


September 1987

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Recommended Citation

Thomas E. McHugh & R. M. Reed, *The Due Process Clause and the Commerce Clause: Two New and Easy Tests for Nexus in Tax Cases*, 90 W. Va. L. Rev. (1987).

Available at: <https://researchrepository.wvu.edu/wvlr/vol90/iss1/6>

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THE DUE PROCESS CLAUSE AND THE COMMERCE CLAUSE: TWO NEW AND EASY TESTS FOR NEXUS IN TAX CASES

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I. INTRODUCTION

In this bicentennial year of the Constitution of the United States the tension between the national and state (and local) governments continues. State taxation of interstate commerce remains a classic area of this tension. Two selected quotations serve to illustrate the current vitality of this struggle. First, the following words were stated by a state court:

[W]e realize that the results in the decisions discussed in this opinion as well as in our [other] recent [interstate commerce taxation] decisions may give the appearance that we will allow the State to expand its taxing powers [over interstate commerce] in sponge-like fashion and with only perfunctory review.¹

In contrast, these comments were by a federal court:

Justice Holmes' words are relevant:

'I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end.' O. Holmes, *Law and the Court*, in *Collected Legal Papers* 291, 295-296 (reprint, 1952).²

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¹ *Western Md. Ry. v. Goodwin*, 167 W. Va. 804, 828, 282 S.E.2d 240, 254 (1981) (citations omitted), *appeal dismissed for want of a substantial federal question*, 456 U.S. 952 (1982).

² *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 653 n.20 (1981) (Blackmun, Powell and Stevens, JJ., dissenting).

The purpose of this article is narrow: to focus upon recent opinions of the West Virginia Supreme Court of Appeals which involve the question of whether there is a sufficient nexus (connection) to sustain a tax, primarily the West Virginia business and occupation tax,³ against a foreign corporation whose only contact with this State, with respect to the transactions in question, is the solicitation, on a less than full-time basis, of product orders, or activities incidental thereto, by nonresident representatives of such corporation. An exhaustive treatment of the subject is not intended.

II. THE FEDERAL CONSTITUTION PROVISIONS AND MAJOR UNITED STATES SUPREME COURT OPINIONS ON GROSS RECEIPTS TAXES

An analysis of whether there is a sufficient nexus to sustain a state (or local) privilege (gross receipts) tax on interstate commerce involves the due process clause⁴ and the commerce clause⁵ of the Constitution of the United States. "Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text."⁶ When courts construe the case law commentary rather than the text of the Constitution and start adding their own judicial "glosses," the added "layers" or "wrinkles" inevitably create more confusion. "[T]he Court's opinion will accomplish the seemingly impossible feat of leaving this area of the law more confused than it found it."⁷ Such

³ W. VA. CODE § 11-13-2(a) (Supp. 1986) and W. VA. CODE § 11-13-2c (1983). The West Virginia business and occupation tax, a privilege (gross receipts) tax, imposed on different classifications of business activities, including sales of tangible property, was, with respect to most classifications, replaced on July 1, 1987, by a severance tax or a business franchise tax, as the case may be. W. VA. CODE § 11-13-2(b) (1987); W. VA. CODE §§ 11-13A-1 to -23 (1987); W. VA. CODE §§ 11-23-1 to -24 (1987). If the recently enacted legislation does not raise sufficient revenues, it remains to be seen whether there will be a return to the business and occupation tax.

⁴ The due process clause reads: "[N]or shall any State deprive any person of life, liberty, or property, without due process of laws; . . ." U.S. CONST. amend. XIV, § 1.

⁵ The commerce clause provides: "The Congress shall have power . . . To regulate Commerce . . . among the several States . . ." U.S. CONST. art. I, § 8, cl. 3. "The Commerce Clause does not state a prohibition; it merely grants specific power to Congress. The prohibitive effect of the Clause on state legislation results from the Supremacy Clause [U.S. CONST. art. VI, cl. 2] and the decisions of this Court." *Department of Revenue v. Association of Wash. Stevedoring Companies*, 435 U.S. 734, 749 (1978).

⁶ *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

⁷ *Research Repository v. United Way (1975)* (Kohns, dissenting) (due process clause analysis).

is the case, it seems, with each succeeding opinion on state taxation of interstate commerce.

Before discussing the recent “tax nexus” opinions of the West Virginia Supreme Court of Appeals, a summary of a few of the relevant opinions of the Supreme Court of the United States is in order because it is the federal forum which is the final decision maker on a question of state taxation of interstate commerce.

In *Norton Co. v. Department of Revenue*,⁸ the Supreme Court of the United States held that certain interstate sales were subject to a so-called gross receipts tax of the destination state because such sales were “channeled” through an in-state office, that is, the orders were received there or the goods were distributed from there. On the other hand, it was held that where the foreign corporation shoulders its burden of “dissociating” particular transactions from the local business, the gross receipts tax with respect to those transactions is invalid. The Court held:

Where a corporation chooses to stay at home in all respects [with respect to certain transactions] *except to send abroad advertising or drummers* to solicit orders which are sent directly to the [out-of-state] home office for acceptance, filling, and delivery back to the buyer, it is obvious that *the State of the buyer has no local grip* on the seller [with respect to such transactions].⁹

In *General Motors Corp. v. Washington*,¹⁰ the Court upheld a destination state’s so-called gross receipts tax with respect to interstate sales of motor vehicles and parts, where the motor vehicle sales were “enmeshed in local connections,” by the involvement of numerous *resident* representatives and *in-state* offices, so that there was *specific* nexus for such sales. With respect to one miniscule category of sales by one division (the less frequently needed parts and accessories), there was no involvement of in-state personnel or facilities. Applying a general nexus test called a “bundle-of-corporate-activity” test, the Court upheld the tax with respect to these parts and accessories by borrowing nexus from the “maze of local

⁸ *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951).

⁹ *Id.* at 537 (emphasis added).

¹⁰ *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), *overruled, in part, on other grounds*, *Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue*, 107 S. Ct. 2810, 2820 (1987).

connections” relating to the sales of motor vehicles.¹¹ The sales of the motor vehicles obviously created a demand for the parts and accessories. In finding a “bundle of corporate activity,” the Court did not mention the “unitary business” principle.¹² The *General Motors* Court quoted *Norton approvingly* for its transactional “dissociation”-from-local-business principle.

Less than a year *after General Motors* was decided, the Court, in *American Oil Co. v. Neill*,¹³ quoted *Norton approvingly* and applied its transactional “dissociation”-from-local-business principle to invalidate an excise tax against an out-of-state vendor, under the due process clause, because of an insufficient nexus for the transaction in question. No in-state facilities or personnel contributed to the sale. The Court called nexus “the outstanding prerequisite on state power to tax.”¹⁴ The Court also concluded that the fact that the foreign corporation was authorized to do business in the destination state and had, for other transactions, entered into the local market in that state was insufficient to uphold the tax as against attack under the due process clause.¹⁵

Another post-*General Motors* case is *Dunbar-Stanley Studios, Inc. v. Alabama*.¹⁶ The Court therein recognized again that the commerce clause precludes a privilege tax on an interstate enterprise whose only contacts with the taxing state are the solicitation (by nonresident representatives) of orders for merchandise and the subsequent delivery of the merchandise within the taxing state. The nonresidents’ acts of soliciting orders or making deliveries are minimal activities within a state without which there can be no interstate commerce.

Standard Pressed Steel Co. v. Department of Revenue,¹⁷ upheld a destination state’s so-called gross receipts tax on a foreign corporation’s interstate sales business. There, the foreign corporation’s

¹¹ *General Motors*, 377 U.S. at 447-48.

¹² The “unitary business” principle is discussed in subsection III.B. of this article.

¹³ *American Oil Co. v. Neill*, 380 U.S. 451 (1965).

¹⁴ *Id.* at 458.

¹⁵ *Id.* at 457-58.

¹⁶ *Dunbar-Stanley Studios, Inc. v. Alabama*, 393 U.S. 537 (1969).

¹⁷ *Standard Pressed Steel Co. v. Department of Revenue*, 419 U.S. 560 (1975).

sole contact in the taxing state, namely, one *resident* representative with a full-time job in such state, “made possible the realization and continuance of valuable contractual relations between” the taxpayer and its *principal* customer in that state.¹⁸ The Court apparently did *not* borrow the nexus existing as to the principal customer in order to sustain the tax with respect to sales to other customers in the state. The resident representative apparently had no contacts with these other customers. As in *General Motors* and *American Oil*, the *Standard Pressed Steel* Court cited *Norton* approvingly and noted that there was no disagreement in *Norton* as to the “governing principle.” Rather, it was observed that the dissenters in *Norton* believed that the taxpayer had not carried its burden of “dissociating” the sales in question from the taxpayer’s local business.¹⁹

In the much heralded case of *Complete Auto Transit, Inc. v. Brady*,²⁰ the Court was also confronted with a challenge by a foreign corporation to a destination state’s so-called gross receipts tax. The challenge was *solely* upon the basis that the tax violated the commerce clause under *Spector Motor Service, Inc. v. O’Connor*²¹ because it was a tax on the *privilege* of conducting an exclusively interstate business. The Court overruled *Spector Motor Service*. The Court did not attach constitutional significance to the formal language of the taxing statute. Consequently it declined to hold that a *privilege* tax on interstate commerce is *per se* unconstitutional. The Court looked, instead, to the practical, economic effect of the tax. In so doing the Court stated an often-quoted, four-part, due process/commerce clause test for a state’s gross receipts tax. A gross receipts tax is valid when it “is applied to an *activity* with a *substantial* nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.”²² Note well that the first part of this test requires that the nexus be between the activity of the taxpayer and the State, not merely between the taxpayer and the State,

¹⁸ *Id.* at 562.

¹⁹ *Id.* at 562-63.

²⁰ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

²¹ *Spector Motor Serv., Inc. v. O’Connor*, 340 U.S. 602 (1951).

²² *Complete Auto Transit*, 430 U.S. at 279 (emphasis added).

and that the nexus must be substantial, not merely "a" nexus. This is an example of functional, economic analysis requiring case-by-case determination.

That there must be more than "a" nexus is driven home in *National Geographic Society v. California Board of Equalization*²³ decided less than a month *after Complete Auto Transit*. The Supreme Court of the United States in *National Geographic* rejected a "slightest presence" standard for tax nexus, even for a secondary liability for a "collection" tax (sales or use tax). *A fortiori* the Court would reject a "slightest presence" standard for tax nexus for a "direct" tax (such as a gross receipts tax) imposed upon the out-of-state vendor. To sustain the use tax in *National Geographic*, the Court relied upon the fact that the foreign corporation maintained two *offices* and *resident* representatives in the taxing (destination) state.²⁴ Quoting *National Bellas Hess, Inc. v. Department of Revenue*,²⁵ the Court in *National Geographic* stressed "the sharp distinction [even for collection taxes] . . . between mail order sellers with retail outlets, [resident] solicitors, or property within [the taxing] State, and those . . . who do no more than communicate with customers in the State by mail or common carrier [or nonresident solicitors] as part of a general interstate business."²⁶

Finally, the Court in *National Geographic* distinguished collection taxes from direct taxes. It quoted *Norton* for the transactional "dissociation"-from-local-business principle for direct taxes (such as gross receipts taxes), thereby repudiating the applicability to direct taxes of the borrowed or general nexus principle upheld in *National Geographic* as to the use tax collection duties of an out-of-state seller. "The Society argues in other words that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller's activity [such as maintaining offices] within the State."²⁷ Citing *Norton* and *American Oil*, the Court noted that a

²³ *National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977).

²⁴ *Id.* at 555-56.

²⁵ *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 758 (1967).

²⁶ *National Geographic*, 430 U.S. at 559.

showing that particular transactions are dissociated from the local business is fatal to a direct tax. On the other hand, such dissociation does not bar the imposition of the use-tax-collection duty because such a tax, unlike a direct tax, requires only a connection between the taxing state and the *person* it seeks to tax.²⁸

In *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*,²⁹ a very recent opinion involving the business and occupation tax of the State of Washington, the Supreme Court of the United States held that having *resident* sales representatives in the taxing jurisdiction (the destination state) who establish and maintain the market constitutes a sufficient nexus to uphold the business and occupation tax on the sales. The fact that the *resident* sales representatives were independent contractors rather than employees was without constitutional significance.³⁰

In summary, these opinions of the Supreme Court of the United States set forth two holdings on nexus in so-called gross receipts tax cases involving interstate sales, which holdings have been “glossed over” in recent opinions of the West Virginia Supreme Court of Appeals. First, nexus to sustain a gross receipts tax must be “substantial” under *Complete Auto Transit’s* due process/commerce clause analysis and under the traditional “jurisdiction to tax” requirement of the due process clause, also recognized in *Complete Auto Transit*.³¹ A “substantial” nexus is present only when there is a more-or-less permanent, physical presence in the taxing jurisdiction, such as an in-state office or a resident representative, which facilitates the sales. Such a presence makes “possible the realization and continuance of valuable contractual relations”³² An out-of-state vendor’s mere economic exploitation of the market in the destination (taxing) state by utilizing instrumentalities of interstate

²⁸ *Id.* at 560-61.

²⁹ *Tyler Pipe Indus., Inc. v. Washington Dep’t of Revenue*, 107 S. Ct. 2810 (1987).

³⁰ *Id.* at 2821. The Court held, though, that the exemption from the manufacturing tax provided by the Washington business and occupation tax statute to in-state manufacturers/wholesalers only was unconstitutional under the commerce clause as discriminatory against interstate commerce. It is beyond the scope of this article to discuss this discrimination issue.

³¹ *Complete Auto Transit*, 430 U.S. at 281.

³² *Standard Pressed Steel*, 419 U.S. at 562.

commerce, such as interstate ("direct") mail, interstate (network) television or radio advertising or solicitation by nonresident representatives ("drummers") on a part-time basis in this State, does not constitute a "substantial" nexus.

Second, nexus to sustain a gross receipts tax must be between the taxing state and the activity or transaction in question, not merely between the taxing state and the taxpayer. That is, if the taxpayer "dissociates" the particular activity or transaction from any local presence in the taxing state, there is an insufficient nexus for taxation of that activity. Again, this is functional, economic analysis applauded in *Complete Auto Transit*. This analysis also recognizes that *nexus* is *critical* in gross receipts tax cases involving interstate sales, while apportionment in such cases, once nexus is found, is "automatic," especially in light of the apportionment mechanism, settled by case law, of upholding the tax in the destination state and prohibiting the tax in the state of origin for the product.³³

III. RECENT TAX NEXUS OPINIONS OF THE WEST VIRGINIA SUPREME COURT OF APPEALS

As interpretations of the Constitution of the United States, judicial "glosses"³⁴ have been added in this State to those of the Su-

³³ The majority opinion in *J.C. Penney Co. v. Hardesty*, 164 W. Va. 525, 264 S.E.2d 604 (1979), authored by Justice Neely, also recognizes the emphasis upon nexus in gross receipts tax cases involving interstate sales and the de-emphasis upon apportionment in such cases:

'Of course it would make analytic nonsense to talk about a "fairly apportioned" "un-apportioned" tax if the concept of "apportionment" were intended to have any real meaning here. Instead, what seems to have happened in cases like *Standard [Pressed Steel]* is that the Court, while paying lip service to the apportionment principle, has ignored it in fact and had looked to other factors to determine the constitutionality of taxes imposed on the unapportioned gross receipts from interstate sales activity. Notwithstanding doctrinal variations, and assuming that nexus requirements have been satisfied, over the past four decades gross receipts taxes on interstate sales have generally been sustained when imposed by the state to which the goods were shipped and prohibited when imposed by the state from which the goods were sent.' Hellerstein, "State Taxation of Interstate Business and the Supreme court," 62 *Va. L. Rev.* 149, 171 (1976)

. . . [A] gross receipts tax may be levied in the state of delivery if there are sufficient contacts to create a tax nexus but cannot be levied in the state of manufacture. This seems as reasonable as any other method of apportionment since its universal application will avoid the evil of double taxation and it has the further advantage of being easy to administer.

Id. at 537-38, 264 S.E.2d at 612 (emphasis added).

preme Court of the United States in cases involving the West Virginia business and occupation tax and in cases involving the gross income tax imposed by the West Virginia carrier income tax statute.³⁵ Two new tax nexus tests for gross receipts taxes have been created in the process, namely, (1) a “purposive-revenue-generating-activity” test and (2) a “unitary business” nexus (not apportionment) test. With these two new tests, the capture of tax revenues from interstate businesses is virtually a certainty.³⁶

A. *Purposive-revenue-generating-activity nexus test*

In *Western Maryland Ry. Co. v. Goodwin*,³⁷ Justice Neely gave birth to a creature theretofore unknown in tax nexus jurisprudence, specifically, a “purposive-revenue-generating-activity” nexus test: “We conclude that purposive, revenue generating activities in the State are sufficient to render a person liable for taxes.”³⁸ This test stands for the proposition that mere economic exploitation of the market by utilizing instrumentalities of interstate commerce, such as solicitation by nonresidents, interstate television or radio advertising or interstate mail solicitation, is a sufficient nexus to uphold any tax. We have not located any opinion of the Supreme Court of the

³⁵ W. VA CODE § 11-12A-2 (1983) imposed a tax on intrastate gross income of certain carrier businesses. This section was repealed effective July 1, 1987. W. VA. CODE § 11-12A-24(a) (1987). Like the business and occupation tax, it may, however, be reinstated, due to a potential need for additional State revenues. See *supra* note 3.

W. VA. CODE § 11-12A-3 (1983) imposed a tax on net income measured by apportioned interstate net income of certain carrier business. It too was repealed as of July 1, 1987.

³⁶ In the opinions of the West Virginia Supreme Court of Appeals decided after January 1, 1981 and discussed herein, Justice McHugh either dissented (e.g., *Cincinnati Milacron v. Hardesty*, 290 S.E.2d 902 (W. Va. 1982)), did not participate in the consideration or decision thereof because of involvement therein as a circuit judge (e.g., *Armco, Inc. v. Hardesty*, 303 S.E.2d 706 (W. Va. 1983), *rev'd*, 467 U.S. 638 (1984)), or in one per curiam case (*Williams & Co. v. Dailey*, 303 S.E.2d 737 (W. Va. 1983)) succumbed to the “irresistible force of the tide” and noted no dissent. The opinions as reported in the regional reporter (S.E.2d) do not in each case accurately indicate Justice McHugh’s nonparticipation in the West Virginia Supreme Court of Appeals opinion (e.g., *Armco*). The originals of the opinions or orders of the West Virginia Supreme Court of Appeals on file with the Clerk of the West Virginia Supreme Court of Appeals *do* indicate such nonparticipation.

³⁷ *Western Md. Ry. v. Goodwin*, 167 W. Va. 804, 282 S.E.2d 240 (W. Va. 1981), *appeal dismissed for want of a substantial federal question*, 456 U.S. 952 (1982). This opinion consolidates three separate cases. For the purpose of this article, the *Union Barge Line* portion of the opinion is particularly relevant to the question of what constitutes a sufficient nexus.

³⁸ *Western Md. Ry.*, 167 W. Va. at 809, 282 S.E.2d at 244.

United States which is precedent for such a proposition. Rather, as stated previously, that Court, even in and after *Complete Auto Transit*, has always required there to be a more-or-less permanent, physical presence in the taxing jurisdiction to sustain the tax, such as resident representatives or in-state offices which facilitate the transactions in question.³⁹ Under the "purposive-revenue-generating-activity" test, even interstate (network) television or radio advertising or interstate ("direct") mail solicitation would appear to constitute a sufficient nexus for the destination state to tax the business of selling products shipped into such state by common carrier. Such activities are purposive and generate revenue. In fact, it would appear that there is *nothing* which would fail such nexus test. Far from echoing *Complete Auto Transit's* cry for functional, economic analysis on a case-by-case basis, the "purposive-revenue-generating-activity" test is a return to a *per se* rule, only now, unlike in *Spector Motor Service*, the result is that everything is taxable, rather than nontaxable.

The types of contacts found to furnish a sufficient nexus in the *Union Barge Line* portion of the *Western Maryland Ry.* opinion illustrate the extreme ease with which a sufficient nexus and State services are found in tax cases in this State. The West Virginia Supreme Court of Appeals made the following "findings." Union Barge Line's miniscule intrastate business was done primarily as an accommodation to its interstate business. (This fact, contrary to the

³⁹ *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), cited in *Western Md. Ry.*, provides no support for a purposive-revenue-generating-activity test for nexus in tax cases. The foreign corporation in *International Shoe* employed eleven to thirteen salesmen who were residents of the taxing state and whose principal activities were confined to that state. *International Shoe*, 326 U.S. at 313. In that case it is also significant that Congress had explicitly authorized the unemployment tax involved therein.

Similarly, *Virginia Foods of Bluefield, Va., Inc. v. Dailey*, 161 W. Va. 94, 239 S.E.2d 770 (1977), upholding a West Virginia business and occupation tax assessment with respect to a Virginia corporation's sales to West Virginia customers, is not authority for a purposive-revenue-generating-activity test for tax nexus. In *Virginia Foods*, the contacts with this state included full-time solicitation and other services by two representatives who were residents of West Virginia. *Virginia Foods*, 161 W. Va. at 101, 239 S.E.2d at 775.

The authors of this article are aware of only one decision outside West Virginia which supports an economic-exploitation-of-the-market standard for nexus in tax cases, namely, *American Refrigerator Transit Co. v. State Tax Comm'n*, 238 Or. 340, 346, 395 P.2d 127, 130 (1964), a net income tax case involving leases. Accord, *L. J. HELLERSTON, STATE TAXATION*, ¶¶ 6.6, 6.7[2] (1983).

court's opinion, indicates that the interstate business would have occurred without *any* intrastate business.) On an *infrequent* basis the taxpayer's crews purchased food and fuel in West Virginia. *If* any of the taxpayer's barges or tugs break down or become damaged in West Virginia, the taxpayer *at times* will have them repaired here. *If* a crewman becomes ill while traveling through West Virginia he *may* be taken to a West Virginia hospital, and *most* hospitals receive some State aid. The court stated that a "taxpayer's burden of proof in such [interstate commerce taxation] cases is substantial, but it is not insurmountable . . ." ⁴⁰ Query: How could the taxpayer in that case have disproved the hypothetical, speculative contacts "found" by the court?

Justice Neely utilized his "purposive-revenue-generating-activity" test again in *Cincinnati Milacron Co. v. Hardesty*.⁴¹ In that case the solicitation of product orders on a part-time basis in this State by nonresident representatives of a foreign corporation was held to be "purposive, revenue generating activities" sufficient for nexus purposes. *Standard Pressed Steel* and *General Motors*, cited in support, are actually authorities *contra*. In *Standard Pressed Steel* the quality or nature of the contacts was materially distinguishable, specifically, there was a *resident* representative therein to provide the requisite more-or-less permanent, physical presence. In *General Motors* the quality and quantum of contacts were materially distinguishable, specifically, there were *numerous resident* representatives and in-state *offices* which contributed to the sales.

Referring to the State's argument that nexus is automatically met by the temporary, periodic presence of "drummers" in this State, the author of the dissenting opinion in *Cincinnati Milacron* remarked: "That doctrine is uncomplicated and simple to apply. I fear that this Court is being lured into that greedy embrace."⁴² Then these comments were added: "I always thought that a sufficient nexus between the activities of the taxpayer and the State was required. How much longer will sufficient modify nexus in West Vir-

⁴⁰ *Western Md. Ry.*, 167 W. Va. at 828, 282 S.E.2d at 254.

⁴¹ *Cincinnati Milacron Co. v. Hardesty*, 290 S.E.2d 902, (W. Va. 1982).

⁴² *Id.* at 905 (McHugh, J., dissenting).

ginia?"⁴³ The answer appears to be, not any longer. Judicial predictability has apparently triumphed.

A final case applying the "purposive-revenue-generating-activity" test is *Williams & Co. v. Dailey*,⁴⁴ Solicitation on a part-time basis in this State by nonresident representatives in a particular geographic section of the State generated the sales in question. The record established only hypothetical, purely speculative assistance by personnel and facilities in a separate geographic section of the State. Not surprisingly, a sufficient nexus was easily found with respect to the sales in the geographic section in question. There were, after all, "purposive, revenue generating activities." *Tyler Pipe Industries, National Geographic, Dunbar-Stanley Studios, American Oil and Norton*, discussed in section II of this article, are contrary precedents of the Supreme Court of the United States. Taxpayers may well wonder whether *Williams* represents the "high water mark" in the wave of cases employing the extremely broad "purposive-revenue-generating-activity" test. Taxpayers may also wonder why the court did not utilize the "unitary business" nexus test in *Williams*. That test was utilized in the *Armco* case decided the same day as *Williams*. See subsection III (B) of this article *infra* for a discussion of *Armco* and the "unitary business" nexus test.

In the first "drummer" case of the Supreme Court of the United States, the Court observed that Congressional action was necessary to provide a uniform national system governing state taxation of interstate commerce. Otherwise, the disorder which prevailed under the Articles of Confederation would be repeated.⁴⁵ In 1959, in response to the *Northwestern States Portland Cement* opinion,⁴⁶ Congress exercised its power granted by the commerce clause to regulate interstate commerce. It enacted legislation to establish "minimum standards" for the imposition of net income taxes on interstate busi-

⁴³ *Id.* (citations omitted).

⁴⁴ *Williams & Co.*, 303 S.E.2d 737.

⁴⁵ *Robbins v. Shelby County Taxing Dist.*, 120 U.S. 489, 498-99 (1887).

⁴⁶ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) (upholding apportioned net income taxes; maintaining an in-state office and employing resident representatives constitute a sufficient nexus).

nesses.⁴⁷ This statute prohibits states (or political subdivisions thereof) from imposing a tax on, or measured by, net income derived by a foreign corporation or nonresident individual within the state from interstate commerce, if the only business activity within the state is solicitation of orders for sales of tangible personal property, which orders are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the state.

While this federal statute does not expressly apply to “gross receipts” taxes like the West Virginia business and occupation tax, the “minimum standards” set forth therein are consistent with the “drummer” line of cases decided by the Supreme Court of the United States. Moreover, because such minimum standards apply to *net* income taxes, *a fortiori* they should be deemed to apply to “gross receipts” taxes, which are, obviously, much more onerous. Accordingly, under existing precedents of the Supreme Court of the United States, solicitation by nonresident representatives of a foreign corporation does not constitute a substantial nexus for the purpose of subjecting the business of selling goods to customers in this State to the West Virginia business and occupation tax, at least where the solicitation in this State is not essentially on a full-time basis.

B. Unitary business nexus test

In *Armco, Inc. v. Hardesty*⁴⁸ another broad test emerged which was theretofore unknown in tax nexus jurisprudence, specifically, a “unitary business” *nexus* test. Actually, there were two precursors to this holding in *Armco*. In a concurring opinion in *J.C. Penney Co. v. Hardesty*,⁴⁹ a business and occupation tax case, it was stated: “The taxpayer cannot escape taxation by attempting to isolate his local activities into compartments and by contending that each compartment must be viewed separately without regard to the taxpayer’s entire activities within the state.”⁵⁰ Conflicting statements on this

⁴⁷ 15 U.S.C. §§ 381-384 (1982).

⁴⁸ *Armco, Inc. v. Hardesty*, 303 S.E.2d 706 (W. Va. 1983) *rev’d on other grounds*, 467 U.S. 638 (1984).

⁴⁹ *J.C. Penney*, 164 W. Va. 525, 264 S.E.2d 604.

⁵⁰ *Id.* at 547, 264 S.E.2d at 617 (Miller, J., concurring).

point were made in *Western Maryland Ry. v. Goodwin*.⁵¹ At one point the author of that opinion remarked: "Neither is it necessary for there to be a nexus between the particular in-state activities of the taxpayer and the activity sought to be taxed."⁵² On the other hand, he later stated in the same opinion:

[T]he fact that appellee does not contest the validity of taxing its wholly in-state business is at least persuasive that some nexus exists with regard to some operations. That, however, is not dispositive since arguably appellee could have identifiable, separate, business operations which are so far removed from this State as to make them immune to our taxation.⁵³

This last statement comports with currently binding precedents of the Supreme Court of the United States. The two immediately preceding quotations do not. Nor does syllabus point 2 of *Armco*:

Where a unitary business has a substantial nexus in this State through its qualifying to do business in this State, and engaging in operations such as coal mining and sales of metal products, we are not required to separate the activities of its various divisions doing business in this State and treat them separately for purposes of determining whether in isolation they have a sufficient connection to this State to warrant imposition of a business and occupation tax.⁵⁴

This holding is in conflict with the opinions of the Supreme Court of the United States in *National Geographic*, *Complete Auto Transit*, *American Oil*, *General Motors* and *Norton*, discussed in section II of this article.

In *Armco*, the foreign corporation had four divisions which had contacts with West Virginia. One of these was the Mining Division. It had coal mining operations in this State. The business and occupation tax with respect to these operations was paid and was not in dispute in the case. The only contacts in this State of the Steel Group division and of the Union Wire Rope Group division were solicitation on a part-time basis in this State by nonresident representatives. The Metal Products Division had an in-state office and resident personnel there. This office and these personnel there did not, however, facilitate the sales of metal buildings by *Armco*.

⁵¹ *Western Md. Ry. v. Goodwin*, 167 W. Va. 804, 282 S.E.2d 240 (1981) *appeal dismissed for want of a substantial federal question*, 456 U.S. 952 (1982).

⁵² *Western Md. Ry.*, 167 W. Va. at 809, 282 S.E.2d at 244.

⁵³ *Id.* at 823, 282 S.E.2d at 252.

The West Virginia Supreme Court of Appeals in *Armco* rejected the claim that there was an insufficient nexus between the sales activities of the three divisions in question and this State to sustain the business and occupation tax. The court did not utilize the “purposive-revenue-generating-activity” test to find a sufficient nexus. Perhaps there was an emerging concern over the validity of that test. In any event, the court held, instead, that the nexus provided by the Mining Division provided all the nexus that was necessary to tax the sales activities of the other three divisions, even though those divisions’ products and activities were shown to be unrelated to the Mining Division. This result is based upon a misreading of precedent and a unique misapplication of a net income tax apportionment principle to a “gross receipts” tax nexus question.

The West Virginia Supreme Court of Appeals was of the opinion that there had been a “weakening” of *Norton* by *General Motors* and *Standard Pressed Steel*.⁵⁵ The discussion of these cases in section II of this article *supra* indicates that *General Motors* and *Standard Pressed Steel*, as well as *American Oil* and *National Geographic*, quote *Norton* approvingly for its transactional “dissociation”-from-local-business principle in “gross receipts” tax cases. Moreover, Justice Clark, who dissented in *Norton* (as to the application of such principle to the facts therein), and who authored *General Motors*, did not criticize *Norton* at all, much less overrule or “weaken” it. Likewise, Justice Douglas, who dissented in *Norton* (as to the application of the “dissociation” principle to the facts therein), and who authored *Standard Pressed Steel*, did not criticize *Norton* at all, much less overrule or “weaken” it. The law in this area is already sufficiently complex without anticipating changes by the high Court and refashioning the rules for that Court in this classic federal question area.⁵⁶

⁵⁵ *Id.* at 711.

⁵⁶ Courts in other states have concluded that *Norton* is still valid and is binding precedent. See, e.g., *State Dep’t of Revenue v. Sears, Roebuck & Co.*, 660 P.2d 1188 (Alaska 1983); *Chicago Bridge & Iron Co. v. Department of Revenue*, 98 Wash. 2d 814, 659 P.2d 463, *appeal dismissed for want of a substantial federal question*, 464 U.S. 1013 (1983). Note that these cases were decided well after the *Complete Auto Transit* case which the Supreme Court of the United States decided in 1977. In *Armco* and other recent opinions of the West Virginia Supreme Court of Appeals, *Complete Auto* Disseminated by The Research Repository at WVU, 1987

It is clear from *Norton* and its progeny that a factual “dissociation” from local business activities and presence is permissible even where the same type of products is involved in the local business and in the transactions generated solely as the result of solicitation on a part-time basis in this State by nonresident representatives of the foreign corporation. *A fortiori* “dissociation” is permissible where, as in *Armco*, unrelated product lines are involved. Otherwise, there could be far-reaching results. A foreign corporation may be involved in diversified business activities, such as manufacturing chemicals and, for example, through a different division, selling exercise equipment. If the latter is accomplished in the taxing jurisdiction by instrumentalities of interstate commerce (“direct” mail solicitation, network television advertising or solicitation on a part-time basis in this State by nonresident representatives), it would stretch the outer limits of nexus to sustain a business and occupation tax on the clearly separate business of selling exercise equipment, based upon the fact that there are chemical plants of the taxpayer in the taxing state. Such a result ignores the nature of the business and occupation tax.

For business and occupation tax purposes, an integrated (unitary) business entity will be *segregated* into its separate components or business to apply the appropriate tax classification to each of the respective businesses engaged in by the same entity.⁵⁷ This segregation into separate businesses is in accord with the truly distinct activities of the integrated (unitary) business. Thus, to hold that the “dissociation”-from-local-business principle is invalid in business

Transit is seen as a major impetus in the “trend” toward upholding state taxation of interstate commerce. However, as Justice Miller noted in his concurring opinion in *J.C. Penney Co.*, “[t]he intriguing part of *Complete Auto* is what it did not expressly decide: “We note again that no claim is made that the activity is not sufficiently connected to the State to justify a tax,...” *J.C. Penney*, 164 W. Va. at 541, 264 S.E.2d at 614 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 279, 287 (1977)). Also see *supra* note 33 for a recognition that this trend of upholding taxation is hinged upon there being a sufficient nexus in “gross receipts” tax cases.

⁵⁷ See *West Virginia Tractor & Equip. Co. v. Hardesty*, 167 W. Va. 511, 519, 280 S.E.2d 270, 275 (1981); *Gilbert Imported Hardwoods, Inc. v. Dailey*, 167 W. Va. 587, 595, 280 S.E.2d 260, 265 (1981); *Koppers Co. v. Dailey*, 167 W. Va. 521, 524, 280 S.E.2d 248, 250 (1981) (and cases cited therein).

and occupation tax cases “is to ignore business reality.”⁵⁸ In contrast, in “unitary business” net income tax apportionment cases, courts usually disregard the often artificial, bookkeeping compartmentalization by multi-jurisdictional business enterprises and, instead, consolidate all of the net income of such unitary businesses for apportionment by statutory formula.

In addition to having the effect of ignoring business reality, to invalidate the “dissociation” principle in business and occupation tax cases by utilizing the “unitary business” principle is to convert (for nexus purposes only) the business and occupation tax from being an activity-based tax to being an income-based tax. The West Virginia business and occupation tax is not an income tax. “Our business and occupation tax is levied on the *privilege* of selling or serving within this state, and not on the sales themselves, or on income.”⁵⁹ To make this point is not “to wax in semantic technicalities without substance.”⁶⁰ Rather, it is to be *consistent* in examining the business and occupation tax under each of the four prongs of *Complete Auto Transit’s* amalgamated due process clause/commerce clause test for the validity of a so-called “gross receipts” tax.⁶¹

In *Armco*, the West Virginia Supreme Court of Appeals, to arrive at a sufficient *nexus*, applied the “unitary business” principle, employed *only* in *net income* tax cases for *apportionment* purposes,⁶²

⁵⁸ *J.C. Penney*, 164 W. Va. at 548, 264 S.E.2d at 617 (Miller, J., concurring) (an opinion consolidating four separate cases). The “business reality” in the *Penney* opinion was that the taxpayer had failed to “dissociate” its direct mail sales of catalog merchandise from its local store business. Local stores displayed many of the same products sold in the catalogs; catalogs were available through many of the local stores; and there otherwise was substantial local impetus to direct mail sales of catalog merchandise. The result reached in *Penney* is consistent with the application of the “dissociation” principle by the dissenters in *Norton* to the facts therein.

⁵⁹ *Hydraulics, Inc. v. Dailey*, 301 S.E.2d 605, 608 (W. Va. 1983) (emphasis in original). *Accord Virginia Foods*, 161 W. Va. at 102 n.4, 239 S.E.2d at 775 n.4; *Bethlehem Mines Corp. v. Haden*, 153 W. Va. 721, 172 S.E.2d 126 (1969) (syl. pt. 3).

⁶⁰ *Cincinnati Milacron*, 290 S.E.2d at 904.

⁶¹ See text accompanying *supra* note 22.

⁶² The cases in which the Supreme Court of the United States has actually applied the unitary business principle are net income tax apportionment cases. See, e.g., *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, (1983) (collecting cases).

As quoted in *Armco*, 303 S.E.2d at 712 n.3, the Supreme Court of the United States included *General Motors*, 377 U.S. 436, a “gross receipts” tax case, in a string cite of cases applying the unitary business principle. *ASARCO, Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 320 n.14 (1982);

while simultaneously rejecting the need to apply net income tax apportionment principles. That is, in the *Armco* opinion of the West Virginia Supreme Court of Appeals, the business and occupation tax is a chameleon: at one time (for nexus purposes) it appears to be a net income tax; at another time (for apportionment purposes) it reverts to its natural color and is a "self-apportioning," activity-based "gross receipts" tax.⁶³

The "unitary business" principle may be described as follows. A "unitary business" is a more-or-less integrated business enterprise operating in more than one jurisdiction. Its total net income, wherever earned, may be subjected to a state net income tax which apportions the total net income based upon a statutory formula taking into account objective estimates of the business enterprise's activities within and without the taxing jurisdiction, such as property, payroll and sales. The thrust of the concept is that a multi-jurisdictional business whose centralized management contributes in definite but often intangible ways to each of the geographical or transactional components may, consistent with the due process and commerce clauses, be subject to a net income tax of a given jurisdiction, as

accord Container Corp., 463 U.S. at 164. This inclusion of *General Motors* is not, however, accurate. *General Motors* does not mention the unitary business principle, nor does it cite any of the unitary business cases, in arriving at its "bundle-of-corporate-activity" nexus test. In a general discussion of various types of state taxes on interstate commerce which had been upheld, *General Motors* does refer to a net income tax case in which a proportional formula was applied to profits of a unitary business. At the conclusion of the general discussion, however, *General Motors* distinguished gross receipts tax cases from the net income tax cases: "However, local taxes measured by gross receipts from interstate commerce have not always fared as well." *General Motors*, 377 U.S. at 440.

⁶³ In discussing *apportionment* (but not *nexus*) in business and occupation tax cases, Justice Miller in *Armco* states: "It must be kept in mind that our business and occupation tax is composed of a number of individual taxes tied to specific business activities occurring within this State." *Armco*, 303 S.E.2d at 714. He strikes this same chord and elaborates upon it in his concurring opinion in *J.C. Penney*:

A business and occupation tax levied on substantial activities of the taxpayer within the taxing state is a fairly apportioned tax, because the local activities or transactions provide not only the tax nexus, but also form the boundary of the tax incident. This State's business and occupation tax is composed of a number of separate taxes on specific business activities occurring within the State. The business and occupation tax does not give rise to the problems surrounding a state income tax, where some type of apportionment standard must be built into the tax statute to segregate local income from that derived from out-of-state sources. Here, the business and occupation tax has its roots in the local transaction, and by its very nature carries its own proportionality.

J.C. Penney, 164 W. Va. at 550, 264 S.E.2d at 618-19 (footnote and citation omitted).

long as at least some part of the business is conducted in that jurisdiction and as long as there is a rational relationship between the income attributed to that jurisdiction and the intrastate values of the enterprise.

The real concern in the unitary business (net income tax) cases is the general fairness of the *apportionment* formula. Only "lip service" is given to the nexus requirement. In such cases the nexus must only be "general," that is, the nexus must only be between the taxing jurisdiction and the "person" of the taxpayer, in the sense of any activities or presence in the taxing jurisdiction. The activities are not being taxed. It is the net income derived therefrom which is being taxed. Therefore, identifying the activities generating the net income is not very important. Instead, the focus in unitary business (net income tax) cases is upon whether the income attributed to the taxing jurisdiction is in fact out of all appropriate proportion to the imprecisely identified business transacted in that jurisdiction.

The exact opposite is true in "gross receipts" tax cases. In such cases the nexus must be "substantial" and "specific," that is, between the taxing jurisdiction and the subject of the tax, namely, the activity or transaction in question. *Complete Auto Transit* is explicit on this point.⁶⁴ In gross receipts tax cases "lip service" is given to the "fair apportionment" requirement, not to the nexus requirement.⁶⁵ Apportionment is accomplished in gross receipts tax cases involving interstate sales by allowing taxation in the destination state and prohibiting taxation in the state of origin for the goods.

In short, to apply a unitary business *nexus* test in a gross receipts tax case is to remove *the primary* due process clause/commerce clause limitation on the imposition of the business and occupation tax in an interstate commerce context, specifically, a requirement that there be a substantial local business presence which contributed to the activity taxed.⁶⁶

⁶⁴ *Complete Auto Transit*, 430 U.S. at 279.

⁶⁵ See *supra* note 33.

⁶⁶ The Supreme Court of the United States in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), held that the West Virginia business and occupation tax as to wholesale sales was unconstitutional as discriminatory against interstate commerce. It is beyond the scope of this article to discuss the

IV. CONCLUSION

In the area of state taxation of interstate commerce, the real issue is not whether out-of-state businesses must pay their "fair share" of taxes in exchange for selling to customers in this State. Of course, they should, if certain fundamental conditions are met. The real issue is, when are those conditions met? To answer that question, the judiciary of this State, in the absence of Congressional action, must follow existing precedents of the Supreme Court of the United States construing the due process clause and the commerce clause. To do otherwise is to risk distorting those two tenets contained in the most fundamental document of our civic existence.

discrimination issue. The Court expressly did "not reach Armco's argument that there was not a sufficient nexus between the State and the sales at issue here to permit taxation of them." *Id.* at 641. The Court missed a golden opportunity to confront the issue of nexus in gross receipts tax cases.