assessment of taxes. Consider that virtually all aspects of commerce are affected by overland travel in some way or another and it becomes apparent that nothing we use or consume, even so-called non-taxable items, is untouched by the tax collector. The Internet is also known as the “Information Super Highway”. Though it is not a road in the traditional sense, the Internet facilitates the movement of a tremendous amount of money, goods, services and ideas.

¹⁸ National Park Service, U.S. Department of the Interior, *El Camino Real de Tierra Adentro*, at <http://www.nps.gov/elca/>.

¹⁹ *Id.*

²⁰ California Highways, *California Highways, Trails and Roads: El Camino Real*, at <http://www.cahighways.org/elcamino.html>.

²¹ See AB 1707, Chapter 739, 10/12/2001.

²² *Id. supra* 19.

²³ Professor Jeff Lustig, Ph.D., California State University Sacramento, Lecture for “American Political Thought”, Fall 1997.

On October 4th 1957, during the International Geophysical Year,²⁴ the world was forever changed when the Soviet Union launched Sputnik I into earth orbit, circling the globe once every 98 minutes on its' elliptical path as it emitted a series of beeps²⁵ for all the world to hear.²⁶ The United States government reasoned that if the Soviet Union could launch a satellite into earth orbit that they could also deliver nuclear warheads using this newly developed technology.²⁷ President Eisenhower reacted by forming two new agencies--NASA (National Aeronautics and Space Administration) and ARPA (Advanced Research Project Agency).²⁸

In time the Advanced Research Project Agency became known as The Defense Advance Research Projects Agency (DARPA). The Defense Advanced Research Projects Agency is the central research and development organization for the Department of Defense. It manages and directs selected basic and applied research and development projects for Department of Defense, and pursues research and technology where risk and payoff are both very high and where success may provide dramatic advances for traditional military roles and missions.²⁹ Though the Defense Advanced Research Projects Agency is responsible for a variety of innovations one in particular stands out—the Internet. Defense Advanced Research Projects Agency's world-famous development of packet switching³⁰ and the Internet began with the development of ARPANet³¹ and its associated TCP/IP network protocol architecture. These 1970s, developments were responsible for the creation of today's multibillion dollar computer networking industry. The TCP/IP protocol suite has been adopted by all major computing and communications

²⁴ Following a suggestion by National Academy of Sciences member Lloyd Berkner, the International Council of Scientific Unions in 1952 proposed a comprehensive series of global geophysical activities to span the period July 1957-December 1958. The International Geophysical Year (IGY), as it was called, was modeled on the International Polar Years of 1882-1883 and 1932-1933 and was intended to allow scientists from around the world to take part in a series of coordinated observations of various geophysical phenomena. Although representatives of 46 countries originally agreed to participate in the IGY, by the close of the activity, 67 countries had become involved. (<http://www.nas.edu/history/igy/>, Copyright © 2005, The National Academy of Sciences).

²⁵ See <http://www.amsat.org/amsat/features/sounds/sputnk1b.wav>.

²⁶ Steve Garber, NASA History Web Curator, *Sputnik and The Dawn of the Space Age*, at <http://www.hq.nasa.gov/office/pao/History/sputnik/>.

²⁷ Roger Guillemette, U.S. Centennial of Flight Commission, *Sputnik and the Crisis That Followed*, at <http://www.centennialofflight.gov/essay/SPACEFLIGHT/Sputnik/SP16.htm>.

²⁸ David S. F. Portree, *Sputnik and the Birth of NASA*, at <http://members.aol.com/dsfportree/sputniknasa.htm>, 2003.

²⁹ Defense Advanced Research Projects Agency, at <http://www.arpa.mil/>.

³⁰ Packet switching refers to protocols in which messages are broken up into small packets before they are sent. Each packet is transmitted individually across the net, and may even follow different routes to the destination. Thus, each packet has a header information about the source, destination, packet numbering, etc. At the destination the packets are reassembled into the original message. Most modern Wide Area Networks (WANs) protocols, such as TCP/IP, X.25 and Frame Relay, are based on packet switching technologies.

Packet switching's main difference from Circuit Switching is that that the communication lines are not dedicated to passing messages from the source to the destination. In Packet Switching, different messages (and even different packets) can pass through different routes, and when there is a "dead time" in the communication between the source and the destination, the lines can be used by other routers.

Circuit Switching is ideal when data must be transmitted quickly, must arrive in sequencing order and at a constant arrival rate. Thus, when transmitting real time data, such as audio and video, Circuit Switching networks will be used. Packet Switching is more efficient and robust for data that is bursty in its nature, and can withstand delays in transmission, such as e-mail messages, and Web pages.

(*Packet Switching Simulation* at <http://www2.rad.com/networks/1998/packet/ps.htm>).

³¹ Defense Advanced Research Projects Agency, *Technology Transition* at, <http://www.darpa.mil/body/pdf/transition.pdf>.

vendors as the basis for their future networking products. Packet switching is now the fundamental element of both public and private network approaches and spans the Department of Defense, the Federal government, the U.S. industry, and the world.³²

Packet switching was developed to be robust and redundant. There are three basic types of networks: 1) centralized, where each node is connected to another node via a centralized hub, 2) decentralized, where several centralized hubs connect the various nodes, and 3) a distributed network with no centralized hub. Of the three, the distributed network is the hardiest because destruction of any part will still allow for transmission to other nodes via alternate routes; making it more redundant and robust than centralized and decentralized networks.³³ The military liked this idea because it would allow for communication if parts of the network were destroyed or inoperable due to various reasons, often referring to the doomsday of nuclear attack.³⁴

The United States government is largely responsible for the creation and development of the Internet. Yet an interesting point about the Internet is that it was developed initially for military purposes, later evolving into commercial and consumer use. The Information Superhighway and *El Camino Real* (including contemporary government financed highways) were developed in essentially the opposite order of each other. However, due to the versatility of both roads and the Internet, they can both be used for commercial and military uses, as well as a variety of other uses.

The development of roads, in conjunction with the collection of taxes, has allowed for expansion from urban to suburban to rural living for large segments of the population. Before the development of extensive roads, populations were more centralized, or in some cases—nomadic.

The development of the Internet and e-commerce has had similar effects on the distribution of goods, services and ideas. Virtually anything is available online and can be accessed from anywhere by anyone who has a computer and a connection. Where at one time certain products or services were available in distinct localities, they are now available world-wide.

II. The Internet, E-Commerce and the Economy

A. The New Marketplace

E-Commerce is the practice of buying and selling products and services over the Internet, utilizing technologies such as the Web, electronic data interchange, email, electronic fund transfers and smart cards.³⁵ E-commerce utilizes aspects of traditional “bricks and mortar” establishments as well as “mail-order” or “catalogue” companies. The most obvious difference between e-commerce and “mail-order” is simply the technology employed. Additionally, many

³² *Id.*

³³ Dirk Husmeier, *Paul Baran's invention of the distributed network and packet-switching*, at http://www.bioss.sari.ac.uk/~dirk/essays/ParShiftsInfTech/eca_baran.html.

³⁴ *Id.*

³⁵ IBLs Editorial Associates, *Models of the Internet Economy and Their Impact on E-Commerce*, IBLs, at <http://www.ibls.com> (August 02, 2002).

companies who engage in e-commerce also have a traditional “bricks and mortar” establishment; these companies being termed “clicks and mortar” or “bricks and clicks”.³⁶

The “Internet Economy” is transforming traditional companies and jobs, and is proving to be a key player in the United States labor market. In the United States, during the first half of 2000, the “Internet Economy” companies generated one dollar out of every five dollars from the Internet, accounting for \$830 billion in revenue in 2000. This is a 58 percent increase over 1999.³⁷

It has to be remembered that commerce, including e-commerce, does not only include Business to Consumer (B2C) transactions, but Business to Business (B2B) and Business to Government (B2G) transactions as well. The latter two provide significant economic consideration that the typical consumer may not be aware of. Many Business to Business (B2B) transactions are taxable. Generally, those purchases which are made under a re-sale license are not taxable at the Business to Business (B2B) level because the business is not the end user. In the United States, sales tax is generally only collected from the end-user. So while a product (or its components) may be bought and sold a number of times, sales tax will generally only be collected once. Business to Government (B2G) sales are not taxable because sales to government entities are exempt from sales and use taxes.

B. The “4-Layer” Internet Model

The University of Texas at Austin and Cisco released a report in 2000 that describes a “4-layer” model of the Internet that describes the various roles that companies play in the Internet economy.³⁸ These four layers are as follows:

Layer 1. Internet Infrastructure Layer. This layer consists of companies that make the Internet function. It includes telecom companies, PC and peripherals manufacturers, networking software and hardware companies and security vendors. Some examples of companies in Layer 1 would include hp Invent, Juniper Networks, WorldCom and Corning.³⁹

Layer 2. Internet Applications Layer. This layer consists of companies that enable the Internet to perform business activities. It includes software developers, search engines, databases, multimedia applications and Internet consultants. Some examples of companies in Layer 2 would include SAP, Oracle, Microsoft and Adobe.⁴⁰

Layer 3. Internet Intermediary Layer. This layer consists of companies that make the electronic marketplaces efficient and facilitates interactions between buyers and sellers. It includes online businesses and web portals. Some examples of companies found in Layer 3 would include Yahoo!, ZD Net, Commerce One and Click Double Click.⁴¹

³⁶ *Id.*

³⁷ Cisco Systems & University of Texas at Austin, *Measuring the Internet Economy*, at http://www.internetindicators.com/jan_2001.pdf, January, 2001.

³⁸ *Id. supra* 34.

³⁹ *Id. supra* 34.

⁴⁰ *Id. supra* 34.

⁴¹ *Id. supra* 34.

Layer 4. Internet Commerce Layer. This layer consists of companies that sell goods and services to consumers and businesses. Some examples of companies found in Layer 4 would include Target, amazon.com, Dell.com and southwest.com.⁴²

The distinction between Business to Business (B2B) and Business to Consumer (B2C) is not always clear, and many companies operate in both marketplaces. A clear example would be the airline Industry that not only sells flights for business and personal travel purposes, but also contracts the transportation air freight for both individuals and businesses.⁴³

A company can be an “Internet” business at various levels. Many times, a company will conduct some sort of operation online—whether it be sales, purchasing, customer relations, et cetera. There are certain companies that came into existence recently when access to the Internet was broadened e.g. Yahoo!, E-Bay and Amazon.com. Other Internet companies began before the Internet was a commercially accessible. These traditional companies typically use the Internet to supplement their methods of selling goods and services, interacting with customers and suppliers and advertising. Many retailers such as Wal-Mart, Barnes & Noble, Borders and H&R Block have expanded their traditional “bricks and mortar” operations to become “bricks and clicks” or “clicks and mortar” operations. Some companies have completely abandoned their “bricks and mortar” establishments, such as Egghead, to become solely web-based businesses. Additionally, many service-oriented companies have been using the internet to maintain and grow markets.⁴⁴

It is also important to point out that each of the four layers of the Internet economy are also supplemented and supported by various industries in unrelated fields. An example that would apply to all layers of the Internet economy would be utilities. All four layers of the Internet economy are comprised of companies. Companies require buildings. Buildings, in order to properly function, require utilities. Utilities such as water, sewer, garbage, gas, electricity, telephone, et cetera all contribute to the Internet economy in an indirect manner. As they are indirect contributors, so are the taxes that are paid by these companies. Taking it a step further, the utility companies rely on the Internet in the daily routine of their business. Again, the interconnectivity of the Internet and taxation expands.

III. Consumption Taxes

A. How Consumption Taxes Vary from Income Taxes

To better understand the relationship of taxes on goods and services to a physical nexus it is important to understand the different types of taxes that are taxed on goods and services.

Sales, use, excise, district, turnover, and Value Added Tax (VAT) are all members of a class of taxes called consumption taxes. Consumption taxes are taxes which are derived from money

⁴² *Id. supra* 34.

⁴³ *Id. supra* 34.

⁴⁴ *Id. supra* 34.

spent. An income tax, by contrast, is derived from money earned. Consumption taxes are generated from purchases by a consumer and collected by the vendor or seller.⁴⁵

A. An Overview of Sales Tax

Sales tax is defined as a state or local tax based on a percentage of the selling price of the goods or service that the buyer must pay. It is not revenue to the seller, who simply collects it and passes it on to the state or local government.⁴⁶ Sales tax is levied at the state or local level. Sales tax is also referred to as “transactions” tax.

Generally, sales tax is collected on the sale or lease of tangible personal property, however it often extends to certain services and intangibles.⁴⁷ Typical services that are subject to sales tax include public utility services, telecommunications services, rental of tangible personal property, and computer software services.⁴⁸ Many states limit taxation of services to only those services enumerated in their statutes. In the event of transactions involving a mixed sale of tangible personal property and services or intangibles (e.g. intellectual property rights), courts often apply the “dominant purpose” or “true object” test to determine whether the transaction will be treated as a taxable sale. See, e.g. *Amerestate, Inc. v. Tracy*, 72 Ohio St. 3d 222, 648 N.E.2d 1336 (1995).⁴⁹

B. An Overview of Use Taxes

Use tax is defined as a tax that is imposed on the use of certain goods that are bought outside the taxing authority’s jurisdiction; they are designed to discourage the purchase of products that are not subject to the sales tax.⁵⁰ Use tax is levied at the state or local level. “Use” is defined as the use, storage, or other consumption of tangible personal property.⁵¹

Sales and Use tax are often referred to as “District Taxes”, although some clarification is necessary. A “district” is a local jurisdiction that, under enabling statutes in various codes, may impose sales or use taxes within its borders. Most district taxes, but not all, are levied on a county-wide basis.⁵² While district tax ordinances must incorporate provisions of the Sales and Use Tax Law, the taxes are generally the same except.⁵³

⁴⁵ IBLS Editorial Associates, *Rules for the Consumption Taxation of Crossborder Trade*, IBLS, at <http://www.ibls.com> (August 22, 2002).

⁴⁶ BARRON’S BUSINESS GUIDES DICTIONARY OF ACCOUNTING TERMS 387 (3rd ed. 2000).

⁴⁷ Julian S. Millstein, Jeffery D. Neuberger, Jeffrey P. Weingart, *Doing Business on the Internet: Forms and Analysis*, LEXIS.

⁴⁸ JULIAN S. MILLSTEIN, JEFFREY D. NEUBERGER, JEFREY P. WEINGART, *DOING BUSINESS ON THE INTERNET : FORMS AND ANALYSIS* 8 n.3 (2004) LEXIS.

⁴⁹ *Id.*

⁵⁰ BLACK’S LAW DICTIONARY 1472 (Deluxe 7th ed. 2001).

⁵¹ California State Board of Equalization, *Tax Tips for District Taxes (Sales and Use Taxes)*, at <http://www.boe.ca.gov/pdf/pub44.pdf> (April 2003).

⁵² *Id.*

⁵³ Specific criteria for district taxes may differ from state. The follow is as per the State of California definition of district taxes.

- 1) Property sold in a district and delivered to a customer outside the district may be exempt from the district tax;
- 2) Retailers outside a district delivering property into a district may be required to collect the district's tax if they are engaged in business in the district;
- 3) Sellers or lessors of vehicles or undocumented vessels are required to collect district use tax imposed in the county of registration;
- 4) Sales of tangible personal property, other than fuel or petroleum products, to operators of aircraft are exempt from transaction tax if (1) the aircraft is used as a common carrier of persons or property and (2) the property purchased will be used or consumed principally outside the district where the sale was made; and
- 5) Fixed-price contracts, including leases entered into prior to the starting date of the new tax may be exempt.⁵⁴

Generally speaking the district tax rules follow the nexus concept of districts within a state, much as sales tax rules follow the nexus concept of states within a Country. While this is a bit oversimplified, as there are exceptions and state specific nuances, the general concept of nexus is essentially the same.

D. An Overview of Excise Taxes

Excise tax is defined as a tax that is levied on specific products or services, for specific purposes. (As an example, an excise tax on gasoline might be used to fund road construction and repair). Excise taxes are normally a percentage of the purchase price. Excise taxes are levied at all levels of government, primarily federal and state.⁵⁵

E. An Overview of Value Added Taxes (VAT)

Value Added Tax (VAT) is defined as a tax that is assessed on the increased value of goods at each discrete point in the chain of production and distribution, from the raw material stage to final consumption. The tax on processors or merchants is levied on the amount by which they increase the value of items they purchase and resell. This is achieved by levying the tax at each point en route, as ownership passes from one person to another. At every stage, output tax is charged on the current sales value, but the input tax, which has been charged by those at an earlier stage of production, can be offset or recovered. Thus the tax liability at each stage is based on the difference between the value of the outputs and the value of the inputs, thus deriving added value.⁵⁶

The VAT is widely used in the European Union. It is both a general tax and a consumption tax

⁵⁴ *Id. supra* 51.

⁵⁵ BARRON'S BUSINESS GUIDES DICTIONARY OF ACCOUNTING TERMS 167 (3rd ed. 2000).

⁵⁶ BARRON'S BUSINESS GUIDES DICTIONARY OF INTERNATIONAL BUSINESS TERMS 491 (2nd ed. 2000).

that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. Because the VAT is charged as a percentage of price, the actual tax burden is visible at each discrete stage in the production and distribution line. As the payments are collected fractionally wherein taxable persons⁵⁷ deduct from the VAT the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the VAT is neutral regardless of the number of transactions involved. The VAT is then paid to the revenue authorities by the seller of the goods (the taxable person), while the VAT is actually paid by the buyer to the seller as part of the price, making the VAT an indirect tax.⁵⁸

Exports from European Community countries to non-member countries are not charged the VAT. The VAT already paid on the inputs of the good for export is deducted. This right to deduct the input VAT is called an exemption or, sometimes, a “zero-rating”. Ergo, there is no residual VAT contained in the export price.⁵⁹

Imports are charged the VAT the moment the goods are imported so that they are immediately placed on the same footing as equivalent goods produced in the European Community. Taxable people registered for the VAT will be allowed to deduct this VAT in their next VAT tax return.⁶⁰

While the VAT does not affect interstate commerce in the United States, it is helpful to understand how it works in contrast to the US system of sales, district, excise and use taxes. The VAT, though comparable to our sales, district, excise and use taxes, would be even more comparable to a federal sales tax.

IV. The Concept of “Nexus”

A. Nexus and the United States Constitution

The most important concept involving sales and use taxes and e-commerce is “nexus”. Nexus is defined as a connection between the vendor and a state such that subjecting the vendor to the state’s sales tax rules. In order to meet Constitutional muster these rules must not be unfair to the vendor, nor can they be harmful to interstate commerce. These two requirements stem from the Due Process Clause and the Commerce Clause of the United States Constitution. Both of these requirements must be satisfied before any state will be able to impose sales and use tax collection responsibilities on a vendor.⁶¹

⁵⁷ For VAT purposes, a taxable person is any individual, partnership, company or other entity which supplies taxable goods and services in the course of business.

⁵⁸EUROPA – TAXATION AND CUSTOMS UNION / HOW VAT WORKS, *at*, http://europa.eu.int/comm/taxation_customs/vat/how_vat_works/ihhttp://europa.eu.int/comm/taxation_customs/vat/how_vat_works/index_en.htm.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ IBLs Editorial Associates, *The Concept of “Nexus” in Sales and Use Tax*, IBLs, *at* <http://www.ibls.com> (August 24, 2002).

B. Sales Tax and the Corollary Use Tax

State sales and use taxes form an integrated system for taxing intrastate and interstate commerce.⁶² Generally, sales tax is a tax that is imposed by a state on the sale or lease of tangible personal property, as well as certain services and intangibles.⁶³ A sales tax is a tax on the “freedom of purchase,”⁶⁴ and typically is levied on intrastate transactions in which goods or services are purchased and destined for use in the same state. Sales taxes are generally levied on the purchaser at the time and place of transaction.⁶⁵ States imposing a sales tax on in-state purchases often impose a compensating use tax on out-of-state purchases of goods that are used in-state. Use taxes are designed as a means of protecting in-state merchants from unfair competition from out-of-state merchants in states that have lower or no sales taxes.⁶⁶ As such, use tax statutes are designed to prevent consumers from avoiding the state sales tax by purchasing goods out-of-state for use in-state.⁶⁷

Consider the following transaction: Joe, who lives in State A, purchases a product from a company in State B. This purchase is a taxable transaction. However, since the company in State B does not have a store or office in State A, and ownership title does not change hands until Joe receives it⁶⁸ there is no sales tax liability incurred in State B. It gets a bit more complex. Suppose in the transaction that Joe resides in State C. Again, suppose his purchase is made from State B. Depending on the local rules for FOB⁶⁹ shipping, the transaction may or may not be taxable by the seller. In either case, providing that the transaction occurred in a state that collects sales tax, sales tax or use tax must be paid. The primary difference would be when the tax is paid and who collects the tax. The sales tax is collected by the seller and remitted to the relevant tax authorities. The use tax is in place to make up for sales taxes that are not collected. The use

⁶² Doing Business on the Internet § 9.03, at <http://www.lexis.com/research>.

⁶³ Typical services subject to sales tax include public utility services, telecommunications services, rental of tangible personal property and computer software services. Many states limit taxation of services to only those services enumerated in their statutes. Transactions which involve a mixed sale of tangible personal property and services or intangibles (e.g. intellectual property rights), courts often apply the “dominant purpose” or “true object” test to determine whether the transaction will be treated as a taxable sale. *See: Amerestate, Inc. v. Tracy*, 72 Ohio St. 3d 222, 648 N.E. 2d 1336 (1995).

⁶⁴ *See: McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944).

⁶⁵ Sales taxes are “destination taxes.” In New York, for example, sales tax depends on the point at which possession is transferred from the vendor to the purchaser. *See: 20 N.Y.R.R. § 525.2.*

⁶⁶ *See: National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 555, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977) (“all states that impose sales tax also impose a corollary use tax on tangible property bought out of state to protect sales tax revenues and put local retailers on a competitive parity with out-of-state retailers exempt from sales tax”);

⁶⁷ *See: National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977).

⁶⁸ This is disregarding FOB / FAS terms, as different states have different rules pertaining to collection of sales tax on certain FOB / FAS terms.

⁶⁹ FOB stands for “Free On Board”. FOB is a shipping term indicating that delivery will be made on board or into a carrier by the shipper without charge. The abbreviation is followed by a shipping point or destination. The invoice price includes delivery at seller’s expense and seller’s risk to the specified location. Title normally passes from seller to buyer at the FOB point. (Dictionary of Accounting Terms, Third Edition, 195). FAS stands for “Free Alongside Ship”. FAS is a mercantile term designating that the seller is responsible for delivering the goods to the dock and for paying the costs of delivery there. When the seller delivers the goods to the specified dock, the risk of loss passes to the buyer. (Black’s Law Dictionary, Deluxe Seventh Edition, 673).

tax is remitted by the buyer to the state tax authorities. This is usually done when the state income tax is filed.

Many states impose on vendors a duty to collect use taxes. The circumstances under which such a duty may be imposed on out-of-state vendors is a critical issue in electronic commerce. This is due to the general nature of e-commerce and the fact that many electronic vendors may not know the identity or location of their customers. This would limit their ability to comply with the state laws imposing a duty to collect use tax.⁷⁰

Use taxes are typically imposed on one of two bases, either on goods “purchased for use” within the state, or on goods brought into the state regardless of any intent to use them in-state.⁷¹ The impact of use taxes typically is similar to that of the sales taxes in that similar classes of property are affected. It should be noted however, that a state’s use tax base may not be broader in scope than its sales tax base.⁷²

In 1992, the US Supreme Court decided in *Quill Corporation v. North Dakota*⁷³ that an out-of-state vendor would have to have a “nexus” of some sort in order to be liable for collection and remission of sales tax. The US Supreme Court decided that it would be contrary to the Commerce Clause of the United States Constitution to impose out-of-state merchants with a sales tax collection obligation. Further, the US Supreme Court established a “bright line”⁷⁴ physical presence test. The “bright line” physical presence test states that without a physical presence, the seller does not have “substantial nexus” with a state and therefore cannot be required to collect its use tax.⁷⁵

This rule applies to conventional and electronic commerce. However, if a business lacks physical presence in a state, that state must be able to claim taxing jurisdiction through the activities of a third party that are attributable to the business. This principle has been established since 1960 when the US Supreme Court held that “an out-of-state seller could be required to collect and remit use tax in Florida based on orders that its independent sales representatives solicited for it in the state.”⁷⁶ The presence of salesmen and technicians performing repairs and providing on-site assistance will also establish a physical presence and establish a nexus.⁷⁷

Different states have taken different views as to what amount of physical presence will be considered negligible to shield their revenue base. The consolidation of the *New York Court of Appeals in Orvis Co. v. Tax Appeals Tribunal* and *Vermont Information Processing v. Tax Appeals Tribunal* is the leading case in this area.⁷⁸ The court stated that there was substantial

⁷⁰ Doing Business on the Internet § 9.03, at <http://www.lexis.com/research>.

⁷¹ The tax is sometimes referred to as a tax on the “privilege” or enjoyment of property which was purchased out of state. See: *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944).

⁷² *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 83 S.Ct. 1201, 10 L.Ed.2d 202 (1963).

⁷³ *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

⁷⁴ A “bright-line rule” is a judicial rule of decision that tends to resolve issues, especially ambiguities, simply and straightforwardly, sometimes sacrificing equity for certainty. (Black’s Law Dictionary, Deluxe Seventh Edition, 187).

⁷⁵ *Id.*, supra 60.

⁷⁶ See: *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

⁷⁷ *Id.*, supra 60.

⁷⁸ See *Orvis Co. v. Tax App. Trib. & Vt. Info. Processing v. Tax App. Trib.*, x54 N.E.2d 954 (N.Y. 1995).

physical presence since “the company’s presence consisted of substantial equipment that was hauled on twenty-seven trucks with 209 employees.”⁷⁹

Unlike the New York Court of Appeals, the Florida Supreme Court, in *Department of Revenue v. Share International, Inc.*⁸⁰, held that the temporary presence which consisted of three days each year that took the out-of-state seller to a trade show in Florida did not establish a physical presence in that state. Further, the court in *Department of Revenue v. Share International, Inc.*, stated that “the corporation manufactured and distributed chiropractic supplies and sold them through direct mail. Other than the presence of its president and vice president as speakers at a national seminar in Florida, the corporation had no physical presence in the state.”

If attention is paid to the amount of “temporary” equipment and personnel, it is clear that the more equipment, the greater the duration of time and the more personnel all contribute to a substantial physical presence.

Likewise questions arise with regard to the minimum requirement of physical presence with property in the state. In *Quill Corporation v. North Dakota*, the US Supreme Court held that “the presence of a few floppy disks in North Dakota (Quill licensed some software to some of its customers in the state of North Dakota) did not create a taxable nexus with that state.” However, the US Supreme Court stopped short of defining what would constitute more than a few disks. Thus, some states would argue that the presence of a substantial amount of licensed software establishes substantial nexus under *Quill Corporation v. North Dakota*. Further, some states may argue that the existence of a web page potentially creates property, thus, establishing the physical presence in their state.⁸¹ Furthermore, it can be argued that even though the web pages are intangible property or advertising, but because they are located on a third-party computer server, they therefore create the physical presence in the state in which the third-party server is located.⁸²

A company may be deemed to have a physical presence based upon a relationship with an in-state agent or representative of the company.⁸³ Recently, several states have begun attack on several “captive” retail internet sales companies under an “agency nexus” or “attributional nexus” theory. California, for example, successfully imposed sales and use tax filing obligations on the Internet affiliates of several large national booksellers even though the Internet affiliates did not have any offices, employees or any other physical presence in the state.⁸⁴ The rationale used to impose a nexus was that the in-state brick and mortar affiliates of the Internet sellers were acting as the agents of the Internet seller in makes sales into the state. This was because the

⁷⁹ *Id. supra* 60.

⁸⁰ Dep’t of Rev. v. Share Int’l, Inc., 676 So. 2d 1362 (Fla. 1996), cert. denied, 519 U.S. 1056 (1997).

⁸¹ *Id. supra* 60.

⁸² State Taxation on the Internet: A Review of Some Issues, 7 Willamette J. Int’l L. & Dispute Res. 136, 2000, by George B. Delta.

⁸³ *See*: National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977); *Scripto Inc. v. Carson*, 362 U.S. 207 (1960).

⁸⁴ *In the Matter of Barnes & Noble.com*, No. 89872 (Cal. Bd. of Equalization, Sept. 12, 2002); *In re Borders Online*, No. SC OHA 97-638364 (Cal. Bd. of Equalization, Sept. 26, 2001).

bricks and mortar stores accepted merchandise returns from the online sellers and distributed coupons for goods sold by the Internet company.⁸⁵

In July 2002, in *America Online, v. Johnson*,⁸⁶ the Tennessee Court of Appeals ruled that “physical presence” or “nexus” could include the leasing of equipment and hiring of local businesses by an out-of-state Internet company. The court noted that America Online used a substantial number of businesses in Tennessee to market its services to Tennessee customers. The court also noted that America Online’s activities in Tennessee were not inconsequential and that they amounted to more than merely Internet contact. Accordingly, America Online was deemed to have a physical presence in Tennessee.⁸⁷

Alabama is even more aggressive when it comes to defining physical presence and nexus. Under House Bill 649, Alabama automatically requires Internet companies to collect sales and use taxes when such companies have brick and mortar affiliates in Alabama that are engaged in selling the same goods and services as the Internet seller.⁸⁸

Generally speaking, out-of-state vendors that sell online do not use the same local services that a local business would use. It would therefore be unfair to tax them to pay for such services. Yet when a business pays income tax or remits sales tax to the state in which it is located, there is a reasonable connection among the taxes paid, the services provided, and legislative representation. Generally speaking the local firms benefit from police and fire protection, road construction, waste collection, and other services provided by the taxing authority.⁸⁹

Further, local firms can make their voices known to the local government via lobbying, voting, membership in local interest groups. For the out-of-state vendor who markets goods over the Internet and delivers them via common carrier, the situation is not the same. Typically, the remote, out-of-state vendor does not benefit from most of the services that are provided by the distant state’s local governments.⁹⁰

The Framers of the US Constitution prudently placed strong protections on interstate commerce and empowered Congress to enforce those protections. Thus, the states should not be allowed to weaken these protections by collecting taxes from the majority of out-of-state transactions.⁹¹

Recent cases have suggested that the presence of a company’s intangible property in a state may give rise to a nexus under certain conditions.⁹² It should be noted, however, that almost all such

⁸⁵ Law of the Internet § 9.03, at <http://www.lexis.com/research>.

⁸⁶ No. M2001-00927-COA-R3-CV, 2002 Tenn. App. LEXIS 555 (July 30, 2002).

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ IBLS Editorial Associates, *Limitations for Imposing Income Tax on E-Commerce by Out-of-State Firms*, IBLS, at <http://www.ibls.com> (August 25, 2002).

⁹⁰ *Id.*, *supra* 60.

⁹¹ *Id.*, *supra* 60.

⁹² *See: Geoffrey, Inc. v. South Carolina Tax Commissioner*, 313 S.C. 15, 437 S.E. 2d 13 (1993) (license of trade name to an in-state user creates income tax nexus for the non-resident); *Comptroller of the Treasury v. Crown Cork & Seal Company (Delaware), Inc./Comptroller of the Treasury v. Sys, Inc.* Nos. 76 & 80 (Md. Ct. App. 2003).

cases have generally been decided in the context of state attacks on intellectual property holding companies, and not in the context of imposing tax on Internet sellers.⁹³

V. The Commerce Clause, the Due Process Clause, And the Import-Export Clause of the United States Constitution

A. Constitutional Considerations of Interstate Commerce

Taxation of interstate commerce, including e-commerce, is largely governed by the Commerce Clause and Due Process Clause of the United States Constitution. Currently, there are at least forty-five states in the United States that impose a general sales tax and a compensating use tax on commercial transactions.⁹⁴ The most important concept involving sales and use taxes as they pertain to interstate commerce (and e-commerce) is the concept of “nexus”⁹⁵. In order for a state to be able to impose a sales tax or a use tax, or an obligation to collect use tax depends on whether a nexus exists that would support the state’s taxing authority.⁹⁶ This nexus is established by a vendor having a physical presence in the particular state that the sale is made in.

Under the Commerce Clause and the Due Process Clause of the United States Constitution the requirement of a vendor to collect a sales tax must not be unfair to the vendor, nor may it be harmful to interstate commerce.⁹⁷ Both of these requirements must be satisfied before any state will be able to impose sales and use tax collection responsibilities on a vendor.⁹⁸ While the Due Process and Commerce clauses of the United States Constitution are closely related, they do impose separate and distinct limits on the taxing powers of the states as the United States Supreme Court noted in *Quill Corp. v. North Dakota*.⁹⁹

B. The Due Process Clause of the United States Constitution

Under the Due Process clause, there must be some minimum connection between the taxing state and the person, property, or transaction it seeks to tax, whereas for a tax to withstand scrutiny under the Commerce clause, there must be “substantial” nexus with the taxing state.¹⁰⁰

Under the concept of “Nexus by Affiliation” the nexus of a company is imputed to a parent, subsidiary or other related entity.¹⁰¹ Under this concept courts have generally found that a taxing nexus does exist.¹⁰²

⁹³ Law of the Internet § 9.03, at <http://www.lexis.com/research>.

⁹⁴ *Id.*, supra 46.

⁹⁵ *Id.*, supra 60.

⁹⁶ *Id.*, supra 46.

⁹⁷ *Id.*, supra 60.

⁹⁸ *Id.*, supra 60.

⁹⁹ *Id.*, supra 46.

¹⁰⁰ *Id.*, supra 46.

¹⁰¹ Doing Business on the Internet § 9.03, at <http://www.lexis.com/research>.

¹⁰² See *Pennsylvania: Bloomingdale’s by Mail, Ltd. V. Dep’t of Revenue*, 130 Pa. Commw. 190, 567 A.2d 773 (1989), aff’d 591 A.2d 1047, cert. denied 504 U.S. 955 (1992).

The Due Process Clause of the Constitution requires the following criteria be met in order for a tax to be Constitutional:

Criteria One: There must be some minimum connection between the taxing state and the person, property or transaction it seeks to tax;

Criteria Two: Closely related to juridical jurisdiction in that it requires an examination of the quality and quantity of contracts with a taxing state¹⁰³; and

Criteria Three: The Due Process nexus focuses on the fundamental fairness of governmental activity, and requires an examination of whether an entity's connections with a state are substantial enough to justify a state's exercise of power over it.¹⁰⁴

C. The Commerce Clause of the United States Constitution

Article 1, Section 8, Clause 3 of the United States Constitution states “The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States, but all Duties, Imposts and Excises shall be uniform throughout the United States;. . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . .” Known as the commerce clause, this small section of the US Constitution has huge impacts on interstate commerce—including e-commerce.

The Commerce Clause of the US Constitution has been interpreted not only as conferring power on the national government to regulate commerce, but also as limiting the states' power to interfere with commerce.¹⁰⁵ This restriction is often referred to as the “dormant” or “negative” commerce clause.¹⁰⁶

“The Commerce Clause is not designed to protect taxpayers or residents of the taxing state,¹⁰⁷ but to protect interstate commerce,¹⁰⁸ markets and participants in markets.¹⁰⁹ States are prevented from retreating into economic isolation or jeopardizing the welfare of the nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.^{110,111}

¹⁰³ *Id, supra* 100.

¹⁰⁴ See *Quill Corporation, Petitioner v. North Dakota by and through its Tax Commissioner, Heidi Heitkamp*, No. 91-194, Supreme Court of the United States (504 U.S. 298; 112 S Ct. 1904).

¹⁰⁵ *Id, supra* 100.

¹⁰⁶ See generally Tribe, *American Constitutional Law* (1978).

¹⁰⁷ See *Woosley v. State of California*, 3 Cal. 4th 758, 13, Cal Rptr. 2d 30, 838 P.2d 758 (1992), as modified on denial of reh'g, (Dec. 31, 1992); *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn. 1999), cert. denied. 528 U.S. 821, 120 S. Ct. 66, 145 L. Ed. 2d 57 (1999).

¹⁰⁸ See *Woosley v. State of California*, 3 Cal. 4th 758, 13, Cal Rptr. 2d 30, 838 P.2d 758 (1992), as modified on denial of reh'g, (Dec. 31, 1992).

¹⁰⁹ *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn. 1999), cert. denied. 528 U.S. 821, 120 S. Ct. 66, 145 L. Ed. 2d 57 (1999).

¹¹⁰ *Pfizer Inc. v. Lancaster County Bd. of Equalization*, 260 Neb. 265, 616 N.W.2d 326 (2000).

¹¹¹ Laura Hunter Dietz, J.D. and Jane E. Lehman, J.D., of the National Legal Research Group, Inc., *71 Am Jur 2d State and Local Taxation* § 175, LEXIS.

The primary influence of the Commerce Clause is that it disallows states from impeding free private trade in the national marketplace¹¹² via taxation on value earned outside its borders.¹¹³ Disparate tax treatment based on an affiliated group's geographic location and/or corporate structure constitutes an impermissible burden on interstate commerce.¹¹⁴ Furthermore, local taxing authorities, such as states, are subject to the negative Commerce Clause.¹¹⁵

The Dormant Commerce Clause does not immunize interstate commerce from state taxation,¹¹⁶ and state taxes levied on interstate commerce are not per se invalid.¹¹⁷ The Commerce Clause is designed to protect against multiple and discriminatory taxation, not a means of escaping all taxation.¹¹⁸ For apparent reasons a state has significant interest in exacting from interstate commerce its fair share of the cost of the state government,¹¹⁹ and interstate commerce may be made to pay its own way.¹²⁰

In 1977, in the case of *Complete Auto Transit v. Brady*, the United States Supreme Court established a four-part test that governs the constitutionality of state taxes under the Commerce Clause.¹²¹ Appellant transportation corporation challenged an order from the Supreme Court of Mississippi, which ruled that Miss. Code Ann. § 10105 (1972), which imposed a "privilege of doing business" tax within the state for activity in interstate commerce, did not run afoul of the Commerce Clause, U.S. Const. art. I, § 8, cl. 3.¹²²

The transportation corporation, which transported motor vehicles from train stops in Mississippi to Mississippi car dealers, was assessed back taxes for the sales of transportation services. The taxes were imposed pursuant to Miss. Code Ann. § 10105 (1972), which imposed a "privilege of doing business" tax within the state upon activity in interstate commerce. The corporation challenged the imposition of the tax, claiming that under previous Supreme Court precedent, the "privilege" of engaging in an activity in the state could not be applied to an activity that was part of interstate commerce and that such a tax ran afoul of the Commerce Clause, U.S. Const. art. I, § 8, cl. 3. The Court agreed with the Mississippi Supreme Court's finding that the tax was constitutional. In so finding, the Court overruled *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), which had held that a state tax on the "privilege of doing business" was per se unconstitutional when it was applied to interstate commerce. The Court found that the rule

¹¹² See *Reeves, Inc. v. Stake*, 447 U.S. 429, 100 S. Ct. 2271, 65 L. Ed. 2d 244 (1980).

¹¹³ See *Caterpillar, Inc. v. New Hampshire Dept. of Revenue Admin.*, 144 N.H. 253, 741 A.2d 56 (1999), cert. denied, 529 U.S. 1021, 120 S. Ct. 1424, 146 L. Ed. 2d 315 (2000).

¹¹⁴ See *General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. 1998).

¹¹⁵ See *General Motors Corp. v. City and County of Denver*, 990 P.2d 59 (Colo. 1999).

¹¹⁶ *Id.*

¹¹⁷ See *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981); *President Riverboat Casino-Missouri, Inc. v. Missouri Gaming Com'*

¹¹⁸ See *M & T Charters, Inc. v. Commissioner of Revenue*, 404 Mass. 137, 533 N.E.2d 1359 (1989).

¹¹⁹ See *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981).

¹²⁰ See *Franks & Son, Inc. v. State*, 136 Wash. 2d 737, 966 P.2d 1232 (1998), cert. denied, 526 U.S. 1066, 119 S. Ct. 1458, 143 L. Ed. 2d 544 (1999).

¹²¹ *Complete Auto Transit v. Brady*, Chairman, Mississippi Tax Commission, 430 U.S. 274; 97 S. Ct. 1076; 51 L. Ed. 2d 326; 1977 U.S. LEXIS 56

¹²² *Id.*

placed form over substance and merely served as a trap for unwary draftsmen, since an identical tax, called another name, would have been valid.¹²³

The court affirmed the judgment of the Mississippi Supreme Court, ruling that the tax imposed by the state upon the corporation engaged in interstate commerce for the "privilege of doing business" was not unconstitutional.¹²⁴

The Appellant claimed that its transportation was but one part of an interstate movement, and that the taxes assessed and paid were unconstitutional as applied to operations in interstate commerce. App. 4, 6-7. The Chancery Court, in an unreported opinion, sustained the assessments. *Id.*, at 99-102. The Mississippi Supreme Court affirmed. It concluded: "It will be noted that Taxpayer has a large operation in this State. It is dependent upon the State for police protection and other State services the same as other citizens. It should pay its fair share of taxes so long, but only so long, as the tax does not discriminate against interstate commerce, and there is no danger of interstate commerce being smothered by cumulative taxes of several states. There is no possibility of any other state duplicating the tax involved in this case." 330 So. 2d, at 272.¹²⁵

D. The Four-Prong Test of *Complete Auto Transit v. Brady*

As a result of *Complete Auto Transit v. Brady*, the United States Supreme Court developed a four-prong test to determine if the tax is Constitutional. In order for a tax to be Constitutional it must meet all four of the following criteria:

Test One: Does a substantial nexus exist within the taxing state? Note the difference between the Commerce Clause "substantial nexus" and the Due Process "some minimum connection". The tax cannot unduly burden commerce;

Test Two: Is the tax fairly apportioned? The goal of preventing discrimination against out-of-state businesses;

Test Three: Does the tax discriminate against interstate commerce? The Goal of preventing discrimination against out-of-state businesses.

Test Four: Is the tax fairly related to the services provided by the state? This ensures that a tax does not unduly burden commerce.¹²⁶

A state tax does not violate the Dormant Commerce Clause when the four-pronged test of *Auto Transit v. Brady* are met. If even a single prong of the test is failed, the state tax will be unconstitutional and held to be invalid.¹²⁷

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id, supra* 100..

¹²⁷ See *Marx v. Truck Renting and Leasing Ass'n Inc.* 520 So. 2d 1333 (Miss. 1987).

In *Commonwealth Edison v. Montana* (1981),¹²⁸ the United States Supreme Court considered the constitutionality of a thirty percent (30%) severance tax that Montana¹²⁹ imposed on removed coal. Most of the coal came from federally owned land. Approximately ninety percent (90%) of the coal was for shipment out of state. The US Supreme Court's primary focus was on the fourth prong of the *Complete Auto Transit* test, e.g. was the tax fairly related to the services provided by the state? The US Supreme Court noted that certain state benefits received by *Commonwealth Edison* did meet the test. However, there were three dissenters who argued that the Commerce Clause was violated whenever states asked interstate commerce to bear more than their fair share of the tax burden. They believed that this tax did just that.¹³⁰

The United States Supreme Court has repeatedly made pronouncements stating that where the power to tax exists, it is accompanied by the right to set the rate of the tax¹³¹. The very nature of determining an appropriate rate of taxation is a legislative function, and have been settled under the principles of the Commerce Clause adjudication and the Supremacy Clause analysis¹³².

Furthermore, under the terms of the Mineral Lands Leasing Act, which explicitly reserves to the states "the right to levy and collect taxes upon improvements, output of mines, or other rights, property or assets of any lessee of the United States."¹³³ Through this section, the United States Congress affirmatively endorsed the right of the states to determine appropriate rates of taxation free from federal interference.¹³⁴

In *Commonwealth Edison*, the court followed the unbroken lines of precedent in this and other courts dismissing Commerce Clause attacks on state severance taxes. The sound principle underlying these decisions is this: Not every state tax that allegedly affects interstate commerce burdens it within the meaning of the Commerce Clause. Under this principle, non-discriminatory state severance taxes have never been viewed as imposing a burden on interstate commerce. The principle was right when it was first articulated; it is right today; and it is not undermined by decisions relied upon by appellants which expansively construe the power of Congress to regulate interstate commerce.¹³⁵

Second, considering appellants' Commerce Clause claims on the assumption that this Court's severance tax decisions were not dispositive, the state court properly rejected appellants' contentions that the levy is not fairly related to benefits provided by the state and discriminates

¹²⁸ *Commonwealth Edison Company, et al., Appellants v. State of Montana, et al., Appellees*, No. 80-581.

¹²⁹ Nature has graciously endowed the State of Montana with a wealth of natural resources, including large deposits of low sulfur coal. Throughout its history, Montana's economy has depended upon the development of those resources. In the words of one historian, "Nature, not the evil designs of men, decreed that Montana be a place with a colonial economy." K. Ross Toole, *Montana: An Uncommon Land* 7 (1957). As a result, Montana has long suffered economic dislocations of boom and bust cycles of mineral production, along with the scars left from mining operations.

¹³⁰ Doug Linder, University of Missouri Kansas City, *Interstate Taxation and the Commerce Clause*, at <http://www.law.umkc.edu/faculty/projects/frivals/conlaw/intestatetax.htm>

¹³¹ See *City of Pittsburg v. Alco Parking Corporation*, 417 U.S. 379 (1974).

¹³² *Commonwealth Edison Company, et al., Appellants v. State of Montana, et al., Appellees*, No. 80-581 at: <http://www.lexisnexis.com>.

¹³³ 30 U.S.C. § 189.

¹³⁴ *Id.*, *supra* 131.

¹³⁵ *Id.*, *supra* 131.

against interstate commerce. In providing the taxpayers with "services that include not only police and fire protection, but the benefits of a trained work force and the advantages of a civilized society," *Japan Line, Ltd, v. County of Los Angeles*, 441 U.S. 434, 445 (1979), Montana has satisfied the "fair relation" requirement enunciated by this Court in its recent Commerce Clause opinions. The tax similarly satisfies the requirement that it not discriminate against interstate commerce; the tax, both on its face and in practical effect, falls equally on coal consumed in Montana and coal destined out of state.¹³⁶

In *Quill Corporation v. North Dakota* (1992),¹³⁷ the US Supreme Court looked at a North Dakota use tax that was applied to sales by out-of-state vendors¹³⁸ to North Dakota residents. Quill Corporation raised several constitutional objections to the tax. While the US Supreme Court did find that by Quill Corporation mailing catalogs into a state was sufficient to satisfy the "minimum contacts" requirement of the Due Process Clause of the United States Constitution, this act was NOT sufficient to satisfy the "substantial nexus" requirement of the Commerce Clause of the United States Constitution. The US Supreme Court noted that Quill Corporation had no physical presence in North Dakota, *i. e.* no salespersons, no outlets, no warehouse, and no offices. Justice White dissented and argued that it was silly to make a state's ability to tax depend upon whether or not a corporation has one traveling salesperson in the state. The majority of the US Supreme Court, however, saw advantages in a bright line "physical presence" test.¹³⁹

In 1995, the case of *Oklahoma Tax Commission v. Jefferson Lines* found its way to the United States Supreme Court. This case focused on the "fair apportionment" prong of the *Complete Auto Transit* test. The state of Oklahoma imposed a sales tax on Jefferson Lines for the full cost of every bus ticket sold in Oklahoma, regardless of where the trip started or ended. Jefferson Lines argued that the Commerce Clause prohibited the state of Oklahoma from imposing a sales tax on that portion of the ticket reflecting the cost of miles traveled outside of the state of Oklahoma. The court disagreed. The position of the court is that the sale of a ticket is viewed as "a discrete event facilitated at the point of sale." The court, however, was not unanimous and Justices Breyer and O'Connor argued that Oklahoma must apportion its tax to the percentage of miles of the trip on Oklahoma roads.¹⁴⁰

Of particular concern for internet businesses and those who transact business online is how the courts view technology and the nature of the internet. An important issue for Internet Service Providers (ISPs) and Internet Access Providers (IAPs) is whether nexus can exist based on a Point of Presence (POP) site in a taxing state. Internet Service Providers and Internet Access Providers typically maintain Point of Presence sites in several states in order to provide users with local access to the Internet and other electronic networks. Point of Presence sites often consist of only a room filled with modems and telephony lines.¹⁴¹

¹³⁶ *Id, supra* 131.

¹³⁷ *Id, supra* 103.

¹³⁸ Primarily catalogue companies such as L.L. Bean and Land's End.

¹³⁹ Doug Linder, University of Missouri Kansas City, *Interstate Taxation and the Commerce Clause*, at http://www.law.umkc.edu/faculty/projects/ftrials/conlaw/inte_rstatetax.htm

¹⁴⁰ *Id.*

¹⁴¹ *Id, supra* 100.

It can be argued that the presence of a Point of Presence site would create a taxing nexus within a state's jurisdiction. However, under the physical presence standard, the tax consequences of maintaining Point of Purchase servers in several states in such circumstances are unclear.¹⁴² The state of Illinois has taken the position that a taxable nexus may be created by a Point of Presence site. In a Letter Ruling, the Illinois Department of Revenue has determined that a Point of Presence does create a sufficient nexus for a taxing nexus to exist.¹⁴³

Although the issue of whether or not a Point of Presence site has not been addressed by the courts or by legislation as of yet, the critical question is whether maintaining a Point of Presence site in-state will be considered a *de minimis* physical presence. Arguably, maintaining a Point of Presence site in-state is no different than leasing an office. The difference is that, typically, no business is transacted at the Point of Presence site; solicitations are not made, nor are orders fulfilled.¹⁴⁴

The principle of nexus through agency or affiliation is an important consideration when looking at Point of Presence sites. If it can be determined that nexus can be found via the presence of an in-state Point of Presence site, it is likely that states will attempt to find nexus over electronic vendors based on a theory that their Internet Service Providers (ISPs) or Internet Access Points (IAPs) are acting as agents of the electronic vendors. Conceivably, this could result in vendors being subject to taxing nexus in any states where the Internet Service Providers or Internet Access Points maintain their Point of Presence sites. Furthermore, this could also affect service providers who conduct electronic commerce activities through their own networks and web sites.¹⁴⁵

Of course treating Internet Service Providers (ISPs) and Internet Access Points (IAPs) as agents of electronic vendors would be analogous to treating telecommunication providers, or common carriers, as agents of telemarketing and mail order companies. Obviously, this is generally not done. Ergo, as in the mail-order realm, it is unlikely that a taxing nexus will exist absent a vendor's physical presence in-state as affirmed by *Quill Corporation v. North Dakota*.¹⁴⁶

These days, there is a considerable amount of electronic commerce that involves the transfer of intangible rights, i.e. intellectual property rights in the form of goods and services. In *Geoffrey, Inc. v. South Carolina Tax Commission*,¹⁴⁷ the Supreme Court of South Carolina found nexus for income tax purposes on the basis of in-state presence of intangible property. This particular property was a licensed trademark. In *Geoffrey, Inc. v. South Carolina*, the court distinguished the United States Supreme Court's physical presence requirement on the basis that its scope had not been extended beyond sales and use tax. It is therefore likely that in the absence of action by the United States Supreme Court or by the federal government, that states will seek to find taxing

¹⁴² *Id, supra* 100.

¹⁴³ See: Illinois Dep't of Rev., Ltr. Rul No. ST-96-0491 at: <http://www.revenue.state.il.us/legalinformation/letter/rulings/st/1996/st960491.pdf>.

¹⁴⁴ *Id, supra* 100.

¹⁴⁵ *Id, supra* 100.

¹⁴⁶ *Id, supra* 100.

¹⁴⁷ See *Geoffrey, Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 S.E.2d 13 (1993).

jurisdiction over the activities of entities engaged in electronic commerce on the basis of the court's holding in *Geoffrey, Inc. v. South Carolina Tax Commission*.¹⁴⁸

Public Law 86-272¹⁴⁹ restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of solicitation of orders for sales of tangible personal property which are fulfilled by shipment or delivery from points outside the state.¹⁵⁰ However, while there are similarities, the specifics for taxation of income versus sales tax collection do differ.

E. The Import-Export Clause of the United States Constitution

Section 10 of Article 1 of the United States Constitution states “no state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws.” This clause is known as the “import-export” clause. The import-export clause permits states to impose generally applicable, nondiscriminatory taxes even if those taxes fall on imports or exports.¹⁵¹ The export clause has been interpreted as allowing no room for any federal tax. However, generally applicable or nondiscriminatory taxes on goods in export transit, the import-export clause has been interpreted as permitting states to impose nondiscriminatory taxes on imports and exports.¹⁵² The import-export clause forbids states to impose duties on imports and exports does not require blanket tax immunity for any business that buys or manufactures goods for shipment overseas. The import-export clause allows states to impose sufficient taxes to defray the expenses of providing local services to importers and exporters of goods,¹⁵³ thereby equitably distributing the tax burden. Extending to international commerce, the state tax must pass the same test as that which is used to evaluate laws which affect interstate commerce.¹⁵⁴

“The threshold inquiry in a Foreign Commerce Clause analysis of a state tax that must be made is whether the tax at issue actually implicates foreign commerce; the taxpayer has the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed.¹⁵⁵ The purpose of the Foreign Commerce Clause is to protect markets and participants in markets, not taxpayers as such; it is not the purpose of the Foreign Commerce Clause to protect state residents from their own state taxes.^{156,157}

The scenario of goods destined for, or in the course of removal from the state deserves discussion. Simply because property within a state is to be exported at a future date does not exempt it from taxation.¹⁵⁸ The mere intent to export is not enough, but, rather the goods must

¹⁴⁸ *Id.*, *supra* 100.

¹⁴⁹ 15 U.S.C. §§ 381 et seq.

¹⁵⁰ *Id.*, *supra* 100.

¹⁵¹ See *Auto Cargo, Inc. v. Miami Dade County*, 237 F.3d 1289 (11th Cir. 2001).

¹⁵² *Id.*

¹⁵³ See *Coast Pacific Trading, Inc. v. State, Dept. of Revenue*, 105 Wash. 2d 912, 719 P.2d 541 (1986).

¹⁵⁴ *In re: Barton-Dobenin*, 269 Kan. 851, 9 P.3d 9 (2000), cert. denied, 121 S. Ct. 765 (U.S. 2001).

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ Laura Hunter Dietz, J.D. and Jane E. Lehman, J.D., of the National Legal Research Group, Inc., *71 Am Jur 2d State and Local Taxation* § 176, LEXIS.

¹⁵⁸ See *Sumitomo Forestry Co., Ltd. Of Japan v. Thurston County, Washington*, 504 F.2d 604 (9th Cir.

begin their physical entry into the stream of exportation to be exempted from taxes.¹⁵⁹ Even though goods which are products of a state may be intended for exportation, until they become exports within the import-export clause, they do not cease to be part of the general mass of property in the state. As such, they are within the jurisdiction of the state and therefore subject to taxation in the usual way.¹⁶⁰ It should be noted that not every preliminary movement of goods toward eventual exportation is sufficient to invoke the protection of the import-export clause.¹⁶¹

In an effort to avoid ambiguity, insistence on a physical entry into the stream of exportation to secure the protection of the import-export clause from local taxation may be subject to argument that it represents an overly mechanistic approach. Yet, this area is one in which a matter of certainty is required since it is highly important, both to the shipper and the state.¹⁶² The use of a common carrier to carry goods from one resting place to another with the same state is insufficient to commence the exportation process and immunize the goods from nondiscriminatory local taxation.¹⁶³ (See: Laura Hunter Dietz, J.D. and Jane E. Lehman, J.D., of the National Legal Research Group, Inc., *71 Am Jur 2d State and Local Taxation* § 177, LEXIS.)

Property that is in interstate transit through a state acquires no *situs* for purposes of taxation in the state,¹⁶⁴ and property in a state only as an incident to its transfer to some other state is not taxable in such state.¹⁶⁵ Imagine the potential tax ramifications if a purchase was made from a company located in New York and ultimately delivered to a purchaser in California. If the common carrier delivery mode was overland travel, imagine the potential tax liabilities that could be incurred—especially if a circuitous route were traveled. One should be aware, however, that delays in interstate transit may create a taxable *situs* in an intermediate state, depending upon the nature and duration of the delay. Obviously, intent to transport the property would exempt the property from creating a taxable *situs*. However, if the property is detained in transit to accomplish some particular purpose or object of the owner, other than transportation to its ultimate destination, a taxable *situs* is created.¹⁶⁶ Similarly, when property is brought from another state into a state, for the purpose of subjecting it to a manufacturing process to prepare it for shipping out of state, it is likely that a *situs* for taxation will be created where the process occurs.¹⁶⁷

1974).

¹⁵⁹ See *Virginia Indonesia Co. v. Harris County Appraisal Dist.*, 910 S.W.2d 905 (Tex. 1995), reh'g of cause overruled, (Dec. 22, 1995).

¹⁶⁰ See *Farmers' Rice Cooperative v. County of Yolo*, 14 Cal. 3d 616, 122 Cal Rptr. 65, 536 P.2d 465 (1975).

¹⁶¹ See *Kosydar v. National Cash Register Co.*, 417 U.S. 62, 94 S. Ct. 2108, 40 L. Ed. 2d 660 (1974).

¹⁶² *Id.*

¹⁶³ See *Connell Rice & Sugar Co. Inc. v. Yolo County*, 569 F.2d 514 (9th Cir. 1978); *Farmers' Rice Cooperative v. County of Yolo*, 14 Cal. 3d 616, 122 Cal Rptr. 65, 536 P.2d 465 (1975).

¹⁶⁴ See *Hall v. American Refrigerator Transit Co.*, 24 Colo. 291, 51 P. 421 (1897), aff'd, 174 U.S. 70, 19 S. Ct. 599 43 L. Ed. 899 (1899); *Berkshire v. Douglas County Bd. of Equalization*, 200 Neb. 113, 262 N.W. 2d 449 (1978); *County Bd. of Arlington County v. Stull*, 217 Va. 238, 227 S.E.2d 698 (1976).

¹⁶⁵ See *Coe v. Town of Errol*, 116 U.S. 517, 6 S. Ct. 475, 29 L. Ed. 715 (1886).

¹⁶⁶ See *People v. Bacon*, 243 Ill. 313, 90 N.E. 686 (1909), aff'd, 227 U.S. 504, 33 S. Ct. 299, 57 L. Ed. 615 (1913).

¹⁶⁷ See *Standard Oil Co. v. Combs*, 96 Ind. 179, 1884 WL 5340 (1884).

There is a maxim, “*mobilia sequuntur personam*” meaning “movable things follow the person” is subject to many exceptions as applied to the taxation of tangible personal property.¹⁶⁸ The domicile of the owner is the taxable *situs* assigned to tangibles where an actual *situs* has not been acquired elsewhere.¹⁶⁹ The state of domicile is the *situs* for purposes of taxation of tangible personal property when actual *situs* has not been acquired elsewhere as in the situation of property temporarily in another state, but not permanently located there.¹⁷⁰ However, when tangible personal property is permanently located in a state other than the state of the owner’s domicile, the *situs* for taxation is in the state where the property is located. As such the state where the property owner is domiciled does not have jurisdiction to tax said property.¹⁷¹ Ergo, tangible personal property that has acquired a fixed *situs* in a state other than that of the domicile of its owner is immune from taxation when considered as a form of riches upon which to base a tax *in personam* upon its owner.¹⁷² However, the state of domicile retains jurisdiction to tax tangible personal property that has not acquired an actual *situs* elsewhere.¹⁷³ Furthermore, if the facts show that the personal property has a taxable *situs* in more than one state, the domiciliary state may not tax the personal property at full value.¹⁷⁴

VI. *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*

A. Evolution of Law, The Continued Development of Interstate Commerce Law

The case of *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*¹⁷⁵ played an import role in developing the landscape of taxation of interstate commerce.

National Bellas Hess, Inc. was a mail order house with its principal place of business in North Kansas City, Missouri. National Bellas Hess, Inc. was licensed to do business in Missouri and Delaware. It did not maintain a place of business, had no representatives, and owned no property, real or personal, in the State of Illinois. Furthermore, National Bellas Hess, Inc. did not have a telephone listing, nor did it advertise its merchandise by radio, television, billboards, or newspapers in the State of Illinois. National Bellas Hess, Inc. mailed catalogues twice a year to customers throughout the United States, including Illinois, supplemented by occasional flyers. Orders for merchandise were mailed to the plant in Missouri, while goods were sent to customers

¹⁶⁸ Hunter Dietz, J.D. and Jane E. Lehman, J.D., of the National Legal Research Group, Inc., *71 Am Jur 2d State and Local Taxation* § 589, LEXIS.

¹⁶⁹ See *Hawley v. City of Malden*, 232 U.S. 1, 34 S. Ct. 201 58 L. Ed. 477 (1914); *Ainsworth v. Fillmore County*, 166 Neb. 779, 90 N.W.2d 360 (1958).

¹⁷⁰ See *Brock & Co. v. Board of Sup’rs of Los Angeles County*, 8 Cal. 2d 286, 65 P.2d 791, 110 A.L.R. 700 (1937); *Ainsworth v. Fillmore County*, 166 Neb. 779, 90 N.W.2d 360 (1958); *Commonwealth v. American Dredging Co.*, 122 Pa. 386, 15 A. 443 (1888).

¹⁷¹ See *Curry v. McCanness*, 307 U.S. 357, 59 S. Ct. 900, 83 L. Ed. 1339, 123 A.L.R. 162 (1939); *Lawrence v. State Tax Commission of Mississippi*, 286 U.S. 276, 52 S. Ct. 556, 76 L. Ed. 1102, 87 A.L.R. 374 (1932).

¹⁷² See *Delaware, Lackawanna & W R Co v. Com. Of Pennsylvania*, 198 U.S. 341, 25 S. Ct. 669, 49 L. Ed. 1077 (1905); *Miami Coal Co. v. Fox*, 203 Ind. 99, 176 N.E. 11, 79 A.L.R. 333 (1931).

¹⁷³ See *Upper Missouri River Corp. v. Board of Review, Woodbury County*, 210 N.W.2d 828 (Iowa 1973).

¹⁷⁴ See *Appraisal Review Bd. of Galveston County, Tex. v. Tex-Air Helicopters, Inc.*, 970 S.W.2d 530 (Tex.1998).

¹⁷⁵ *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 386 U.S. 753; 87 S. Ct. 1389; 18 L. Ed. 2d 505; 1967 U.S. LEXIS 2792.

via United States mail or common carrier. In fact, all of the contacts with the State of Illinois were via the United States mail or common carrier.¹⁷⁶

Although the company had neither outlets nor sales representatives in the State of Illinois, the Illinois Department of Revenue obtained a judgment that the company was required to collect and pay to the State of Illinois use taxes. The judgment was issued by the Illinois State Supreme Court who held that the taxpayer was required to collect and pay to the State of Illinois use taxes imposed by Illinois Revenue Statute Chapter 120, Section 439.3 (1965).¹⁷⁷

B. The United States Supreme Court Opinion on *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*

The Illinois State Supreme Court stated:

“[National] does not maintain in Illinois any office, distribution house, sales house, warehouse or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois.”¹⁷⁸

Nonetheless, the Illinois State Supreme court ruled that the manner of doing business was sufficient under the Illinois statute to classify National as a “retailer maintaining a place of business in this State,” since the term “retailer” includes any retailer: “Engaging in soliciting orders within this State from users by means of catalogues or other advertising whether such orders are received or accepted within or without this State.”

The case came before the United States Supreme court on February 23, 1967. On May 08, 1967 Mr. Justice Stewart of the United States Supreme Court set forth the following opinion:

“The appellant, National Bellas Hess, is a mail order house with its principal place of business in North Kansas City, Missouri. It is licensed to do business in only that State and in Delaware, where it is incorporated. Although the company has neither outlets nor sales representatives in Illinois, the appellee, Department of Revenue, obtained a judgment from the Illinois Supreme Court that National is required to collect and pay to the State the use taxes imposed by Ill. Rev. Stat. c. 120, § 439.3 (1965).¹⁷⁹ Since National's constitutional objections to the imposition of this liability present a substantial federal question, we noted probable jurisdiction of its appeal.¹⁸⁰

¹⁷⁶ *Id.*

¹⁷⁷ See *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 34 Ill. 2d 164, 214 N. E. 2d 755.

¹⁷⁸ 34 Ill. 2d, at 166-167, 214 N. E. 2d at 757.

¹⁷⁹ See 34 Ill. 2d 164, 214 N. E. 2d 755.

¹⁸⁰ See 385 U.S. 809.

The facts bearing upon National's relationship with Illinois are accurately set forth in the opinion of the State Supreme Court:

"[National] does not maintain in Illinois any office, distribution house, sales house, warehouse or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois."¹⁸¹

All of the contacts which National does have with the State are via the United States mail or common carrier. Twice a year catalogues are mailed to the company's active or recent customers throughout the Nation, including Illinois. This mailing is supplemented by advertising "flyers" which are occasionally mailed to past and potential customers. Orders for merchandise are mailed by the customers to National and are accepted at its Missouri plant. The ordered goods are then sent to the customers either by mail or by common carrier.

This manner of doing business is sufficient under the Illinois statute to classify National as a "retailer maintaining a place of business in this State," since that term includes any retailer:

"Engaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State." Ill. Rev. Stat. c. 120, § 439.2 (1965).

Accordingly, the statute requires National to collect and pay to the appellee Department the tax imposed by Illinois upon consumers who purchase the company's goods for use within the State.¹⁸² When collecting this tax, National must give the Illinois purchaser "a receipt therefore in the manner and form prescribed by the [appellee]," if one is demanded.¹⁸³ It must also "keep such records, receipts, invoices and other pertinent books, documents, memoranda and papers as the [appellee] shall require, in such form as the [appellee] shall require," and must submit to such investigations, hearings, and examinations as are needed by the appellee to administer and enforce the use tax law.¹⁸⁴ Failure to keep such records or to give required receipts is punishable by a fine of up to \$5,000 and imprisonment of up to six months.¹⁸⁵ Finally, to allow service of process on an out-of-state company like National, the statute designates the Illinois Secretary of State as National's appointed agent, and jurisdiction in tax collection suits attaches when process is served on him and the company is notified by registered mail.¹⁸⁶

¹⁸¹ See 34 Ill. 2d, at 166-167, 214 N. E. 2d, at 757.

¹⁸² See Ill. Rev. Stat. c. 120, § 439.3 (1965).

¹⁸³ *Id.*, § 439.5.

¹⁸⁴ *Id.*, § 439.11.

¹⁸⁵ *Id.*, § 439.14.

¹⁸⁶ *Id.*, § 439.12a.

National argues that the liabilities which Illinois has thus imposed violate the Due Process Clause of the Fourteenth Amendment and create an unconstitutional burden upon interstate commerce. These two claims are closely related. For the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a State's compliance with the requirements of due process in this area are similar. See *Central R. Co. v. Pennsylvania*, 370 U.S. 607, 621-622 (concurring opinion of MR. JUSTICE BLACK). As to the former, the Court has held that "State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." *Freeman v. Hewitt*, 329 U.S. 249, 253. See also *Greyhound Lines v. Mealey*, 334 U.S. 653, 663; *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450, 462. And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the "simple but controlling question is whether the state has given anything for which it can ask return." *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444. See also *Standard Oil Co. v. Peck*, 342 U.S. 382; *Ott v. Mississippi Barge Line*, 336 U.S. 169, 174. The same principles have been held applicable in determining the power of a State to impose the burdens of collecting use taxes upon interstate sales. Here, too, the Constitution requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345; *Scripto, Inc. v. Carson*, 362 U.S. 207, 210-211.¹⁸⁷ See also *American Oil Co. v. Neill*, 380 U.S. 451, 458.

In applying these principles the Court has upheld the power of a State to impose liability upon an out-of-state seller to collect a local use tax in a variety of circumstances. Where the sales were arranged by local agents in the taxing State, we have upheld such power. *Felt & Tarrant Co. v. Gallagher*, 306 U.S. 62; *General Trading Co. v. Tax Comm'n*, 322 U.S. 335. We have reached the same result where the mail order seller maintained local retail stores. *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359; *Nelson v. Montgomery Ward*, 312 U.S. 373.¹⁸⁸ In those situations the out-of-state seller was plainly accorded the protection and services of the taxing State. The case in this Court which represents the furthest constitutional reach to date of a State's power to deputize an out-of-state retailer as its collection agent for a use tax is *Scripto, Inc. v. Carson*, 362 U.S. 207. There we held that Florida could constitutionally impose upon a Georgia seller the duty of collecting a state use tax upon the sale of goods shipped to customers in Florida. In that case the seller had "10 wholesalers, jobbers, or 'salesmen' conducting continuous local solicitation in Florida and forwarding the resulting

¹⁸⁷ Strictly speaking, there is no question of the connection or link between the State and "the person . . . it seeks to tax." For that person in *Miller Bros. Co. v. Maryland*, 347 U.S. 340, in *Scripto, Inc. v. Carson*, 362 U.S. 207, and in the present case is the user of the goods to whom the out-of-state retailer sells. National is not the person being directly taxed, but rather it is asked to collect the tax from the user. It is, however, made directly liable for the payment of the tax whether collected or not. Ill. Rev. Stat. c. 120, § 439.8 (1965).

¹⁸⁸ National acknowledges its obligation to collect a use tax in Alabama, Kansas, and Mississippi, since it has retail outlets in those States.

orders from that State to Atlanta for shipment of the ordered goods." 362 U.S., at 211.

But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail. Indeed, in the *Sears, Roebuck* case the Court sharply differentiated such a situation from one where the seller had local retail outlets, pointing out that "those other concerns . . . are not receiving benefits from Iowa for which it has the power to exact a price." 312 U.S., at 365. And in *Miller Bros. Co. v. Maryland*, 347 U.S. 340, the Court held that Maryland could not constitutionally impose a use tax obligation upon a Delaware seller who had no retail outlets or sales solicitors in Maryland. There the seller advertised its wares to Maryland residents through newspaper and radio advertising, in addition to mailing circulars four times a year. As a result, it made substantial sales to Maryland customers, and made deliveries to them by its own trucks and drivers.

In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities,¹⁸⁹ is a valid one, and we decline to obliterate it.

We need not rest on the broad foundation of all that was said in the *Miller Bros.* opinion, for here there was neither local advertising nor local household deliveries, upon which the dissenters in *Miller Bros.* so largely relied. 347 U.S., at 358. Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes.¹⁹⁰ The many variations in rates of tax,¹⁹¹ allowable

¹⁸⁹ As of 1965, 11 States besides Illinois had use tax statutes which required a seller like National to participate in the tax collection system. However, state taxing administrators appear to have generally considered an advertising nexus insufficient. For they have testified that doubts as to the constitutionality of such statutes underlay their failure to take full advantage of their statutory authority. Report of the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, H. R. Rep. No. 565, 89th Cong., 1st Sess., 631-635 (1965). These doubts were substantiated by the only other State Supreme Court that has considered the issue now before us. The Alabama Supreme Court, dealing with a situation very much like the present one, found that this application of the use tax statute would be invalid under the Federal Constitution. *State v. Lane Bryant, Inc.*, 277 Ala. 385, 171 So. 2d 91.

¹⁹⁰ "Local sales taxes are imposed today [1965] by over 2,300 localities. . . . In most States, the local sales

exemptions, and in administrative and record-keeping requirements¹⁹² could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government."

The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.¹⁹³

The judgment is *Reversed*.

It should be noted that the United States Supreme Court was not unanimous in its decision. Justices Fortas, Black and Douglas dissented. In their dissent they made the point that in addition to catalogue sales by National Bella Hess, Inc., that a substantial part of their business was sales on credit.

"...A substantial part of Bellas Hess' sales is on credit. Its catalogue features 'NBH Budget Aid Credit' – which requires no money down but requires the purchaser to make monthly payments which include a service fee or interest charge, and which also incorporates an agreement, unless expressly rejected by the purchaser, for 'Budget Aid Family Insurance'...There should be no doubt that that this large-scale systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient 'nexus' to require Bellas Hess to collect from Illinois customers and to remit the use tax, especially when coupled with the use of the credit resources of residents of Illinois, dependent as that mechanism is upon the State's banking and credit institutions. Bellas Hess is not simply using the facilities of interstate commerce to serve customers in Illinois. It is regularly and continuously engaged in 'exploitation of the consumer market' of Illinois (*Miller Bros. Co. v Maryland*, 347 (1954)) by soliciting residents of Illinois who live and work there and have homes and banking connections there, and who, absent the solicitation of Bellas Hess, might buy locally and pay the sales tax to support their State. Bellas Hess could not carry on its business in Illinois, and

tax is complemented by a use tax." H. R. Rep. No. 565, *supra*, at 872.

¹⁹¹ In 1964 there were seven different rates of sales and use taxes: 2, 2 1/4, 2 1/2, 3, 3 1/2, 4, and 5%. H. R. Rep. No. 565, *supra*, at 611-613, 607-608. The State of Washington has recently added an eighth, 4.2%. Wash. Rev. Code § 82.12.020 (Supp. 1965).

¹⁹² "The prevailing system requires [the seller] to administer rules which differ from one State to another and whose application -- especially for the industrial retailer -- turns on facts which are often too remote and uncertain for the level of accuracy demanded by the prescribed system." H. R. Rep. No. 565, *supra*, at 673. "Given the broad spread of sales of even small and moderate sized companies, it is clear that if just the localities which now impose the tax were to realize anything like their potential of out-of-State registrants the recordkeeping task of multi-state sellers would be clearly intolerable." *Id.*, at 882.

¹⁹³ Congress has in fact recently evidenced an active interest in this area. See Tit. II, Pub. L. 86-272, 73 Stat. 556, as amended by Pub. L. 87-17, 75 Stat. 41, which authorized the detailed congressional study of state taxation of interstate commerce that resulted in H. R. Rep. No. 565, *supra*. See also H. R. Rep. No. 2013, 89th Cong., 2d Sess. (1966).

particularly its substantial credit business, without utilizing Illinois banking and credit facilities...”¹⁹⁴

Nonetheless, the dominant view of the United States Supreme Court was that the State of Illinois did not have the authority to require National Bellas Hess, Inc. to collect sales tax on sales made to customers residing in the state of Illinois. This decision is one of the Supreme Court decisions that has helped to shape today’s landscape of sales and use tax collection in the United States.

VII. *Quill Corporation v. North Dakota*

A. Evolution of Law, The Present Supreme Court Position on Taxation of Interstate Commerce

No case has had more impact on the landscape of US interstate taxation as *Quill Corporation v. North Dakota*.¹⁹⁵ Quill Corporation¹⁹⁶ was a mail-order company located in Palatine, Illinois, with no outlets or representatives in North Dakota. Nevertheless, North Dakota brought suit to collect use taxes from Quill Corporation pursuant to North Dakota Century Code Section 57-40.2.01(6).¹⁹⁷ Although the trial court ruled in favor of Quill Corporation, the State Supreme court reversed. This reversal overruled *National Bellas Hess, Inc. v. Department of Revenue of Illinois*.¹⁹⁸ Quill Corporation appealed. The court found Quill Corporation purposefully directed sufficient activities at respondent’s residents to satisfy due process minimum contacts, but nevertheless fell within the safe harbor provisions of the Commerce Clause “substantial nexus” requirement proffered by National Bellas Hess. The court held that *stare decisis* and the differences between the controlling principles of the Due Process and Commerce Clauses mandated that the National Bellas Hess rule remain good law. Accordingly, the judgment of the court was reversed, and the case remanded for further proceedings consistent with the court’s opinion. The order requiring Quill Corporation to pay use taxes was reversed and the case remanded because while petitioner had met the requisite minimum contacts required

¹⁹⁴ *Id.*, *supra* 174.

¹⁹⁵ *Id.*, *supra* 103.

¹⁹⁶ For more about Quill Corporation visit: <http://www.quill.com>.

¹⁹⁷ "Retailer" includes every person engaged in the business of selling tangible personal property for use within the meaning of this chapter, but, when in the opinion of the commissioner, it is necessary for the efficient administration of this chapter to regard any salesman, representative, trucker, peddler, or canvasser as the agent of the dealer, distributor, supervisor, employer, or other person under whom that person operates or from whom that person obtains the tangible personal property sold by that person, whether that person is making sales in that person's own behalf or in behalf of such dealer, distributor, supervisor, employer, or other person, the commissioner may regard that person as such agent, and may regard the dealer, distributor, supervisor, employer, or other person as a retailer for the purposes of this chapter. A retailer includes any organization licensed by the attorney general to conduct bingo games pursuant to section 53-06.1-03. A retailer also includes every person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system.
(<http://www.legis.nd.gov/cencode/t57c402.pdf>).

¹⁹⁸ *Id.*, *supra* 174.

by the Due Process Clause, it lacked the “substantial nexus” required by the Commerce Clause for the imposition of use taxes as apportioned by North Dakota.¹⁹⁹

B. Synopsis of *Quill Corporation v. North Dakota*

The synopsis of the case is as follows:

Respondent North Dakota, through its Tax Commissioner, Heidi Heitkamp, filed an action in state court to require petitioner Quill Corporation—an out-of-state mail-order house with neither outlets nor sales representatives in the state—to collect and pay a use tax on goods purchased for use in the state. The trial court ruled in Quill’s favor. It found the case indistinguishable from *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505, which, in holding that a similar Illinois statute violated the Fourteenth Amendment’s Due Process Clause and created an unconstitutional burden on interstate commerce, concluded that a “seller whose only connection with customers in the state is by common carrier or . . . mail” lacked the requisite minimum contacts with the state. The State Supreme Court reversed, concluding, *inter alia*, that, pursuant to *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076, and its progeny, the Commerce Clause no longer mandated the sort of physical presence nexus suggested in [National] *Bellas Hess, Inc.*; and that, with respect to the Due Process Clause, cases following [National] *Bellas Hess, Inc.* had not construed minimum contacts to require physical presence within a state as a prerequisite to the legitimate exercise of state power.²⁰⁰

¹⁹⁹ *Quill Corporation, Petitioner v North Dakota* by and through its Tax Commissioner, Heidi Heitkamp, 504 U.S. 298; 112 S. Ct. 1904; 119 L. Ed. 2d 91; 1992 U.S. LEXIS 3123; 60 U.S.L.W. 4423; 92 Cal. Daily Op. Service 4458; 92 Daily Journal DAR 7142; 6 Fla. L. Weekly Fed. S 269.

²⁰⁰ *Id.*

Held²⁰¹:

1. The Due Process Clause does not bar enforcement of the state's use tax against Quill. This Court's due process jurisprudence has evolved substantially since *Bellas Hess*, abandoning formalistic tests focused on a defendant's presence within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of the federal system of Government, to require it to defend the suit in that State. See *Shaffer v. Heitner*, 433 U.S. 186, 212, 53 L. Ed. 2d 683, 97 S. Ct. 2569. Thus, to the extent that this Court's decisions have indicated that the Clause requires a physical presence in a State, they are overruled. In this case, Quill has purposefully directed its activities at North Dakota residents, the magnitude of those contacts are more than sufficient for due process purposes, and the tax is related to the benefits Quill receives from access to the State.²⁰²

²⁰¹ Briefs of amici curiae urging reversal were filed for the State of New Hampshire et al. by John P. Arnold, Attorney General of New Hampshire, and Harold T. Judd, Senior Assistant Attorney General, Charles M. Oberly III, Attorney General of Delaware, and John R. McKernan, Jr., Governor of Maine; for the American Bankers Association et al. by John J. Gill III, Michael F. Crotty, and Frank M. Salinger; for the American Council for the Blind et al. by David C. Todd and Timothy J. May; for Arizona Mail Order Co., Inc., et al. by Maryann B. Gall, Timothy B. Dyk, Michael J. Meehan, Frank G. Julian, David J. Bradford, George S. Isaacson, Martin I. Eisenstein, and Stuart A. Smith; for Carrot Top Industries, Inc., et al. by Charles A. Trost and James F. Blumstein; for the Clarendon Foundation by Ronald D. Maines; for the Coalition for Small Direct Marketers by Richard J. Leighton and Dan M. Peterson; for the Direct Marketing Association by George S. Isaacson, Martin I. Eisenstein, and Robert J. Levering; for the National Association of Manufacturers et al. by Bruce J. Ennis, Jr., David W. Ogden, Jan S. Amundson, and John Kamp; for Magazine Publishers of America, Inc., et al. by Eli D. Minton, James R. Cregan, Ian D. Volner, and Stephen F. Owen, Jr.; and for the Tax Executives Institute, Inc., by Timothy J. McCormally.

and
Briefs of amici curiae urging affirmance were filed for the State of Connecticut et al. by Richard Blumenthal, Attorney General of Connecticut, and Paul J. Hartman, Charles W. Burson, Attorney General of Tennessee, Daniel E. Lungren, Attorney General of California, Winston Bryant, Attorney General of Arkansas, Robert A. Butterworth, Attorney General of Florida, Michael J. Bowers, Attorney General of Georgia, Larry EchoHawk, Attorney General of Idaho, Roland W. Burris, Attorney General of Illinois, Bonnie J. Campbell, Attorney General of Iowa, Frederic J. Cowan, Attorney General of Kentucky, William J. Guste, Jr., Attorney General of Louisiana, J. Joseph Curran, Jr., Attorney General of Maryland, Scott Harshbarger, Attorney General of Massachusetts, Frank J. Kelley, Attorney General of Michigan, Mike Moore, Attorney General of Mississippi, Frankie Sue Del Papa, Attorney General of Nevada, Robert Abrams, Attorney General of New York, Lee Fisher, Attorney General of Ohio, Susan B. Loving, Attorney General of Oklahoma, Ernest D. Preate, Jr., Attorney General of Pennsylvania, T. Travis Medlock, Attorney General of South Carolina, Dan Morales, Attorney General of Texas, Paul Van Dam, Attorney General of Utah, Jeffrey L. Amestoy, Attorney General of Vermont, Mary Sue Terry, Attorney General of Virginia, Ken Eikenberry, Attorney General of Washington, Mario J. Palumbo, Attorney General of West Virginia, and John Payton; for the State of New Jersey by Robert J. Del Tufo, Attorney General, Sarah T. Darrow, Deputy Attorney General, Joseph L. Wannotti, Assistant Attorney General, Richard G. Taranto, and Joel I. Klein; for the State of New Mexico by Tom Udall, Attorney General, and Frank D. Katz, Special Assistant Attorney General; for the City of New York by O. Peter Sherwood, Edward F. X. Hart, and Stanley Buchsbaum; for the International Council of Shopping Centers, Inc., et al. by Charles Rothfeld; for the Multistate Tax Commission by James F. Flug and Martin Lobel; for the National Governors' Association et al. by Richard Ruda; and for the Tax Policy Research Project by Rita Marie Cain.

²⁰² *Id.*, *supra* 198.

2. The State's enforcement of the use tax against Quill places an unconstitutional burden on interstate commerce.²⁰³
- (a) *Bellas Hess* was not rendered obsolete by this Court's subsequent decision in *Complete Auto, supra*, which set forth the four-prong test that continues to govern the validity of state taxes under the Commerce Clause. Although *Complete Auto* renounced an analytical approach that looked to a statute's formal language rather than its practical effect in determining a State tax statute's validity, the *Bellas Hess* decision did not rely on such formalism. Nor is *Bellas Hess* inconsistent with *Complete Auto*. It concerns the first part of the *Complete Auto* test and stands for the proposition that a business whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause.²⁰⁴
- (b) Contrary to the State's argument, a mail-order house may have the "minimum contacts" with a taxing State as required by the Due Process Clause and yet lack the "substantial nexus" with the State required by the Commerce Clause. These requirements are not identical and are animated by different constitutional concerns and policies. Due process concerns the fundamental fairness of governmental activity, and the touchstone of due process nexus analysis is often identified as "notice" or "fair warning." In contrast, the Commerce Clause and its nexus requirement are informed by structural concerns about the effects of State regulation of the national economy.²⁰⁵
- (c) The evolution of this Court's Commerce Clause jurisprudence does not indicate repudiation of the *Bellas Hess* rule. While cases subsequent to *Bellas Hess* and concerning other types of taxes have not adopted a bright-line, physical-presence requirement similar to that in *Bellas Hess*, see, e. g., *Standard Pressed Steel Co. v. Department of Revenue of Wash.*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719, their reasoning does not compel rejection of the *Bellas Hess* rule regarding sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the rule remains good law.²⁰⁶
- (d) The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve.²⁰⁷

Justice Stevens delivered the opinion for a unanimous Court with respects to Parts I, II and III and the opinion of the Court with respect to Part IV²⁰⁸, in which

²⁰³ *Id, supra* 198.

²⁰⁴ *Id, supra* 198.

²⁰⁵ *Id, supra* 198.

²⁰⁶ *Id, supra* 198.

²⁰⁷ *Id, supra* 198.

²⁰⁸ The Opinion of the Court was divided into four sections (I-IV).

Rehnquist, Blackmun, O'Connor, and Souter joined. Scalia, filed an opinion concurring in part and concurring in the judgment, in which Kennedy and Thomas joined. White filed an opinion concurring in part and dissenting in part.²⁰⁹ (A complete copy of the opinion of the US Supreme Court may be found in Appendix A).

C. Analysis of the United States Supreme Court Decision

Part I of the decision opens with a background of Quill Corporation and the type of business that it conducts. It then proceeds to talk about North Carolina and how it imposes a use tax that is corollary to its sales tax under the N.D. Cent Code §57-40.2-07. This Century Code was amended to define the term of “retailer” to include “every person who engages in regular or systematic solicitation of a consumer market in the state.”²¹⁰ This, by definition, would include Quill Corporation.

When the case first went to trial at the state level, the trial court found for Quill Corporation, finding the case indistinguishable from *Bellas Hess*; specifically, it found that because the state had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no “nexus to allow the state to define retailer in the manner it chose.”²¹¹

The state appealed the case to the Supreme Court of North Dakota. The North Dakota Supreme Court reversed the lower court’s decision. Their reasoning was that “wholesale changes in both the economy and the law” had made it inappropriate to follow *Bellas Hess* today. Of particular interest to the Court was that the growth of mail-order business had dramatically expanded, and was no longer a “relatively inconsequential market niche,” but rather a “Goliath.” The Supreme Court of North Dakota went on to elaborate as to how the various changes in the legal landscape no longer mandated the sort of physical presence nexus as required by *Bellas Hess*. It was determined by the North Dakota Supreme Court that because of the legal infrastructure that protected Quill Corporation’s market and the fact that Quill Corporation expended so much advertising in North Dakota that Quill Corporation met the economic presence requirement and therefore generated “a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax.”²¹²

Part II of the US Supreme Court’s opinion focuses on the differences between the Due Process Clause and the Commerce Clause of the US Constitution. Noting that there is often considerable overlap in the Due Process Clause and the Commerce Clause, the US Supreme Court went on to state that the Due Process Clause and the Commerce Clause were analytically distinct; noting that even though under Due Process objections a tax may be sustainable, yet fall because of its burdening effect upon commerce. “And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented. . . as if they were separate and distinct, not intermingled ones.”

²⁰⁹ *Id, supra* 198.

²¹⁰ *Id, supra* 198.

²¹¹ *Id, supra* 198.

²¹² *Id, supra* 198.

International Harvester Co. v. Department of Treasury, 322 U.S. 340, 353, 88 L. Ed. 1313, 64 S. Ct. 1019 (1944).²¹³

In Part III the US Supreme Court notes that the Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” noting *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345, 98 L. Ed. 744, 74 S. Ct. 535 (1954). It also notes that the “income attributed to the state for tax purposes must be rationally related to ‘values connected with the taxing state,’” *Moorman Mfg. Co. v. Blair*, 437 U.S. 267, 273, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978). The focus of Part III, however, is on the definite link, the minimum connection. Citing *Scripto, Inc. v. Carson*, 362, U.S. 207, 4 L. Ed. 2d 660, 80 S. Ct. 619 (1960), we are reminded that the Court upheld a use tax despite the fact that the seller’s in-state solicitation was performed entirely by independent contractors. The Court suggested in *Bellas Hess* that some sort of physical presence in the state was necessary, and that not only was it sufficient for jurisdiction under the Due Process Clause, but it was also necessary.²¹⁴

The US Constitution authorized Congress to “regulate Commerce with foreign Nations, and among the several States.”²¹⁵ It should be noted that the Constitution says nothing about the protection of interstate commerce. Justice Johnson, in his concurring opinion in *Gibbons v. Ogden*, 22 U.S. 1, 9 Wheat. 1, 231-232, 6 L. Ed. 23 (1824), that the Commerce Clause is more than an affirmative grant of power, as it has a negative sweep as well. As Justice Stone stated in *South Carolina State Highway Dept. v. Barnwell Brothers, Inc.*, 303 U.S. 117, 185, 82 L. Ed. 734, 58 S. Ct. 510 (1938), that “by its own force” the Commerce Clause prohibits certain state actions that interfere with interstate commerce.²¹⁶ The US Supreme Court notes that the interpretation of the “negative”²¹⁷ Commerce Clause has evolved substantially, particularly in concerns over limitations on state taxation powers.²¹⁸ Part IV deals, in part, with the United States Supreme Court’s interpretation of the “negative” or “dormant” Commerce Clause.

Part IV also spends a great deal of time focusing on the four-part test of *Complete Auto*, and how *Complete Auto* rejected the formal distinction between “direct” and “indirect” taxes on interstate commerce, noting that the validity of statutes hinged on “legal terminology.”²¹⁹

The United States Supreme Court remarked that “The State of North Dakota relies less on *Complete Auto* and more on the evolution of our due process jurisprudence. . .” and “. . .the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent. . .”²²⁰ The United States Supreme Court failed to agree with the State of North Dakota noting that “Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce

²¹³ *Id, supra* 198.

²¹⁴ *Id, supra* 198.

²¹⁵ Constitution of the United States of America, Article I, § 8, cl. 3.

²¹⁶ *Id, supra* 198.

²¹⁷ The “negative” Commerce Clause is also sometimes referred to as the “dormant” Commerce Clause.

²¹⁸ *Id, supra* 198.

²¹⁹ *Id, supra* 198.

²²⁰ *Id, supra* 198.

Clauses are not identical. The two standards are animated by different Constitutional concerns and policies.”²²¹

The United States Supreme Court elaborated on how Due process concerns the fundamental fairness of government activity. The Due Process nexus analysis requirement focus on the issue of whether or not an individual’s connections with a state are substantial enough to legitimate the state’s exercise of power of him. “Notice” or “fair warning” are the analytic touchstones of due process analysis.²²²

The Commerce Clause, however, does not concern the fairness of the individual, but rather the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties not only hindered, but also suppressed interstate commerce.²²³ So in order to avoid this problem, the Framers of the United States Constitution intended the Commerce Clause as a solution to this problem.²²⁴ Accordingly, the United States Supreme Court has ruled that the Commerce Clause prohibits discrimination against interstate commerce,²²⁵ and bars state regulations that unduly burden interstate commerce.²²⁶ Furthermore, *Complete Auto* reflects concerns about the national economy as well. The second and third parts of the *Complete Auto* analysis require fair apportionment and non-discrimination; prohibiting taxes that pass an unfair share of the tax burden onto interstate commerce. While the first and fourth parts of the analysis require a substantial nexus and a relationship between the tax and state-provided services, thereby limiting the reach of the state taxing authority ensuring that state taxation does not unduly burden interstate commerce.²²⁷ The Due Process clause “minimum contacts” requirement is a means for limiting a state’s burden on interstate commerce. Ergo, a corporation may have a “minimum contacts” with a taxing state as required by the Due Process Clause, and yet lack the “substantial nexus” in that state as required by the Commerce Clause.²²⁸

The bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. It is possible to avoid undue burdens on interstate commerce by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes. Also, in some cases, it is possible to avoid these undue burdens on interstate commerce by the “demarcation of a discrete realm of commercial activity that is free from interstate taxation.” This latter choice was followed by *Bellas Hess* and created a safe harbor for vendors “whose only connection with customers in the [taxing] state is by common carrier or the United States mail.” Under *Bellas Hess*, such vendors are free from state-imposed duties to collect sales and use taxes.²²⁹

While bright-line tests often appear artificial, the benefits of a clear rule more than offset this artificial appearance. In the case of *Bellas Hess*, a bright-line rule clearly establishes the

²²¹ *Id, supra* 198.

²²² *Id, supra* 198.

²²³ *Id, supra* 198.

²²⁴ See generally The Federalist Nos. 7, 11 (A. Hamilton).

²²⁵ See, *Philadelphia v. Jersey*, 437 U.S. 617, 57 L. Ed. 2d 475, 98 S. Ct. 2531 (1978).

²²⁶ See, *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662, 67 L. Ed. 2d 580, 101 S. Ct. 1309 (1981).

²²⁷ *Id, supra* 120.

²²⁸ *Id, supra* 198.

²²⁹ *Id, supra* 198.

boundaries of legitimate state authority to impose a duty to collect sales and use tax, thereby reducing litigation concerning said taxes.²³⁰ Noting that the law concerning these taxes is a “quagmire” and the “application of Constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the states in the exercise of their indispensable power of taxation.”²³¹

Justice Stevens went on to state “Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations, and in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry’s dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.”²³²

Bright-line tests have, from time to time, been replaced with more contextual balancing inquiries. For example, in *Arkansas Electric Cooperative v. Arkansas Pub. Serv. Comm’n*,²³³ the United States Supreme Court reconsidered a bright-line test set forth in *Public Util. Comm’n of R.I. v. Attleboro Steam & Electric Co.*²³⁴ *Attleboro* distinguished between state regulation of wholesale sales of electricity, which was Constitutional as an “indirect” regulation of interstate commerce, and state regulation of retail sales of electricity, which was unconstitutional as a “direct” regulation of commerce. In *Arkansas Electric*, the United States Supreme Court had to consider whether to “follow the mechanical test set out in *Attleboro*, or the balance-of-interest test applied in the Commerce Clause cases.”²³⁵

Of paramount importance is the principle of *stare decisis*. The United States Supreme Court does not lightly set aside issues of *stare decisis*. In deciding to reject the *Attleboro* analysis, the Court was influenced by the fact that the “mechanical test” was “anachronistic.” *Bellas Hess* has been used for over 25 years (when *Quill* was decided in 1992) and has never intimated in the United States Supreme Court review that of sales or use taxes that *Bellas Hess* was unsound. Furthermore, the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry. The “interest in stability and orderly development of the law” that undergirds the doctrine of *stare decisis*²³⁶ therefore counsels adherence to settled precedent.²³⁷

The Court, in summation, stated that even though previous cases involving other types of taxes have not adopted a similar bright-line, physical-presence test requirement, does not compel the Court to reject *Bellas Hess*. The Court feels that the continuing value of a bright-line rule and the doctrine and principles of *stare decisis* make *Bellas Hess* good law. That said, the United

²³⁰ *Id.*, *supra* 198.

²³¹ See, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-458, 3 L. Ed. 2d 421, 79 S. Ct. 357 (1959).

²³² *Id.*, *supra* 198.

²³³ See *Arkansas Electric Cooperative v. Arkansas Pub. Serv. Comm’n*, 461 U.S. 375, 76 L. Ed. 2d 1, 103 S. Ct. 1905 (1983).

²³⁴ See *Public Util. Comm’n of R.I. v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 71 L. Ed. 549, 47 S. Ct. 294 (1927).

²³⁵ 461 U.S. at 390-391.

²³⁶ See *Runyon v. McCrary*, 427 U.S. 160, 190-191, 49 L. Ed. 2d 415, 96 S. Ct. 2586 (1976).

²³⁷ *Id.*, *supra* 198.

States Supreme Court disagreed with the North Dakota Supreme Court's decision that the time has come to renounce the bright-line test of *Bellas Hess*. The United States Supreme Court feels that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.²³⁸

It should be noted that the decision was not unanimous. Justices Scalia and White both concurred in part. Justice Scalia, with whom Justice Kennedy and Justice Thomas join, concurred in part and concurred in the judgment. Justice Scalia wrote that "I also agree that the Commerce Clause holding in *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*."²³⁹ Justice White concurred in part and dissented in part. It was noted by Justice White that Quill refused to comply with a state tax prior to it being held unconstitutional. In Justice White's view the appropriate way to challenge a tax as unconstitutional is to pay it, or remit it to escrow, and then sue for declaratory judgment and refund.²⁴⁰ Justice White concluded by stating "Although Congress can and should address itself to this area of law, we should not adhere to a decision, however right it was at the time, that by reason of later cases and economic reality can no longer be rationally justified. The Commerce Clause aspect of *Bellas Hess*, along with its due process holding, should be overruled."²⁴¹

The United States Supreme Court has expressed a desire for Congress to effect a change regarding this issue. It appears that this may happen, as the Streamlined Sales Tax Project is challenging the current system. The Streamlined Sales Tax Project is a radical proposal to the dilemma of lost revenue due to unpaid sales and use taxes. It is in the process of being implemented, and only time will tell if it is going to change the landscape of the current sales and use tax rules.

VIII. The Streamlined Sales Tax Project

A. The Proliferation of Electronic Commerce

The Internet is in a state of perpetual flux. Ideas, new technologies and the law all progress at different rates. While the theory of electronic commerce is not substantially different from that of catalogue sales, the growth rate and volume of e-commerce is staggering. Computers and technology have made it easier, faster and more practical to order from out-of-state vendors than it had been in the past. While it is true that catalogue orders have been popular for quite some time, the Internet is revolutionizing how people conduct business, transact orders and sometimes even how they structure their lives. Consider, for instance, telecommuting. Before the proliferation of the Internet, some people simply worked from home; now, they now telecommute. But, it does not stop there. With our hectic schedules, busy lifestyles, trying to

²³⁸ *Id, supra* 198.

²³⁹ *Id, supra* 198.

²⁴⁰ For the Federal rule, see *Flora v. United States*, 357 U.S. 63, 2 L. Ed. 2d 1165, 78 S. Ct. 1079 (1958); see generally J. Mertens, *Law of Federal Income Taxation* § 58A.05 (1992). North Dakota appears to follow the same principal. See *First Bank of Buffalo v. Conrad*, 350 N.W. 2d 580, 586 (N.D. 1984) (citing 72 Am. Jur. 2d § 1087).

²⁴¹ *Id, supra* 198.

balance kids, career, school, meeting, family obligations and whatever else happens to present itself into our schedules; when do we have time to shop?

Many people take advantage of the convenience of the 24/7 accessibility and convenience of Internet shopping. We can now order groceries, consumer products, college courses, and anything else we want online. The Internet is a huge marketplace that never shuts down. We can make purchases from the local in-town merchant, or as far away as the other side of the world.

From the consumer point of view this is fabulous. No lines, no hassle, no closed signs. The consumer can pay in a myriad of ways: credit card, C.O.D., online purses, Electronic Fund Transfers (EFTs), debit cards, prepay or post pay with check, cash or money order via the mail. There is no wonder why the Internet and e-commerce have proliferated as they have.

B. The Proposed Solution of the Streamlined Sales Tax Initiative

From the tax authorities' point of view the Internet and e-commerce are both a gold mine and a monstrous tax evading mechanism. Many people are unaware that if they purchase something online from a state that does not collect sales tax that when they receive it in their state that does collect sales tax, that there is now a use tax due and payable to the state tax authority. And, while many people are unaware of this, there are those that are aware of it and shop online from states that do not charge a sales tax knowing full well that they will slip through the cracks, evading sales and use taxes.

To the government, this presents quite a problem. People tend not to self-regulate if there is no deterrent for non-compliance. The government being aware of this and the huge tax loss that entails has initiated something called the Streamlined Sales Tax Project. In early 2000, representatives of several state governments and members of the business community formed the Streamlined Sales Tax Project. Its' purpose is to develop measures to design, test and implement a sales and use tax system that radically simplifies sales and use taxes.²⁴²

“One of the goals of the Streamlined Sales Tax Project is to encourage the registration and collection of sales and use taxes by remote sellers who are not now collecting such taxes on an otherwise taxable sales to customers located in states where the remote sellers do not have physical presence sufficient to subject them to the states' jurisdiction to require such collection.”²⁴³ This is in direct opposition to two pivotal US Supreme Court decisions: *National Bellas Hess v. Dept. of Revenue of Ill.*, 386, U.S. 753 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

A report by the Streamlined Sales Tax Project showed that \$440 billion will be lost to the states in the decade between 2001 and 2011. This loss is due to the fact that many remote sellers are not required to collect sales tax and many consumers who are required to pay use tax never do. With a projected loss of \$440 billion over the decade, the Streamlined Sales Tax Project has a

²⁴² Streamlined Sales Tax Project, *State Legislative Status of Streamlined Sales and Use Tax Agreement (As of February 21, 2005)*, at <http://www.streamlinedsalestax.org/statestatus.pdf>.

²⁴³ Streamlined Sales Tax Project, *Resolution No. 07-03*, at <http://www.streamlinedsalestax.org/>.

huge incentive to rework the current system.²⁴⁴

a. Features of the Streamlined Sales Tax Initiative

The following features make the Streamlined Sales Tax Project attractive to member states:

- 1) “Rate simplification. States will be allowed one state rate and a second state rate in limited circumstances (food and drugs). Each local jurisdiction will be allowed one local rate. A state or local government may not choose to tax telecommunications services, for example, at one rate and all other items of tangible personal property or taxable services at another rate. State and local governments will accept responsibility for notice of rate and boundary changes at restricted times. States will provide an on-line rate/jurisdiction database to simplify rate determinations.”²⁴⁵
- 2) “State level tax administration of all state and local sales and use taxes. Businesses will no longer file tax returns with each local government within which it conducts business in a state. Each state will provide a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. A state and its local governments will use common tax bases.”²⁴⁶
- 3) “Uniform sourcing rules. The states will have uniform and simple rules for how they will source transactions to state and local governments. The uniform rules will be destination/delivery based and uniform for tangible personal property, digital property, and services. Special sourcing rules will be developed for unique industries.”²⁴⁷
- 4) “Simplified exemption administration for use- and entity-based exemptions. Sellers are relieved of the “good faith” requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for paying the tax, interest and penalties for claiming incorrect exemptions. States will have a uniform exemption certificate in paper and electronic form.”²⁴⁸
- 5) “Uniform audit procedures. Sellers who participate in one of the certified streamlined Sales Tax System technology models will either not be audited or will have limited scope audits, depending on the technology model used. The states may conduct joint audits of large multi-state businesses.”²⁴⁹
- 6) “State funding of the system. To reduce the financial burdens on sellers, states will assume responsibility for funding some of the technology models. The states are also

²⁴⁴ IBLS Editorial Associates, *Streamlined Sales Tax Project—National Governors Assn*, IBLS, at <http://ibls.com>.

²⁴⁵ Streamlined Sales Tax Project, *Executive Summary, January 2005*, at <http://www.streamlinedsalestax.org/execsum0105.pdf>.

²⁴⁶ *Id.*

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ *Id.*

participating in a joint business – government study of the costs of collection on sellers.”²⁵⁰

C. Conflict of Law

On November 12, 2002, 34 states and the District of Columbia involved in the Streamlined Sales Tax Implementing States process approved the Streamlined Sales and Use Tax Agreement. In 2003, various state legislatures began the process of introducing legislation aimed at conforming their state sales and use tax statutes to the Streamlined Sales and Use Tax Agreement. This Agreement will go into effect when 10 states comprising at least twenty percent (20%) of the population of states imposing a sales tax have come into compliance. However, collection by sellers of sales and use taxes on remote sales remains voluntary under the Agreement until either Congress or the Supreme Court acts to make this collection mandatory.²⁵¹

It should be noted that this approach is a bit like putting the cart in front of the horse. Are we not supposed to enforce existing laws until new laws are legislated and put in place? Under the Streamlined Sales Tax Project, these various states plan to completely disregard the United States Constitution and the United States Supreme Court. The United States Constitution, In Article 1, Section 10.3 states “No state shall, without the consent of Congress, . . . enter into any agreement or compact with another state, or with a foreign power. . .” The Streamlined Sales Tax Project is in direct opposition to two pivotal US Supreme Court decisions: *National Bellas Hess v. Dept. of Revenue of Ill.*, 386, U.S. 753 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992). It is the responsibility of Congress to enact new laws, not some self-serving tax cartel.

IX. A Possible Solution Offering a Different Approach

A. Lack of Uniformity in the United States Sales Tax Arena

As the law currently stands there is no uniform system of sales and use tax in place. Each state is free to set their own sales and use tax rates (provided they do not run afoul of existing laws), yet even a single state can have multiple sales tax rates. As mentioned *supra*, there are over 7,500 sales tax jurisdictions in the United States.

Using the State of California as an example, consider the following: The State of California has a base rate of 7.25% for sales tax. A detailed breakdown of the base sales tax is presented in the table below.²⁵²

(Continued on the next page.)

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² See <http://www.boe.ca.gov/news/sp111500att.htm>.

Components of the California Statewide 7.25 percent Sales and Use Tax Rate*

Rate	Jurisdiction	R & T Code
4.75%	State (General Fund)	6051, 6201
0.25%	State (Fiscal Recovery Fund)	6051.5, 6201.5 (Operative 7/1/04)
0.50%	State (Local Revenue Fund)	6051.2, 6201.2
0.25%	State (General Fund)	6051.3, 6201.3 (Inoperative 01/01/01- 12/31/01)
0.50%	State (Local Public Safety Fund)	§35 Art XIII St. Constitution
1.00%	Local (County/City) 0.25% County transportation funds 0.75% City and county operations	7203.1 (Operative 7/1/04)
7.25%	Total Statewide Base Sales/Use Tax	

* The tax rate in your area may be higher than 7.25% depending on the district taxes that apply there.

Next, consider that the State of California has fifty-eight (58) counties, and each county has its own district tax rate with some cities in the county having higher rates than others.²⁵³ And finally, certain purchases and or sales are also subject to a one percent (1%) use tax.²⁵⁴ A seller who meets the nexus requirements in California who shipped goods to the various locations within the state would be liable for knowing and complying with all the different sales tax rates.

As discussed *supra*, sales taxes are used to support the local police, fire and other public service infrastructures. Use taxes are also corollary taxes that are used to level the playing field, so to speak. By imposing a use tax on an otherwise tax-free purchase, the purchase from the out-of-state vendor is no longer at an advantage of a lower price due to no tax.

B. Shortcomings of the Streamlined Sales Tax Initiative

While the Streamlined Sales Tax Project does answer many issues, it does not include all states, is not currently compulsory, nor does it adequately address the issue that sales and use taxes are, in part, for supporting the local infrastructures. Furthermore, it is unconstitutional. Article 1, Section 10.3 of the United States Constitution states “No state shall, without the consent of Congress, . . . enter into any agreement or compact with another state. . .” The Streamlined Sales Tax Project also is in direct opposition to two pivotal US Supreme Court decisions: *National Bellas Hess v. Dept. of Revenue of Ill.*, 386, U.S. 753 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

²⁵³ See <http://www.boe.ca.gov/pdf/pub71.pdf>.

²⁵⁴ See <http://www.boe.ca.gov/pdf/boe531f.pdf>.

C. Proposed Solution

Perhaps it would be best to have a two-tiered approach to sales and use tax. The first tier would be essentially the same as our current system. For sales that take place intrastate (as in a California vendor selling to a California consumer) the only sales and use taxes that would be charged would be those normally charged in the course of a California purchase transaction. For those states that have no sales and use taxes, any intrastate transactions would not be taxed.

The second tier is where the difference would appear. When an interstate transaction is made, it would then be exempted from state sales and use tax—regardless of nexus or not. It would however, be subjected to a Federal sales and use tax. My formula for a fair Federal sales tax would be to average the tax rates of all states and territories (including those without a sales tax).²⁵⁵ A portion of this tax would be apportioned to the various states based on where delivery was made. The remainder of the tax would be applied in much the same way as state sales and use taxes normally are, but at the Federal level and in cyberspace.

By implementing the either/or approach, the consumer would only be subjected to one sales tax; either their state's sales tax or the Federal sales tax, but in no case would they be subject to both. The exception would be to items already subjected to both such as motor fuels *et alia*.

First, it would impose a use tax as a corollary tax thereby leveling the playing field. Again, using California as an example, consider the following situation. The base rate for sales tax in California is 7.25%. The rate can vary depending on where in the state one is located. Under my proposed system, all sales from a California vendor to a California consumer, or delivery in California would be subjected to the applicable California tax. However, if as a consumer in California, one were to order a product from another state, then the California consumer would be subjected to a Federal sales tax, but not a California use tax, and not an out-of-state sales tax.

It should be noted that five states, Alaska, Delaware, Montana (Whitefish, Montana has a city sales tax),²⁵⁶ New Hampshire, and Oregon do not impose general sales taxes at the state level. However, numerous boroughs and cities in Alaska have their own local sales taxes. Furthermore, the other four states impose sales-type taxes on specific transactions, such as lodging accommodations.²⁵⁷ Under my proposed system, residents of these states would have additional incentive, *i. e.* not having to pay a Federal sales tax, by making purchases in-state.

Imposing a Federal sales tax on international transactions would pose many issues as well. Typically, it would be more beneficial for the United States not to charge a sales tax on international sales. This could discourage foreigners from making US purchases. Any loss of

²⁵⁵ Of course this formula could remain very simple or become rather complex. A possible complexity would be weighting the state's sales tax rates in much the same way that electoral votes are weighted in the different states, and then calculating a weighted average.

By averaging, in one fashion or another the sales tax, it would burden the average consumer no more or no less than if they purchased in their own state.

²⁵⁶ Wikipedia, The Free Encyclopedia, List of U.S. States Without Sales Tax, at http://en.wikipedia.org/wiki/List_of_U.S._states_without_sales_tax

²⁵⁷ CCH, Five States Without Sales Tax, at http://www.toolkit.cch.com/pops/P99_07_4000_01.asp.

revenue from not charging sales tax on international purchases would be made up by the collection of income taxes on the profits made from international sales.

While Internet crime is a topic all to its own, it does deserve some mention. The Internet—cyberspace—is really no different from anywhere else. There are all sorts of people and companies—some good, some bad. Yet, there is little effort to enforce laws online.

The Internet is home to many a criminal, tax evader and scam artist. Yet, there is no serious effort to police the Internet. In part, this is due to technological complexities. It is also because there simply does not exist the manpower, nor the budget to undertake such an endeavor. So, while not police services in the typical sense, the funds collected from the Federal tax could be earmarked for just such purposes. This would include combating fraud, child pornography, intellectual property theft, fraud, tax evasion, terrorism, identity theft, denial of service attacks, viruses, as well as other illegal activities that criminals use the Internet for.

By funding police services, as well as other infrastructure support the Internet would be less friendly to criminals, tax evaders, scam artists, terrorists and the like. Some people like the “Wild West” atmosphere of the Internet, but anarchy is a temporary form of governance and sooner or later law and order will be established. Since, the Internet Corporation for Assigned Names and Numbers (ICANN) is US-owned, the Internet is largely governed by the United States. Federal tax dollars used to police the Internet will strengthen the US grasp on the Internet, thereby maintaining control of the Internet under a democratic, free-market system.

Consider the tax revenue agency’s vantage point. From a tax revenue agency’s viewpoint, administration and compliance has been feckless at best. For instance, many large retailers have established separate legal subsidiaries for the express purpose of handling Internet sales. This relieves them from the physical presence test, thereby circumventing a nexus. In a case such as this no sales and use taxes would have to be collected and remitted to the tax authorities.²⁵⁸ Some retailers are anticipating the Streamlined Sales Tax Project and altering their tax collection policies. However, under my proposed system, subsidiary companies will be required to collect the Federal sales tax, just as the parent company would. There would be no circumventing the law by maneuvers such as this. Furthermore, Federal funding via taxation of interstate commerce (and e-commerce) would provide a mechanism that would allow the Internal Revenue Service to aggressively enforce compliance.

X. Other Current Taxes that Affect the Internet

A. An Overview of Telecommunication Taxes

Many consumers are not aware of just how much they pay in taxes for telecommunications, including taxes for online usage. There are many hidden taxes that the consumer either never directly sees, or simply never pays attention to on their telephone bills.

The Federal Excise Tax (FET) appears on both local and long-distance telephone bills. This tax

²⁵⁸ Nolo, *Sales Tax on the Internet: Who Pays It, Who Doesn't*, at <http://www.nolo.com>.

is charged as a set percentage (three percent) regardless of which telephone service provider one uses.²⁵⁹ As benign as a three percent tax on telecommunications may seem, a little background on the Federal Excise Tax may put things into perspective.

The Federal Excise Tax was originally billed as a luxury tax in 1898.²⁶⁰ Incidentally, in 1898 only the wealthiest people in America had telephones,²⁶¹ whereas today it is commonplace—hardly a “luxury” anymore. The Federal Excise Tax was introduced as a “temporary” tax to help finance the Spanish American War.²⁶² The Spanish-American War lasted only six months, but 107 years later American telephone users are still paying this tax.²⁶³

Now that the war is over, the proceeds of the Federal Excise Tax go to the U.S. Treasury as general revenue. The Americans for Tax Reform (ATR) have proposed that this tax is an anachronism and should be repealed immediately before it has an impact on Internet access and e-commerce transactions.²⁶⁴ Furthermore, there have been several attempts to have this tax repealed. In 2000, the House of Representatives passed legislation by 420-2 repealing the tax, while both the House and Senate passed appropriations legislation to repeal the tax in 2000. However, President Bill Clinton vetoed the legislation.²⁶⁵ The Americans for Tax Reform even have a place on their website where you can email a form letter to your elected officials asking that the Federal Excise Tax be repealed.²⁶⁶

While most probably over fifty percent (50%) of the traffic on the public switched telephone is data rather than voice²⁶⁷ it is clear that this tax (and other telecommunication taxes) affect the Internet and e-commerce. Studies have shown the Federal Excise Tax to be the most regressive of all Federal taxes. It is an impediment to Internet growth and will raise the price of Internet access for households and businesses.²⁶⁸ According to a recent study by the Progress & Freedom Foundation, it was estimated that at least 165,000 U.S. households are priced out of the market for high-speed Internet access due to the high telecom taxes with an unreasonable impact on low-income and rural households.²⁶⁹

“The Federal Excise Tax ranks third, behind alcohol and tobacco, as the largest general fund excise tax in the Federal budget. The Federal Excise Tax raised nearly US\$5 billion in

²⁵⁹ IBLS Editorial Associates, *Federal Excise Tax of Telecommunications*, IBLS, at <http://www.ibls.com> (September 27, 2002).

²⁶⁰ Americans for Tax Reform, *Sen. Rick Santorum (R-PA) Introduces Bill to Repeal Spanish-American War Tax*, at <http://www.atr.org/content/html/2005/jun/062805pr-s1321.htm> (June 28, 2005).

²⁶¹ *Id.*

²⁶² *Id.*, *supra* 209.

²⁶³ *Id.*, *supra* 209.

²⁶⁴ *Id.*, *supra* 209.

²⁶⁵ *Id.*, *supra* 210.

²⁶⁶ See http://capwiz.com/atr/mail/oneclick_compose/?alertid=7565276.

²⁶⁷ *Id.*, *supra* 209.

²⁶⁸ *Id.*, *supra* 209.

²⁶⁹ *Id.*, *supra* 209.

1998 Fiscal Year.²⁷⁰ Taking the Federal Excise Tax, state and local taxes together, the average tax rate on telecommunication services in the United States is over eighteen percent (18%).²⁷¹

Another tax that one may easily overlook is the *Ad Valorem* taxation of interstate telecommunications. *Ad Valorem* is Latin meaning “According to Value”. An *Ad Valorem* tax is a levy that is imposed on the value of a property. The most common *Ad Valorem* tax is that imposed by states, counties or cities on real estate. However, *Ad Valorem* taxes can be imposed on personal property.²⁷²

As internet access is highly dependent on the telecommunications backbone, any unnecessary taxes on telecommunications limits access to the Internet, either through higher costs to users, or under-investment in capital expansion in telecommunications infrastructure. Accessible and affordable Internet access for Americans requires a non-discriminatory tax burden on telecommunications service providers.²⁷³

Discriminatory taxes result in rate increases, furthering the digital divide. The poor spend a higher proportion of their incomes on utilities than do wealthier Americans. The discriminatory property taxes on telecommunications are wholly or partially passed on to consumers in the form of higher utility rates. They constitute a regressive tax aimed at the nations’ less fortunate citizens. Discriminatory property taxes increase telephone rates on the poor and exacerbate the digital divide.²⁷⁴

There are two (2) forms of discriminatory property taxes. The first these is the concept of unit valuation.²⁷⁵ Unit valuation taxes the intangible property of telecommunications companies at a higher rate than the same types of assets held by other businesses.²⁷⁶

The second form of discriminatory property tax is when states apply a higher tax rate to the tangible personal property²⁷⁷ held by utility companies than that held by other business taxpayers generally.²⁷⁸

These discriminatory property taxes have a far-reaching impact across the country. Furthermore, much of this tax ultimately is paid by consumers in the form of higher utility rates. This tax, too,

²⁷⁰ *Id, supra* 209.

²⁷¹ *Id, supra* 209.

²⁷² BARRON’S BUSINESS GUIDES DICTIONARY OF ACCOUNTING TERMS 18 (3rd ed. 2000).

²⁷³ IBLS Editorial Associates, *Proposal to Prohibit the Discriminatory Ad Valorem Taxation of Interstate Telecommunications*, IBLS, at <http://www.ibls.com>, (November 03, 2002).

²⁷⁴ *Id.*

²⁷⁵ States that tax telecommunications companies’ intangible property at a higher rate include: Colorado, Kentucky, Louisiana, Michigan, Mississippi, Montana, North Carolina, Nebraska, Oregon, South Carolina, Utah, West Virginia and Wyoming.

²⁷⁶ *Id, supra* 223.

²⁷⁷ States that tax telecommunications companies’ tangible personal property at a higher rate than other business’ property include: Alabama, Arizona, Arkansas, Colorado, Florida, Kansas, Maryland, Mississippi, Missouri, New Mexico, South Dakota, Tennessee, Texas, Virginia and Washington.

²⁷⁸ *Id, supra* 223.

is a regressive tax that hardest affects the nation's poor and thereby exacerbating the digital divide.²⁷⁹

XI. The Internet Tax Freedom Act and Proposed Internet Taxes

A. An Overview of the Internet Tax Freedom Act

The Internet Tax Freedom Act is a critical component to the makeup of taxation of e-commerce. Drafted by Representative Chris Cox and Senator Ron Wyden, this was signed into law by President Bill Clinton on October 21, 1998. This act established a three (3) year moratorium on taxing Internet access services at the state and local levels, as well as a moratorium on multiple and discriminatory taxes on e-commerce. In December 2001, President Bush signed a two (2) year extension on the Internet Tax Freedom Act extending it until 2003. In 2003, the One Hundred Eighth Congress of the United States of America at the Second Session granted a four (4) year extension to the Internet Tax Freedom Act, extending the moratorium until November 01, 2007.²⁸⁰

While the Internet Tax Freedom Act is still in effect this does not mean that there cannot be any new taxes imposed on e-commerce. For example, SEC. 1108. EXCEPTION FOR VOICE SERVICES OVER THE INTERNET, states "Nothing in this Act shall be construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol. This section shall not apply to any services that are incidental to Internet access, such as voice-capable e-mail or instant messaging." Furthermore, the Internet Tax Freedom act is primarily aimed at Internet access and state taxation of e-commerce. Under the Internet Tax Freedom Act, states may still collect sales and use taxes. The title to this act is a bit of a misnomer. The act focuses on new taxes as they apply to Internet access and multiple and discriminatory taxes on e-commerce. This act would not prevent my proposed solution from being implemented.

B. The Federal Porn Tax

The proposed "Internet Safety and Child Protection Act of 2005", also known as the Federal Porn Tax has a two-fold purpose. The first is to impose a twenty-five percent (25%) excise tax on transactions with for-profit adult web sites. The second is to impose rules that will help ensure that these adult websites do business with adults only.²⁸¹

The revenue generated by the imposition of the excise tax on pornographic web sites would be used for the following purposes:

1. To enforce this act;
2. To provide funds to the Office of Juvenile Justice and Delinquency Prevention to ensure

²⁷⁹ *Id, supra* 223.

²⁸⁰ See http://www.senate.gov/member/nv/ensign/general/issle g/legislation/s_150.htm.

²⁸¹ See <http://www.theorator.com/bills109/s1507.html>.

that the congressionally-mandated cyber tip line is fully operational and staffed 24 hours a day;

3. To provide funds to States to support one (1) Internet Crimes Against Children Task Force center per five million (5,000,000) state residents, with each state receiving sufficient funding to support at least one (1) center and no State receiving funding for more than seven (7) centers;
4. To establish a competitive grant process that will award a minimum of fifteen (15) research and development grants for companies and other organizations who work in the technology field to support the research and development into new filtering technologies that will help parents control children's access to inappropriate content via wireless and other emerging technologies;
5. To provide relevant State agencies with funds to support educational training contributing to greater child Internet safety and reductions in sex trafficking and sex crimes against children; and
6. To provide funding to support child Internet safety activities, as well as activities combating sex trafficking and sex crimes against children, on the part of various Federal agencies.

At the time of writing this bill has yet to become law. It was presented before the 109th Congress on July 27, 2005. The following is a list of statistics provided by the bill's author Senator Blanche Lincoln, of Arkansas:²⁸²

1. The online pornography industry generates \$12 billion dollars in annual revenue—roughly equal to the annual revenues of ABC, NBC, and CBS combined;
2. There are 420 million individual pornographic web pages today, up from 14 million in 1998;
3. The largest group of viewers of Internet pornography is youth between 12 -17 years of age;
4. The average age at which a child is first exposed to pornography is 11 years old;
5. Only three percent (3%) of pornographic websites require age verification that goes beyond the honor system;
6. Two-thirds of sites do not even include an adult content warning;
7. Seventy-four percent (74%) of websites display free "teasers" of pornographic images on their homepages and within their websites that require no payment, credit cards, or adequate age verification;

²⁸² See <http://lincoln.senate.gov/pdf/Internetchild.pdf>.

8. Sixty percent (60%) of 15 to 24 year olds either know how to get around blocking software or know someone else who can show them how to get around it;
9. Consumer Reports recently reviewed eleven popular brands of blocking software, and none were found to be one hundred percent (100%) effective. None received an "excellent" rating.
10. Sixty-four (64%) of teens say that they do things online that they wouldn't want their parents to know about.

XII. Conclusion

The Internet is, above all, in a constant state of flux. The Internet Corporation for Assigned Names and Numbers (ICANN) bears much of the administrative duties of the Internet. The Internet Corporation for Assigned Names and Numbers is an internationally organized, non-profit corporation that has responsibility for Internet Protocol (IP) address space allocation, protocol identifier assignment, generic (gTLD) and country code (ccTLD) Top-Level Domain name system management, and root server system management functions. These services were originally performed under U.S. Government contract by the Internet Assigned Numbers Authority (IANA) and other entities. ICANN now performs the IANA function.²⁸³

ICANN is in a constant state of evolution. In 2005, ICAAN approved the “.eu” top-level domain (TLD) into ICANN root files. The creation of the “.eu” TLD is viewed an important step in promoting e-commerce in Europe as well as the European identity and for creating higher visibility of the internal market.²⁸⁴

The TLD “.XXX” has been proposed by ICANN as a virtual red-light district. ICANN feels that this would be very beneficial because it would allow for easier of filtering by parents so that their children cannot access these sites. Furthermore, those using the .XXX TLD would have to abide by rules to stop spamming and malicious scripts. The US Government, however, is less than thrilled with the idea, as are many conservative groups.²⁸⁵ ICANN is currently re-evaluating the .XXX TLD, though the future of .XXX still remains uncertain at this time.

While the Internet is global in scope, its management is not. The United States in 2005 opted to retain control of the infrastructure of “root servers” that drive the Internet, much to the chagrin of the international community. The "root servers" in question — 13 computers located mostly in the United States — are the Internet's master directories. They tell Web browsers and e-mail programs how to direct traffic, and Internet users the world over interact with them every day, though most without knowing it.²⁸⁶ There are growing concerns about security, and the United

²⁸³ See <http://www.icann.org/general/>.

²⁸⁴ Rohde, Laura, *ICANN approval moves .eu domain forward*, at <http://www.computerworld.com/developmenttopics/websitemgmt/story/0,10801,100582,00.html?source=x10>.

²⁸⁵ Farrell, Nick, *ICANN bottles on .xxx*, at <http://www.theinquirer.net/?article=26235>.

²⁸⁶ The Associated Press, *U.S. Plan on Net Computers Draws Mixed Response*, at http://www.usatoday.com/tech/news/2005-07-01-net-control_x.htm.

States Government feels that the Internet is safest under United States control. Opening the Internet to control by outside countries and agencies invites the opportunity for those who do not embrace democratic ideas, religious freedoms, Constitutional protections and a free-market system to stifle the freedoms that the Internet now embraces and endows.

The Internet has seen a tremendous amount of growth in the past decade. Unlike traditional roads that take years to build and expand, the Internet is growing at a dizzying pace. As such, technology has out-paced many laws. Enforcement and compliance of laws is now facing many new challenges that are unique to the Internet and the Information Age.

Tax laws, in particular, are feeling the strain of not being able to enforce compliance. To remedy this situation several states and major retailers have joined together to form the Streamlined Sales Tax Project. Standing in defiance of the US Constitution, as discussed *supra*, as well as two US Supreme Court decisions, also discussed *supra*, the Streamlined Sales Tax Project is continuing full-steam ahead. Only time will tell the outcome. The United States Supreme Court has indicated that Congress should do something about the current sales and use tax situation. Perhaps this will force Congress to do so.

In this paper I have discussed a possible solution to the interstate sales and use tax dilemma. While no solution is one hundred percent effective, my proposal answers many questions that the Streamlined Sales Project does not. The Streamlined Sales Tax Project does not provide any means for supporting the country-wide telecommunications backbone of the Internet. The Streamlined Sales Tax Project does not address the issue of policing the Internet. And, finally, the Streamlined Sales Tax Project is not compliant with the United States Constitution and United States Supreme Court Decisions.

As a member of the Organization for Economic Cooperation and Development (OECD)²⁸⁷, the United States plays an important role in taxation on a world-wide level. What the United States does affects more than just the United States, as we do not stand in isolation. The key to keeping the Internet the dynamic place that it is, is to regulate and police the Internet enough to keep it a civil place while yet retaining the *laissez faire* approach that is so often associated with free markets. The Internet is unique with its potential and world-wide audience. The future will undoubtedly witness numerous changes to our laws, lifestyles and ways of doing business because of the unique and constantly evolving Internet.

²⁸⁷ See <http://www.oecd.org>.

Appendix A
 Quill Corporation v. North Dakota, US Supreme Court Opinion

JUSTICE STEVENS delivered the opinion of the Court.²⁸⁸

*This case, like National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967), involves a State'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. In *Bellas Hess* we held that a similar Illinois statute violated the Due Process Clause of the Fourteenth Amendment and created an unconstitutional burden on interstate commerce. In particular, we ruled that a "seller whose only connection with customers in the State is by common carrier or the United States mail" lacked the requisite minimum contacts with the State. *Id.*, at 758.*

In this case, the Supreme Court of North Dakota declined to follow *Bellas Hess* because "the tremendous social, economic, commercial, and legal innovations" of the past quarter-century have rendered its holding "obsolete." 470 N.W.2d 203, 208 (1991). Having granted certiorari, 502 U.S. 808, we must either reverse the State Supreme Court or overrule *Bellas Hess*. While we agree with much of the state court's reasoning, we take the former course.

I

Quill is a Delaware corporation with offices and warehouses in Illinois, California and Georgia. None of its employees work or reside in North Dakota, and its ownership of tangible property in that State is either insignificant or nonexistent.²⁸⁹ Quill sells office equipment and supplies; it solicits business through catalogs and flyers, advertisements in national periodicals, and telephone calls. Its annual national sales exceed \$200 million, of which almost \$1 million are made to about 3,000 customers in North Dakota. It is the sixth largest vendor of office supplies in the State. It delivers all of its merchandise to its North Dakota customers by mail or common carrier from out-of-state locations.

As corollary to its sales tax, North Dakota imposes a use tax upon property purchased for storage, use or consumption within the State. North Dakota requires every "retailer maintaining a place of business in" the State to collect the tax from the consumer and remit it to the State. N. D. Cent Code §57-40.2-07 (Supp. 1991). In 1987, North Dakota amended the statutory definition of the term "retailer" to include "every person who engages in regular or systematic

²⁸⁸ Quill Corporation, Petitioner v North Dakota by and through its Tax Commissioner, Heidi Heitkamp, 504 U.S. 298; 112 S. Ct. 1904; 119 L. Ed. 2d 91; 1992 U.S. LEXIS 3123; 60 U.S.L.W. 4423; 92 Cal. Daily Op. Service 4458; 92 Daily Journal DAR 7142; 6 Fla. L. Weekly Fed. S 269.

²⁸⁹ In the trial court, the State argued that because Quill gave its customers an unconditional 90-day guarantee, it retained title to the merchandise during the 90-day period after delivery. The trial court held, however that title passed to the purchaser when the merchandise was received. See App. to Pet. for Cert. A40-A41. The State Supreme Court assumed for the purposes of its decision that that ruling was correct. 470 N.W. 2d 203, 217, n. 13 (1991). The State Supreme Court also noted that Quill licensed a computer software program to some of its North Dakota customers that enabled them to check Quill's current inventories and prices and to place orders directly. *Id.*, at 216-217. As we shall explain, Quill's interests in the licensed software does not affect our analysis of the due process issue and does not comprise the "substantial nexus" required by the Commerce Clause. See n. 239, *infra*.

solicitation of a consumer market in the state.” §57-40.2-01(6). State regulations in turn define “regular or systematic solicitation” to mean three or more advertisements within a 12-month period. N. D. Admin. Code § 81-04.1-01-03.1 (1988). Thus, since 1987, mail-order companies that engage in such solicitation have been subject to the tax even if they maintain no property or personnel in North Dakota.

Quill has taken the position that North Dakota does not have the power to compel it to collect a use tax from its North Dakota customers. Consequently, the State, through its Tax Commissioner, filed this action to require Quill to pay taxes (as well as interest and penalties) on all such sales made after July 1, 1987. The trial court ruled in Quill’s favor, finding the case indistinguishable from *Bellas Hess*; specifically, it found that because the State had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no “nexus to allow the state to define retailer in the manner it chose.” App. to Pet. for Cert. A41.

The North Dakota Supreme Court reversed, concluding that “wholesale changes” in both the economy and the law made it inappropriate to follow *Bellas Hess* today. 470 N.W. 2d at 213. The principal economic change noted by the court was the remarkable growth of the mail-order business “from a relatively inconsequential market niche” in 1967 to a “goliath” with annual sales that reached “the staggering figure of \$183.3 billion in 1989.” Id., at 208, 209. Moreover, the court observed, advances in computer technology greatly eased the burden of compliance with a “welter of complicated obligations” imposed by state and local taxing authorities. Id., at 215 (quoting *Bellas Hess*, 386 U.S. at 759-760).

Equally important, in the court’s view, were the changes in the “legal landscape.” With respect to the Commerce Clause, the court emphasized that *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977), rejected the line of cases holding that the direct taxation of interstate commerce was impermissible and adopted instead a “consistent and rational method of inquiry [that focused on] the practical effect of [the] challenged tax.” *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 443, 63 L. Ed. 2d 510, 100 S. Ct. 1223 (1980). This and subsequent rulings, the court maintained, indicated that the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess*.

Similarly, with respect to the Due Process Clause, the North Dakota court observed that cases following *Bellas Hess* had not construed “minimum contacts” to require physical presence within a State as a prerequisite to the legitimate exercise of state power. The state court then concluded that “the Due Process requirement of a ‘minimal connection’ to establish nexus in encompassed within the *Complete Auto* test” and that the relevant inquiry under the latter test was whether “the state has provided some protection, opportunities, or benefit for which it can expect a return.” 470 N.W. 2d at 216.

Turning to the case at hand, the state court emphasized that North Dakota had created “an economic climate that fosters demand for” Quill’s products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and fliers mailed by Quill into the State every year. Id., at 218-219. Based on these facts, the court concluded that Quill’s “economic presence” in North Dakota depended on services and benefits provided by the State

and therefore generated “a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax.” *Id.*, at 219.²⁹⁰

II

As in a number of other cases involving the application of state taxing statutes to out-of-state sellers, our holding in *Bellas Hess* relied on both the Due Process Clause and the Commerce Clause. Although the “two claims are closely related,” *Bellas Hess*, 386 U.S. at 756, the Clauses pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause. See, e.g. *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987).

The two Constitutional requirements differ fundamentally, in several ways. As discussed at greater length below, see Part IV, *infra*, the Due Process Clause and the Commerce Clause reflect different Constitutional concerns. Moreover, while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce, see *International Shoe Co. v. Washington*, 326 U.S. 310, 315, 90 L. Ed. 95, 66 S. Ct. 154 (1945), it does not similarly have the power to authorize violations of the Due Process Clause.

Thus, although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.

“‘Due Process’ and ‘Commerce Clause’ conceptions are not always sharply separable in dealing with these problems. . . . To some extent they overlap. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes ‘undue.’ But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones.” *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 353, 88 L. Ed. 1313, 64 S. Ct. 1019 (1944) (Rutledge, J., concurring in part and dissenting in part).

Heeding Justice Rutledge’s counsel, we consider each Constitutional limit in turn.

²⁹⁰ The court also suggested that, in view of the fact that the “touchstone of Due Process is fundamental fairness” and that the “very object” of the Commerce Clause is protection of interstate business against discriminatory local practices, it would be ironic to exempt Quill from this burden and thereby allow it to enjoy a significant competitive advantage over local retailers. 470 N.W. 2d at 214-215.

III

The Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-345, 98 L. Ed. 744, 74 S. Ct. 535 (1954), and that the “income attributed to the State for tax purposes must be rationally related to ‘values connected with the taxing State,’” Moorman Mfg. Co. v. Blair, 437 U.S. 267, 273, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978) (citation omitted). Here, we are concerned primarily with the first of these requirements. Prior to *Bellas Hess*, we had held that requirement was satisfied in a variety of circumstances involving use taxes. For example, the presence of sales personnel in the State²⁹¹ or the maintenance of local retail stores in the State²⁹² justified the exercise of that power because of the seller’s local activities were “plainly accorded the protection and services of the taxing State.” Bellas Hess, 386 U.S. at 757. The furthest extension of that power was recognized in Scripto, Inc. v. Carson, 362 U.S. 207, 4 L. Ed. 2d 660, 80 S. Ct. 619 (1960), in which the Court upheld a use tax despite the fact that all of the seller’s in-state solicitation was performed by independent contractors. These cases all involved some sort of physical presence within the State, and in *Bellas Hess* the Court suggested that such presence was not only sufficient for jurisdiction under the Due Process Clause, but also necessary. We expressly decline to obliterate the “sharp distinction. . . between mail-order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as a part of a general interstate business.” 386 U.S. at 758.

Our due process jurisprudence has evolved substantially in the 25 years since *Bellas Hess*, particularly in the area of judicial jurisdiction. Building on the seminal case of International Shoe Co. v. Washington, 326 U.S. 310, 90 L. Ed. 95, 66 S. Ct. 154 (1945), we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction “such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice.’” Id., at 316 (quoting Milliken v. Meyer, 311 U.S. 457, 463, 85 L. Ed. 278, 61 S. Ct. 339 (1940)). In that spirit, we have abandoned more formalistic tests that focused on a defendant’s “presence” within a State in favor of a more flexible inquiry into whether a defendant’s contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State. In Shaffer v. Heitner, 433 U.S. 186, 212, 53 L. Ed. 2d 683, 97 S. Ct. 2569 (1977), the Court extended the flexible approach that *International Shoe* had prescribed for purposes of *in personam* jurisdiction to *in rem* jurisdiction, concluding that “all assertions of state-court jurisdiction must be evaluated according to the standards set forth in *International Shoe* and its progeny.”

Applying these principles, we have held that if a foreign corporation purposefully avails itself to the benefits of an economic market in the forum State, it may subject itself to the State’s *in personam* jurisdiction even if it has no physical presence in the State. As we explained in Burger King Corp. v. Rudzewicz, 471 U.S. 462, 85 L. Ed. 2d 528, 105 S. Ct. 2174 (1985):

“Jurisdiction in these circumstances may not be avoided merely because the defendant did not *physically* enter the forum State. Although territorial presence frequently will enhance a

²⁹¹ Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62, 83 L. Ed. 488, 59 S. Ct. 376 (1939).

²⁹² Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 85 L. Ed. 888, 61 S. Ct. 586 (1941).

potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' towards residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there." *Id.*, at 476 (emphasis in original).

Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has "fair warning [its] activity may subject [it] to the jurisdiction of a foreign sovereign." *Shaffer v. Heitner*, 433 U.S. at 218 (STEVENSON, J. concurring in judgment). In "modern commercial life" it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.

In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

IV

Article I, § 8, cl. 3, of the Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." It says nothing about the protection of interstate commerce in the absence of any action by Congress. Nevertheless, as Justice Johnson suggested in his concurring opinion in *Gibbons v. Ogden*, 22 U.S. 1, 9 Wheat. 1, 231-232, 6 L. Ed. 23 (1824), the Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well. The Clause, in Justice Stone's paraphrasing, "by its own force" prohibits certain state actions that interfere with interstate commerce. *South Carolina State Highway Dept. v. Barnwell Brothers, Inc.*, 303 U.S. 177, 185, 82 L. Ed. 734, 58 S. Ct. 510 (1938).

Our interpretation of the "negative" or "dormant" Commerce Clause has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers. See generally P. Hartman, *Federal Limitations on State and Local Taxation* §§ 2:9-2:17 (1981). Our early cases, beginning with *Brown v. Maryland*, 25 U.S. 419, 12 Wheat. 419, 6 L. Ed. 678 (1827), swept broadly, as in *Leloup v. Port of Mobile*, 127 U.S. 640, 648, 32 L. Ed. 311, 8 S. Ct. 1380 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. See *e.g.*, *Sanford v. Poe*, 69 F. 546 (CA6 1895), *aff'd sub nom. Adams Express Co. v. Ohio State Auditor*,

165 U.S. 194, 220, 41 L. Ed. 683, 17 S. Ct. 305 (1897). Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256-258, 58 S. Ct. 546, 82 L. Ed. 823 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a “multiple-taxation doctrine” that focused not on whether a tax was “direct” or “indirect” but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in Freeman v. Hewit, 329 U.S. 249, 256, 91 L. Ed. 265, 67 S. Ct. 274 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana’s imposition of a gross receipts tax on a particular transaction because that application would “impose a direct tax on interstate sales.” Most recently, in Complete Auto Transit, Inc. v. Brady, 430 U.S. at 285, we renounced the *Freeman* approach as “attaching constitutional significance to a semantic difference.” We expressly overruled one of *Freeman*’s progeny, Spector Motor Service, Inc. v. O’Connor, 340 U.S. 602, 95 L. Ed. 573, 71 S. Ct. 508 (1951), which held that a tax on “the privilege of doing interstate business” was unconstitutional, while recognizing that a differently denominated tax with the same economic effect would not be unconstitutional. *Spector*, as we observed in Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441, 3 L. Ed. 2d 450, 79 S. Ct. 411 (1959), created a situation in which “magic words or labels” could “disable an otherwise constitutional levy.” *Complete Auto* emphasized the importance of looking past “the formal language of the tax statute [to] its practical effect,” 430 U.S. at 279, and set forth a four-part test that continues to govern the validity of state taxes under the Commerce Clause.²⁹³

Bellas Hess was decided in 1967, in the middle of this latest rally between formalism and pragmatism. Contrary to the suggestion of the North Dakota Supreme Court, this timing does not mean that *Complete Auto* rendered *Bellas Hess* “obsolete.” *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.” 430 U.S. at 281. *Bellas Hess* did not rely on any such labeling of taxes and therefore did not automatically fall with *Freeman* and its progeny.

While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases. Under *Complete Auto*’s four-part test, we will sustain a tax against a Commerce Clause challenge so long as 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.” *Bellas Hess* concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the “substantial nexus” required by the Commerce Clause.

Thus, three weeks after *Complete Auto* was handed down we cited *Bellas Hess* for this proposition and discussed the case at some length. In National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 559, 51 L. Ed. 2d 631, 97 S. Ct. 1386 (1977), we affirmed the continuing vitality of *Bellas Hess*’ “sharp distinction. . .between mail-order sellers with [a

²⁹³ Under our current Commerce Clause jurisprudence, “with certain restrictions, interstate commerce may be required to pay its fair share of state taxes. D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31, 100 L. Ed. 2d 21, 108 S. Ct. 1619 (1988); see also Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-624, 69 L. Ed. 884, 101 S. Ct. 2946 (1981) (“It was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of [the] State tax burden even though it increases the cost of doing business”) (internal quotation marks and citation omitted).

physical presence in the taxing] State and those. . .who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.” We have continued to cite *Bellas Hess* with approval ever since. For example, in *Goldberg v. Sweet*, 488 U.S. 252, 263, 102 L. Ed. 2d 607, 109 S. Ct. 582 (1989), we expressed “doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. See *National Bellas Hess*. . .(receipt of mail provides insufficient nexus).” See also *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 33, 100 L. Ed. 2d 21, 108 S. Ct. 1619 (1988); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981); *Mobil Oil Corp v. Commissioner of Taxes*, 445 U.S. at 437; *National Geographic Society*, 430. U.S. at 559. For these reasons, we disagree with the State Supreme Court’s conclusion that our decision in *Complete Auto* undercut the *Bellas Hess* rule.

The State of North Dakota relies less on *Complete Auto* and more on the evolution of our due process jurisprudence. The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process “minimum contacts” test, then that corporation also meets the Commerce Clause “substantial nexus” test. We disagree. Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different Constitutional concerns and policies.

Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual’s connections with a State are substantial enough to legitimate the State’s exercise of power over him. We have, therefore, often identified “notice” or “fair warning” as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. See generally *The Federalist* Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce, see, e.g., *Philadelphia v. New Jersey*, 437 U.S. 617, 57 L. Ed. 2d 475, 98 S. Ct. 2531 (1978), and bars state regulations that unduly burden interstate commerce, see e.g., *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662, 67 L. Ed. 2d 580, 101 S. Ct. 1309 (1981).

The Complete Auto analysis reflects these concerns about the national economy. The second and third parts of that analysis, which require fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.²⁹⁴ Thus, the “substantial nexus” requirement is not, like due

²⁹⁴ North Dakota’s use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine,

process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause.²⁹⁵

State Supreme Court reviewed our recent Commerce Clause decisions and concluded that those rulings signaled a "retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach" and thus supported its decision not to apply *Bellas Hess*. 470 N.W.2d at 214 (citing *Standard Pressed Steel Co. v. Department of Revenue of Wash.*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975), and *Tyler Pipe Industries, Inc v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987)). Although we agree with the state court's assessment of the evolution of our cases, we do not share its conclusion that this evolution indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law.

First, as the state court itself noted, 470 N.W.2d at 214, all of these cases involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* or compel that it be overruled. Second, and more importantly, although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established "bright-line" tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.

Complete Auto, it is true, renounced *Freeman* and its progeny as "formalistic." But not all formalism is alike. *Spector's* formal distinction between taxes on the "privilege of doing business" and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood "only as a trap for the unwary draftsman." *Complete Auto*, 430 U.S. at 279. In contrast, the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the

a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions. See *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 759-760, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967) (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations") (footnotes omitted); see also Shaviro, An Economic and Political Look at Federalism in Taxation, 90 Mich. L. Rev. 895, 925-926 (1992).

²⁹⁵ We have sometimes stated that the "*Complete Auto* test, while responsive to Commerce Clause dictates, encompasses as well . . . due process requirement[s]." *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 373, 112 L. Ed. 2d 884, 111 S. Ct. 818 (1991). Although such comments might suggest that every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause, it does not follow that the converse is as well true: A tax may be consistent with due process and yet unduly burden interstate commerce. See, e.g., *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987).

demarcation of a discrete realm of commercial activity that is free from interstate taxation. *Bellas Hess* followed the latter approach and created a safe harbor for vendors "whose only connection with customers in the [taxing] State is by common carrier or the United States mail." Under *Bellas Hess*, such vendors are free from state-imposed duties to collect sales and use taxes.²⁹⁶

Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office. Cf. *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 51 L. Ed. 2d 631, 97 S. Ct. 1386 (1977); *Scripto, Inc. v. Carson*, 362 U.S. 207, 4 L. Ed. 660, 80 S. Ct. 619 (1960). This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit is important, for as we have so frequently noted, our law in this area is something of a "quagmire" and the "application of Constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-458, 3 L. Ed. 2d 421, 79 S. Ct. 357 (1959).

Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals.²⁹⁷ Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.

Notwithstanding the benefits of bright-line tests, we have, in some situations, decided to replace such tests with more contextual balancing inquiries. For example, in *Arkansas Electric Cooperative v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 76 L. Ed. 2d 1, 103 S. Ct. 1905 (1983), we reconsidered a bright-line test set forth in *Public Util. Comm'n of R.I. v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 71 L. Ed. 549, 47 S. Ct. 294 (1927). *Attleboro* distinguished

²⁹⁶ In addition to its common-carrier contracts with the State, Quill also licensed software to some of its North Dakota clients. See n. 232, *supra*. The State "concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus." Brief for Respondent 46. We agree. Although title to "a few floppy diskettes" present in a State might constitute some minimal nexus, in *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 556, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977), we expressly rejected a "'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.

²⁹⁷ It is worth noting that Congress, has at least on one occasion, followed a similar approach in its regulation of state taxation. In response to this Court's indication in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 452, 3 L. Ed. 2d 421, 79 S. Ct. 357 (1959), that, so long as the taxpayer has an adequate nexus with the taxing State, "net income from the interstate operations of a foreign corporation may be subjected to state taxation," Congress enacted Pub. L. 86-272, codified at 15 U.S.C. § 381. That statute provides that a State may not impose a net income tax on any person if that person's "only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled. . . outside the State." *Ibid.* As we noted in *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275, 280, 34 L. Ed. 2d 472, 93 S. Ct. 483 (1972), in enacting § 381, "Congress attempted to allay the apprehension of businessmen that 'mere solicitation' would subject them to state taxation. . . Section 381 was designed to define clearly a lower limit for the exercise of [the State's power to tax]. Clarity that would remove uncertainty was Congress' primary goal." (Emphasis supplied.)

between state regulation of wholesale sales of electricity, which was constitutional as an “indirect” regulation of interstate commerce, and state regulation of retail sales of electricity, which was unconstitutional as a “direct regulation” of commerce. In *Arkansas Electric*, we considered whether to “follow the mechanical test set out in *Attleboro*, or the balance-of-interests test applied in our Commerce Clause cases.” 461 U.S. at 390-391. We first observed that “the principle of *stare decisis* counsels us, here as elsewhere, not lightly to set aside specific guidance of the sort we find in *Attleboro*.” *Id.*, at 391. In deciding to reject the *Attleboro* analysis, we were influenced by the fact that the “mechanical test” was “anachronistic,” that the Court had rarely relied on the test, and that we could “see no strong reliance interests” that would be upset by the rejection of that test. 461 U.S. at 391-392. None of those factors obtains in this case. First, the *Attleboro* rule was “anachronistic” because it relied on formal distinctions between “direct” and “indirect” regulation (and on the regulatory counterparts of our *Freeman* line of cases); as discussed above, *Bellas Hess* turned on a different logic and thus remained sound after the Court repudiated an analogous distinction in *Complete Auto*. Second, unlike the *Attleboro* rule, we have, in our decisions, frequently relied on the *Bellas Hess* rule in the last 25 years, see *supra*, at 311, and we have never intimated in our review of sales or use taxes that *Bellas Hess* was unsound. Finally, again unlike the *Attleboro* rule, the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry. The “interest in stability and orderly development of the law” that undergirds the doctrine of *stare decisis*, see *Runyon v. McCrary*, 427 U.S. 160, 190-191, 49 L. Ed. 2d 415, 96 S. Ct. 2586 (1976) (STEVENS, J., concurring), therefore counsels adherence to settled precedent.

In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law. For these reasons, we disagree with the North Dakota Supreme Court’s conclusion that the time has come to renounce the bright-line test of *Bellas Hess*.

This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve,²⁹⁸ but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. See *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 90 L. Ed. 1342, 66 S. Ct. 1142 (1946). Indeed, in recent years Congress has considered legislation that would “overrule” the *Bellas Hess* rule.²⁹⁹ Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *Bellas Hess* that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly, Congress is now free to decide whether, when,

²⁹⁸ Many States have enacted use taxes. See App. 3 to Brief for Direct Marketing Association as *Amicus Curiae*. An overruling of *Bellas Hess* might raise thorny questions concerning the retroactive application of those taxes and might trigger substantial unanticipated liability for mail-order houses. The precise allocation of such burdens is better resolved by Congress rather than this Court.

²⁹⁹ See, e. g. H. R. 2230, 101st Cong., 1st Sess. (1989); S. 480, 101st Cong., 1st Sess. (1989); S. 2368, 100th Cong., 2d Sess. (1988); H. R. 3521, 100th Cong., 1st Sess. (1987); S. 1099, 100th Congress., 1st Sess. (1987); H. R. 3549, 99th Cong., 1st Sess. (1985); S. 983, 96th Cong. 1st Sess. (1979); S. 282, 93d Cong., 1st Sess. (1973).

and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.

Indeed, even if we were convinced that *Bellas Hess* was inconsistent with our Commerce Clause jurisprudence, “this very fact [might] giv[e us] pause and counsel withholding our hand, at least for now. Congress has the power to protect interstate commerce from intolerable or even undesirable burdens.” *Commonwealth Edison Co. v. Montana*, 453 U.S. at 637 (WHITE, J., concurring). In this situation, it may be that “the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.” *Id.*, at 638.

The judgment of the Supreme Court of North Dakota is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

CONCUR BY: SCALIA (In Part); WHITE (In Part)

CONCUR: JUSTICE SCALIA, with whom JUSTICE KENNEDY and JUSTICE THOMAS join, concurring in part and concurring in the judgment.

National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967), held that the Due Process and Commerce Clauses of the Constitution prohibit a State from imposing the duty of a use-tax collection and payment upon a seller whose only connection with the State is through common carrier or the United States mail. I agree with the Court that the Due Process Clause holding of *Bellas Hess* should be overruled. Even before *Bellas Hess*, we had held, correctly I think, that state regulatory jurisdiction could be asserted on the basis of contacts with the State through the United States mail. See *Travelers Health Assn. v. Virginia ex rel. State Corp. Comm’n*, 339 U.S. 643, 646-650, 94 L. Ed. 1154, 70 S. Ct. 927 (1950) (blue sky laws). It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax. As an original matter, it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected that. *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 558, 51 L. Ed. 2d 631, 97 S. Ct. 1386 (1977); *Scripto, Inc. v. Carson*, 362 U.S. 207, 211, 4 L. Ed. 2d 660, 80 S. Ct. 619 (1960). I agree with the Court, moreover, that abandonment of *Bellas Hess*’ due process holding is compelled by reasoning “comparable” to that contained in our post-1967 cases dealing with state jurisdiction to adjudicate. *Ante*. I do not understand this to mean that the due process standards for adjudicative jurisdiction and those for legislative (or prescriptive) jurisdiction are necessarily identical; and on that basis I join Parts I, II, and III of the Court’s opinion. Compare *Asahi Metal Industry Co. v. Superior Court of Cal., Solano Cty.*, 480 U.S. 102, 94 L. Ed. 2d 92, 107 S. Ct. 1026 (1987), with *American Oil Co. v. Neill*, 380 U.S. 451, 14 L. Ed. 2d 1, 85 S. Ct. 1130 (1965).

I also agree that the Commerce Clause holding of *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*. *American Trucking Assns., Inc. v. Smith*, 496 U.S. 167, 204, 110 L. Ed. 2d

148, 110 S. Ct. 2323 (1990) (SCALIA, J., concurring in Judgment). Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so. We have long recognized that the doctrine of *stare decisis* has “special force” where “Congress remains free to alter what we have done.” *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-173, 105 L. Ed. 2d 132, 109 S. Ct. 2363 (1989). See also *Hilton v. South Carolina Public Railways Comm’n*, 502, U.S. 197, 202, 116 L. Ed. 2d 560, 112 S. Ct. 660 (1991); *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736, 52 L. Ed. 2d 707, 97 S. Ct. 2061 (1977). Moreover, the demands of the doctrine are “at their acme. . . where reliance interest are involved.” *Payne v. Tennessee*, 501, U.S. 808, 828, 115 L. Ed. 2d 720, 111 S. Ct. 2597 (1991). As the Court notes, “the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry.” *Ante*.

I do not share JUSTICE WHITE’s view that we may disregard these reliance interests because it has become unreasonable to rely upon *Bellas Hess*. *Post*, at 331-332. Even assuming for the sake of argument (I do not consider the point) that later decisions in related areas are inconsistent with the principles upon which *Bellas Hess* rested, we have never acknowledged that, but have instead carefully distinguished the case on its facts. See, e. g. *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 33, 100 L. Ed. 2d 21, 108 S. Ct. 1619 (1988); *National Geographic Society, supra*. It seems to me important that we retain our ability—and, what comes to the same thing, that we maintain public confidence in our ability—sometimes to adopt new principles for the resolution of new issues without abandoning clear holdings of the past that those principles contradict. We seemed to be doing that in this area. Having affirmatively suggested that the “physical presence” rule could not be reconciled with our new jurisprudence, we ought not visit economic hardship upon those who took us at our word. We have recently told lower courts that “if a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.” *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484, 104 L. Ed. 2d 526, 109 S. Ct. 1917 (1989). It is strangely incompatible with this to demand that private parties anticipate our over-rulings. It is my view, in short, that reliance upon a square, unabandoned holding of the Supreme Court is *always* justifiable reliance (though reliance alone may not always carry the day). Finally, the “physical presence” rule established in *Bellas Hess* is not “unworkable,” *Patterson, supra*; to the contrary, whatever else may be the substantive pros and cons of the rule, the “bright-line” regime that it establishes, see *ante*, is unqualified in its favor. JUSTICE WHITE’s concern that reaffirmance of *Bellas Hess* will lead to a flurry of litigation over the meaning of “physical presence,” see *post*, seems to me contradicted by 25 years of experience under the decision.

For these reasons, I concur in the judgment of the Court and join Parts I, II and II of its opinion.

DISSENT BY: WHITE (In Part)

DISSENT: JUSTICE WHITE, concurring in part and dissenting in part.

Today the Court repudiates that aspect of our decision in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967), which restricts, under the Due Process Clause of the Fourteenth Amendment, the power of the States to

impose use tax collection responsibilities on out-of-state mail-order businesses that do not have a “physical presence” in the State. The Court stops short, however, of giving *Bellas Hess* the complete burial it justly deserves. In my view, the Court should also overrule that part of *Bellas Hess* which justifies its holding under the Commerce Clause. I, therefore, respectfully dissent from Part IV.

I

In Part IV of its opinion, the majority goes to some lengths to justify the *Bellas Hess* physical-presence requirement under our Commerce Clause jurisprudence. I am unpersuaded by its interpretation of our cases. In *Bellas Hess*, the majority placed great weight on the interstate quality of the mail-order sales, stating that “it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail-order transactions here involved.” *Id.* As the majority correctly observes, the idea of prohibiting States from taxing “exclusively interstate” transactions had been an important part of our jurisprudence for many decades, ranging intermittently from such cases as *Case of State Freight Tax*, 82 U.S. 232, 15 Wall. 232, 279, 21 L. Ed. 146 (1873), through *Freeman v. Hewit*, 329 U.S. 249, 256, 91 L. Ed. 265, 67 S. Ct. 274 (1946), and *Spector Motor Service, Inc. v. O’Connor*, 340 U.S. 602, 95 L. Ed. 573, 71 S. Ct. 508 (1951). But though it recognizes that *Bellas Hess* was decided amidst an upheaval in our Commerce Clause jurisprudence, in which we began to hold that “a State, with proper drafting, may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause,” *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 285, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977), the majority draws entirely the wrong conclusion from this period of ferment.

The Court attempts to paint *Bellas Hess* in a different hue from *Freeman* and *Spector* because the former “did not rely” on labeling taxes that had “direct” and “indirect” effects on interstate commerce. See *ante*. Thus, the Court concludes, *Bellas Hess* “did not automatically fall with *Freeman* and its progeny” in our decision in *Complete Auto*. See *ante*. I am unpersuaded by this attempt to distinguish *Bellas Hess* from *Freeman* and *Spector*, both of which were repudiated by this Court. See *Complete Auto, supra*. What we disavowed in *Complete Auto* was not just the “formal distinction between ‘direct’ and ‘indirect’ taxes on interstate commerce,” *ante*, but also the whole notion of underlying the *Bellas Hess* physical-presence rule – that “interstate commerce is immune from state taxation,” *Complete Auto, supra*.

The Court compounds its misreading by attempting to show that *Bellas Hess* “is not inconsistent with *Complete Auto* and our recent cases.” *Ante*. This will be news to commentators, who have rightly criticized *Bellas Hess*.³⁰⁰ Indeed, the majority displays no small amount of audacity in claiming that our decision in *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 559, 51 L. Ed. 2d 631, 97 S. Ct. 1386 (1977), which was rendered several weeks after *Complete Auto*, reaffirmed the continuing vitality of *Bellas Hess*. See *ante*.

³⁰⁰ See, e. g., P. Hartman, Federal Limitations on State and Local Taxation § 10.8 (1981); Hartman, Collection of Use Tax on Out-of-State Mail-Order Sales, 39 Vand. L. Rev. 993, 1006-1015 (1986); Hellerstein, Significant Sales and Use Tax Developments During the Past Half Century, 39 Vand. L. Rev. 961, 984-9865 (1986); McCray, Overturning *Bellas Hess*: Due Process Considerations, 1985 B. Y. U. L. Rev. [165, 288-290; Rothfeld, Mail Order Sales and State Jurisdiction to Tax, 53 Tax Notes 1405, 1414-1418 (1991).

Our decision in that case did just the opposite. *National Geographic* held that the National Geographic Society was liable for use tax collection responsibilities in California. The Society conducted an out-of-state mail-order business similar to the one at issue here and in *Bellas Hess*, and in addition, maintained two small offices in California that solicited advertisements for National Geographic Magazine. The Society argued that its physical presence in California was unrelated to its mail-order sales, and thus that the *Bellas Hess* rule compelled us to hold that the tax collection responsibilities could not be imposed. We expressly rejected that view, holding that the “requisite nexus for requiring an out-of-state seller [the Society] to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller’s activities carried on within the State, but simply whether the facts demonstrate ‘some definite link, some minimum connection, between (the State and) the person. . .it seeks to tax.’” 430 U.S. at 651 (citation omitted).

By decoupling any notion of a *transactional* nexus from the inquiry, the *National Geographic* Court in fact repudiated the free trade rationale of the *Bellas Hess* majority. Instead, the *National Geographic* Court relied on a due process-type minimum contacts analysis that examined whether a link existed between the seller and the State wholly apart from the seller’s in-state transaction that was being taxed. Citations to *Bellas Hess* notwithstanding, see 430 U.S. at 559, it is clear that rather than adopting the rationale of the *Bellas Hess*, the *National Geographic* Court was instead politely brushing it aside. Even were I to agree that the free trade rationale embodied in *Bellas Hess*’ rule against taxes of purely interstate sales was required by our cases prior to 1967, therefore, I see no basis in the majority’s opening premise that this substantive underpinning of *Bellas Hess* has not since been disavowed by our cases.³⁰¹

II

The Court next launches into an uncharted and treacherous foray into differentiating between the “nexus” requirements under the Due Process and Commerce Clauses. As the Court explains: “Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies.” *Ante*. The due process nexus, which the Court properly holds is met in this case, see *ante*, at Part III, “concerns the fundamental fairness of governmental activity.” *Ante*. The Commerce Clause nexus requirement, on the other hand, is “informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.” *Ibid*.

Citing *Complete Auto*, the Court then explains that the Commerce Clause nexus requirement is

³⁰¹ Similarly, I am unconvinced by the majority’s reliance on subsequent decisions that have cited *Bellas Hess*. See *ante*. In *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 33, 100 L. Ed. 2d 21, 108 S. Ct. 1619 (1988), for example, we distinguished *Bellas Hess* on the basis of the company’s “significant economic presence in Louisiana, its many connections with the State, and the direct benefits it receives from Louisiana in conducting its business.” We then went on to note that the situation presented was much more analogous to that in *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 51 L. Ed. 2d 631 97 S. Ct. 1386 (1977). See 486 U.S. at 33-34. In *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981), the Court cited *Bellas Hess* not to revalidate the physical-presence requirement, but rather to establish that a “nexus” must exist to justify imposition of a state tax. And finally, in *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 437, 63 L. Ed. 2d 510, 100 S. Ct. 1223 (1980), the Court cited *Bellas Hess* for the due process requirements necessary to sustain a tax. In my view, these citations hardly signal the continuing support of *Bellas Hess* that the majority seems to find persuasive.

not “like ‘due process’ ‘minimum contacts’ requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.” *Ante*. This is very curious, because parts two and three of the *Complete Auto* test, which require fair apportionment and nondiscrimination in order that interstate commerce not be unduly burdened, now appear to become the animating features of the nexus requirement, which is the first prong of the *Complete Auto* inquiry. The Court freely acknowledges that there is no authority for this novel interpretation of our cases and that we have never before found, as we do in this case, sufficient contacts for due process purposes but an insufficient nexus under the Commerce Clause. See *ante*.

The majority’s attempt to disavow language in our opinions acknowledging the presence of due process requirements in the *Complete Auto* test is also unpersuasive. See *ante*, (citing *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 373, 112 L. Ed. 2d 884, 111 S. Ct. 818 (1991)). Instead of explaining the doctrinal origins of the Commerce Clause nexus requirement, the majority breezily announces the rule and moves on to other matters. See *ante*. In my view, before resting on the assertion that the Constitution mandates inquiry into two readily distinct “nexus” requirements, it would seem prudent to discern the origins of the “nexus” requirement in order to better understand whether the Court’s concern traditionally has been with the fairness of a State’s tax or some other value.

The cases from which the *Complete Auto* Court derived the nexus requirement in its four-part test convince me that the issue of “nexus” is really a due process fairness inquiry. In explaining the sources of the four-part inquiry in *Complete Auto*, the Court relied heavily on Justice Rutledge’s separate concurring opinion in *Freeman v. Hewitt*, 329 U.S. 249, 91 L. Ed. 265, 67 S. Ct. 274 (1946), the case whose majority opinion the *Complete Auto* Court was in the process of comprehensively disavowing. Instead of the formalistic inquiry into whether the State was taxing interstate commerce, the *Complete Auto* Court adopted the more functionalist approach of Justice Rutledge in *Freeman*. See *Complete Auto*, 430 U.S. at 280-281. In conducting this inquiry, Justice Rutledge used language that by now should be familiar, arguing that a tax was unconstitutional if the activity lacked sufficient connection to the State to give ‘jurisdiction to tax,’ *Freeman, supra*; or if the tax discriminated against interstate commerce; or if the activity was subjected to multiple tax burdens. 329 U.S. at 276-277. Justice Rutledge later refined these principles in *Memphis Natural Gas Co. v. Stone*, 335 U.S. 80, 92 L. Ed. 1832, 68 S. Ct. 1475 (1948), in which he described the principles that the *Complete Auto Court* would later subsequently adopt: “It is enough for me to sustain the tax imposed in this case that it is one clearly within the state’s power to lay insofar as any limitation of due process or ‘jurisdiction to tax’ in that sense is concerned; it is nondiscriminatory. . . ; [it] is duly apportioned. . . ; and cannot be repeated by any other state.” 335 U.S. at 96-97 (concurring opinion) (footnotes omitted).

By the time the Court decided *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 3 L. Ed. 2d 421, 79 S. Ct. 357 (1959), Justice Rutledge was no longer on the Court, but his view of the nexus requirement as grounded in the Due Process Clause was decisively adopted. In rejecting challenges to a state tax based on the Due Process and Commerce Clauses, the Court stated: “The taxes imposed are levied only on that portion of the taxpayer’s net income which arises from its activities within the taxing State. These activities form a sufficient ‘nexus’ between such a tax and transactions within a state for which the tax is an exaction.” *Id.* (citation omitted). The Court went on to observe that “it strains reality to say, in terms of our decisions,

that each of the corporations here was not sufficiently involved in local events to forge ‘some definite link, some minimum connection’ sufficient to satisfy due process requirements.” *Id.* (quoting *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345, 98 L. Ed. 744, 74 S. Ct. 535 (1954)). When the Court announced its four-part synthesis in *Complete Auto*, the nexus requirement was definitely traceable to concerns grounded in the Due Process Clause, and not the Commerce Clause, as the Court’s discussion of the doctrinal antecedents for its rule made clear. See *Complete Auto, supra*. For the Court now to assert that our Commerce Clause jurisprudence supports a separate notion of nexus is without precedent or explanation. Even were there to be such an independent requirement under the Commerce Clause, there is no relationship between the physical-presence/nexus rule the Court retains and Commerce Clause considerations that allegedly justify it. Perhaps long ago a seller’s “physical presence” was a sufficient part of a trade to condition imposition of a tax on such presence. But in today’s economy, physical presence frequently has very little to do with a transaction a State might seek to tax. Wire transfers of money involving billions of dollars occur every day; purchasers place orders with sellers by fax, phone, and computer linkup; sellers ship goods by air, road, and sea through sundry delivery services without leaving their place of business. It is certainly true that the days of door-to-door salesperson are gone. Nevertheless, an out-of-state direct marketer derives numerous commercial benefits from the State in which it does business. These advantages include laws establishing sound local banking institutions to support credit transactions; courts to ensure collection of the purchase price from the seller’s customers; means of waste disposal from garbage generated by mail-order solicitations; and creation and enforcement of consumer protection laws, which protect buyers and sellers alike, the former by ensuring that they will have a ready means of protecting against fraud, and the latter by creating a climate of consumer confidence that inures to the benefit of reputable dealers in mail-order transactions. To create, for the first time, a nexus requirement under the Commerce Clause independent of that established for due process purposes is one thing; to attempt to justify an anachronistic notion of physical presence in economic terms is quite another.

III

The illogic of retaining the physical-presence requirement in these circumstances is palpable. Under the majority’s analysis, and our decision in *National Geographic*, an out-of-state seller with one salesperson in a State would be subject to use tax collection burdens on its entire mail-order sales even if those sales were unrelated to the salesperson’s solicitation efforts. By contrast, an out-of-state seller in a neighboring State could be the dominant business in the putative taxing State, creating the greatest infrastructure burdens and undercutting the State’s home companies by its comparative price advantage in selling products free of use taxes, and yet not have to collect such taxes if it lacks a physical presence in the taxing State. The majority clings to the physical-presence rule not because of any logical relation to fairness or any economic rationale related to principles underlying the Commerce Clause, but simply out of the supposed convenience of having a bright-line rule. I am less impressed by the convenience of such adherence than the unfairness it produces. Here, convenience should give way. Cf. *Complete Auto, supra* (“We believe, however, that administrative convenience. . .is insufficient justification for abandoning the principle that ‘interstate commerce may be made to pay its way’”).

Also very questionable is the rationality of perpetuating a rule that creates an interstate tax shelter for one for of business—mail-order sellers—but no countervailing advantage for its competitors. If the Commerce Clause was intended to put businesses on an even playing field, the majority’s rule is hardly a way to achieve that goal. Indeed, arguably even under the majority’s explanation for its “Commerce Clause nexus” requirement, the unfairness of its rule on retailers other than direct marketers should be taken into account. See *ante*, (stating that the Commerce Clause nexus requirement addresses the “structural concerns about the effects of state regulation on the national economy”). I would think that protectionist rules favoring a \$180 billion-a-year industry might come within the scope of such “structural concerns.” See Brief for State of New Jersey as *Amicus Curiae* 4.

IV

The Court attempts to justify what it rightly acknowledges is an “artificial” rule in several ways. See *ante*. First, it asserts that the *Bellas Hess* principle “firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes.” *Ante*. It is very doubtful, however, that the Court’s opinion can achieve its aims. Certainly our cases now demonstrate two “bright-line” rules for mail-order sellers to follow: Under the physical-presence requirement reaffirmed here, they will not be subjected to use tax collection if they have no physical presence in the taxing State; under the *National Geographic* rule, mail-order sellers will be subject to use tax collection if they have some presence in the taxing State even if that activity has no relation to the transaction being taxed. See *National Geographic*, 430 U.S. at 560-562. Between these narrow lines lies the issue of what constitutes the requisite “physical presence” to justify imposition of use tax collection responsibilities.

Instead of confronting this question head on, the majority offers only a cursory analysis of whether Quill’s physical presence in North Dakota was sufficient to justify its use tax collection burdens, despite briefing on this point by the State.³⁰² See brief for Respondent 45-47. North Dakota contends that even should the Court reaffirm the *Bellas Hess* rule, Quill’s physical presence in North Dakota was sufficient to justify application of its use tax collection law. Quill concedes it owns software sent to its North Dakota customers, but suggests that such property is insufficient to justify a finding of nexus. In my view, the question of Quill’s actual physical presence is sufficiently close to cast doubt on the majority’s confidence that it is propounding a truly “bright-line” rule. Reasonable minds surely can, and will, differ over what showing is required to make out a “physical presence” adequate to justify imposing responsibilities for use tax collection. And given the estimated loss in revenue to States of more than \$3.2 billion this year alone, see Brief for Respondent 9, it is a sure bet that the vagaries of “physical presence” will be tested to their fullest in our courts.

The majority next explains that its “bright-line” rule encourages “settled expectations” and

³⁰² Instead of remanding for consideration of whether Quill’s ownership of software constitutes sufficient physical presence under its new Commerce Clause nexus requirement, the majority concludes as a matter of law that it does not. See *ante*. In doing so, the majority rebuffs North Dakota’s challenge without setting out any clear standard for what meets the Commerce Clause physical-presence nexus standard and without affording the State an opportunity on remand to attempt to develop facts or otherwise argue that Quill’s presence is constitutionally sufficient.

business investment. *Ante*. Though legal certainty promotes business confidence, the mail-order business has grown exponentially despite the long line of our post-*Bellas Hess* precedents that signaled the demise of the physical-presence requirement. Moreover, the Court's seeming but inadequate justification of encouraging settled expectations in fact connotes a substantive economic decision to favor out-of-state direct marketers to the detriment of other retailers. By justifying the *Bellas Hess* rule in terms of "the mail-order industry's dramatic growth over the last quarter century," *ante*, the Court is effectively imposing its own economic preferences in deciding this case. The Court's invitation to Congress to legislate in this area signals its preferences are not immutable, but its approach is different from past instances in which we have deferred to state legislatures when they enacted tax obligations on the States' shares of interstate commerce. See, e. g., *Goldberg v. Sweet*, 488 U.S. 252, 102 L. Ed. 2d 607, 109 S. Ct. 582 (1989); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981).

Finally, the Court accords far greater weight to *stare decisis* than was given to that principle in *Complete Auto* itself. As that case demonstrates, we have not been adverse to overruling our precedents under the Commerce Clause when they have become anachronistic in light of later decisions. See *Complete Auto*, 430 U.S. at 288-289. One typically invoked rationale for *stare decisis*—an unwillingness to upset settled expectations—is particularly weak in this case. It is unreasonable for companies such as Quill to invoke a "settled expectation" in conducting affairs without being taxed. Neither Quill nor any of its *amici* point to any investment decisions or reliance interests that suggest any unfairness in overturning *Bellas Hess*. And the costs of compliance with the rule, in light of today's modern computer software technology, appear to be nominal. See Brief for Respondent 40; Brief for State of New Jersey as *Amicus Curiae* 18. To the extent Quill developed any reliance on the old rule, I would submit that its reliance was unreasonable because of its failure to comply with the law as enacted by the North Dakota State Legislature. Instead of rewarding companies for ignoring the studied judgments of duly elected officials, we should insist that the appropriate way to challenge a tax as unconstitutional is to pay it (or in this case collect it and remit it or place it in escrow) and then sue for declaratory judgment and refund.³⁰³ Quill's refusal to comply with a state tax statute prior to its being held unconstitutional hardly merits a determination that its reliance interests were unreasonable.

The Court hints, but does not state directly, that a basis for its invocation of *stare decisis* is a fear that overturning *Bellas Hess* will lead to the imposition of retroactive liability. *Ante*. See *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 115 L. Ed. 2d 481, 111 S. Ct. 2439 (1991). As I thought in that case, such fears are groundless because no one can "sensibly insist on automatic retroactivity for any and all judicial decisions in the federal system." *Id.* (WHITE, J., concurring in judgment). Since we specifically limited the question on which certiorari was granted in order not to consider the potential retroactive effects of overruling *Bellas Hess*, I believe we should leave that issue for another day. If indeed fears about retroactivity are driving the Court's decision in this case, we would be better served, in my view, to address those concerns directly rather than permit them to infect our formulation of the applicable substantive rule.

³⁰³ For the federal rule, see *Flora v. United States*, 357 U.S. 63, 2 L. Ed. 2d 1165, 78 S. Ct. 1079 (1958); see generally J. Mertens, *Law of Federal Income Taxation* § 58A.05 (1992). North Dakota appears to follow the same principle. See *First Bank of Buffalo v. Conrad*, 350 N.W. 2d 580, 586 (N. D. 1984) (citing 72 Am. Jur. 2d § 1087).

Although Congress can and should address itself to this area of law, we should not adhere to a decision, however right it was at the time, that by reason of later cases and economic reality can no longer be rationally justified. The Commerce Clause aspect of *Bellas Hess*, along with its due process holding, should be overruled.

Appendix B
The Internet Tax Freedom Act

S.150

*One Hundred Eighth Congress
of the
United States of America
AT THE SECOND SESSION*

Begun and held at the City of Washington on Tuesday,

the twentieth day of January, two thousand and four

An Act

To make permanent the moratorium on taxes on Internet access and multiple and discriminatory taxes on electronic commerce imposed by the Internet Tax Freedom Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the 'Internet Tax Nondiscrimination Act'.

SEC. 2. FOUR-YEAR EXTENSION OF INTERNET TAX MORATORIUM.

(a) IN GENERAL- Subsection (a) of section 1101 of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended to read as follows:

'(a) MORATORIUM- No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending November 1, 2007:

'(1) Taxes on Internet access.

'(2) Multiple or discriminatory taxes on electronic commerce.'

(b) CONFORMING AMENDMENTS- (1) Section 1101 of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking subsection (d) and redesignating subsections (e) and (f) as subsections (d) and (e), respectively.

(2) Section 1104(10) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended to read as follows:

'(10) Tax on internet access-

'(A) IN GENERAL- The term 'tax on Internet access' means a tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax.

'(B) GENERAL EXCEPTION- The term 'tax on Internet access' does not include a tax levied upon or measured by net income, capital stock, net worth, or property value.'

(3) Section 1104(2)(B)(i) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking 'except with respect to a tax (on Internet access) that was generally imposed and actually enforced prior to October 1, 1998,'.

(c) Internet Access Service; Internet Access-

(1) INTERNET ACCESS SERVICE- Paragraph (3)(D) of section 1101(d) (as redesignated by subsection (b)(1) of this section) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking the second sentence and inserting 'The term 'Internet access service' does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.'

(2) INTERNET ACCESS- Section 1104(5) of that Act is amended by striking the second sentence and inserting 'The term 'Internet access' does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.'

SEC. 3. GRANDFATHERING OF STATES THAT TAX INTERNET ACCESS.

The Internet Tax Freedom Act (47 U.S.C. 151 note) is amended--

- (1) by redesignating section 1104 as section 1105; and
- (2) by inserting after section 1103 the following:

'SEC. 1104. GRANDFATHERING OF STATES THAT TAX INTERNET ACCESS.

'(a) Pre-October 1998 Taxes-

'(1) IN GENERAL- Section 1101(a) does not apply to a tax on Internet access that was generally imposed and actually enforced prior to October 1, 1998, if, before that date--

'(A) the tax was authorized by statute; and

'(B) either--

'(i) a provider of Internet access services had a reasonable opportunity to know, by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; or

'(ii) a State or political subdivision thereof generally collected such tax on charges for Internet access.

'(2) TERMINATION-

'(A) IN GENERAL- Except as provided in subparagraph (B), this subsection shall not apply after November 1, 2007.

'(B) STATE TELECOMMUNICATIONS SERVICE TAX-

'(i) DATE FOR TERMINATION- This subsection shall not apply after November 1, 2006, with respect to a State telecommunications service tax described in clause (ii).

'(ii) DESCRIPTION OF TAX- A State telecommunications service tax referred to in subclause (i) is a State tax--

'(I) enacted by State law on or after October 1, 1991, and imposing a tax on telecommunications service; and

'(II) applied to Internet access through administrative code or regulation issued on or after December 1, 2002.'

'(b) Pre-November 2003 Taxes-

'(1) IN GENERAL- Section 1101(a) does not apply to a tax on Internet access that was generally imposed and actually enforced as of November 1, 2003, if, as of that date, the tax was authorized by statute and--

`(A) a provider of Internet access services had a reasonable opportunity to know by virtue of a public rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; and

`(B) a State or political subdivision thereof generally collected such tax on charges for Internet access.

`(2) TERMINATION- This subsection shall not apply after November 1, 2005.'

SEC. 4. ACCOUNTING RULE.

The Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by adding at the end the following:

`SEC. 1106. ACCOUNTING RULE.

`(a) IN GENERAL- If charges for Internet access are aggregated with and not separately stated from charges for telecommunications services or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.

`(b) DEFINITIONS- In this section:

`(1) CHARGES FOR INTERNET ACCESS- The term `charges for Internet access' means all charges for Internet access as defined in section 1105(5).

`(2) CHARGES FOR TELECOMMUNICATIONS SERVICES- The term `charges for telecommunications services' means all charges for telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.'

SEC. 5. EFFECT ON OTHER LAWS.

The Internet Tax Freedom Act (47 U.S.C. 151 note), as amended by section 4, is amended by adding at the end the following:

`SEC. 1107. EFFECT ON OTHER LAWS.

`(a) UNIVERSAL SERVICE- Nothing in this Act shall prevent the imposition or collection of any fees or charges used to preserve and advance Federal universal service or similar State programs--

`(1) authorized by section 254 of the Communications Act of 1934 (47 U.S.C. 254); or

`(2) in effect on February 8, 1996.

`(b) 911 and E-911 Services- Nothing in this Act shall prevent the imposition or collection, on a service used for access to 911 or E-911 services, of any fee or charge specifically designated or presented as dedicated by a State or political subdivision thereof for the support of 911 or E-911 services if no portion of the revenue derived from such fee or charge is obligated or expended for any purpose other than support of 911 or E-911 services.

`(c) NON-TAX REGULATORY PROCEEDINGS- Nothing in this Act shall be construed to affect any Federal or State regulatory proceeding that is not related to taxation.'

SEC. 6. EXCEPTION FOR VOICE AND OTHER SERVICES OVER THE INTERNET.

The Internet Tax Freedom Act (47 U.S.C. 151 note), as amended by section 5, is amended by adding at the end the following:

`SEC. 1108. EXCEPTION FOR VOICE SERVICES OVER THE INTERNET.

`Nothing in this Act shall be construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol. This section shall not apply to any services that are incidental to Internet access, such as voice-capable e-mail or instant messaging.'

SEC. 6A. EXCEPTION FOR TEXAS MUNICIPAL ACCESS LINE FEE.

The Internet Tax Freedom Act (47 U.S.C. 151 note), as amended by section 6, is amended by adding at the end the following:

`SEC. 1109. EXCEPTION FOR TEXAS MUNICIPAL ACCESS LINE FEE.

`Nothing in this Act shall prohibit Texas or a political subdivision thereof from imposing or collecting the Texas municipal access line fee pursuant to Texas Local Govt. Code Ann. ch. 283 (Vernon 2005) and the definition of access line as determined by the Public Utility Commission of Texas in its `Order Adopting Amendments to Section 26.465 As Approved At The February 13, 2003 Public Hearing', issued March 5, 2003, in Project No. 26412.'

SEC. 7. GAO STUDY OF EFFECTS OF INTERNET TAX MORATORIUM ON STATE AND LOCAL GOVERNMENTS AND ON BROADBAND DEPLOYMENT.

The Comptroller General shall conduct a study of the impact of the Internet tax moratorium, including its effects on the revenues of State and local governments and on the deployment and adoption of broadband technologies for Internet access throughout the United States, including the impact of the Internet Tax Freedom Act (47 U.S.C. 151 note) on build-out of broadband technology resources in rural underserved areas of the country. The study shall compare deployment and adoption rates in States that tax broadband Internet access service with States that do not tax such service, and take into account other factors to determine whether the Internet Tax Freedom Act has had an impact on the deployment or adoption of broadband Internet access services. The Comptroller General shall report the findings, conclusions, and any recommendations from the study to the Senate Committee on Commerce, Science, and Transportation and the House of Representatives Committee on Energy and Commerce no later than November 1, 2005.

SEC. 8. EFFECTIVE DATE.

The amendments made by this Act take effect on November 1, 2003.

Speaker of the House of Representatives.

Vice President of the United States and

President of the Senate.

END