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# Questioning Quill

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# QUESTIONING *QUILL*

*Hayes R. Holderness\**

*The physical presence rule of Quill Corp. v. North Dakota is under increasing attack from the “Kill Quill” movement — a consortium of state tax administrators, industry leaders, and academics opposed to the decision. The physical presence rule prohibits states from requiring many out-of-state vendors to collect taxes on goods sold into the states. Though the Kill Quill movement has succeeded in getting a challenge to the rule before the Supreme Court, the case for overturning the physical presence rule remains cloudy.*

*Technology and the economy have changed in the twenty-five years since Quill was decided, but are these changes enough to convince the Court to recalibrate the rule? This article argues that more will be needed; attention must be drawn to the analytical gaps in the cases endorsing the physical presence rule. These cases have failed to explain the basis for requiring any connection between a taxing state and a taxpayer under the Commerce Clause (under which the physical presence rule originates) and have blended together the substance of sales taxes and use taxes for jurisdictional purposes without clear justification. Through unpacking these issues, the article exposes principles to guide the development of fundamentally sound rules for sales tax and use tax jurisdiction.*

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## I. INTRODUCTION

“I want to kill Quill . . . Say it with me: ‘Kill Quill, kill Quill.’”<sup>1</sup> So urged former Alabama Revenue Commissioner Julie Magee at a meeting of tax officials, expressing her clear disdain for the Supreme Court’s 1992 *Quill Corporation v. North Dakota* ruling, which established that a vendor must have a physical presence in a state before that state can require the vendor to collect the state’s sales and use taxes.<sup>2</sup> Commissioner Magee is not the only

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<sup>1</sup> Billy Hamilton, *It’s Almost Time to Upgrade to Version 20.17 (Thank Goodness)*, 2017 ST. TAX TODAY 2–15 (Jan. 4, 2017).

<sup>2</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 317–18 (1992). A use tax is a tax on the use of a taxable good or service; in current practice, use taxes apply to the use of taxable things

person unhappy with the *Quill* decision, and a “Kill *Quill*” movement has grown recently to the point where states have enacted legislation and passed regulations expressly disregarding the Supreme Court’s ruling.<sup>3</sup> Whether or not to “kill *Quill*” is a major issue: the decision is the reason that many consumers today are not charged taxes on online purchases; changing *Quill*’s physical presence rule would impact anyone who shops online.

The Kill *Quill* movement is symptomatic of rifts within the state and local tax community as to the appropriate “nexus” standard for state tax actions, particularly those related to sales and use taxes.<sup>4</sup> “Nexus” is a term of art referring to the connection between a state and a person or thing that must exist before the U.S. Constitution permits the state to tax the person or thing. The growing divide between those supporting *Quill*’s physical presence nexus rule and those opposed to it threatens to upset the *status quo*, as those opposed to the rule seek ways around it and those in support of it entrench themselves against such actions. Regardless of result, a return to the issue by the Supreme Court would help settle this volatile landscape.<sup>5</sup> Though the Court has been loath to hear challenges to the physical presence

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when sales taxes were not collected when those things were purchased (a common example of such a situation involves things purchased over the internet). See *infra* notes 21–24 and accompanying text.

<sup>3</sup> See S.D. CODIFIED LAWS § 10-64-1 *et seq.*; ALA. ADMIN CODE r. 810-6-2-.90.03; TENN. COMP. R. & REGS. 1320-05-01-.129.

<sup>4</sup> Compare, e.g., John A. Swain, *Quexit: The Time Has Come*, 81 ST. TAX NOTES 695 (Sept. 12, 2016) (arguing in favor of overturning *Quill*); Robert D. Plattner, *Quill: Ten Years After*, 25 ST. TAX NOTES 1017 (Sept. 30, 2002) (criticizing *Quill*) with Arthur R. Rosen & Matthew P. Hedstrom, *Quill—Stare at the Decision*, 60 ST. TAX NOTES 931 (June 27, 2011) (defending *Quill*); Edward A. Zelinsky, *Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause*, 28 VA. TAX REV. 1, 4 (2008) (offering a political-voice-based argument for the physical presence rule); Joseph Henschman, *Why the Quill Physical Presence Test Shouldn’t Go the Way of Personal Jurisdiction*, 46 ST. TAX NOTES 387 (Nov. 5, 2007) (defending *Quill*). See also Laura Davison, *States, Retailers Continue to Spar as Online Sales Grow*, Bloomberg Daily Tax Report (BNA) (Apr. 13 2017).

<sup>5</sup> See *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring) (urging a reconsideration of *Quill* given technological and economic changes since 1992); Brief of Interested Law Professors as Amici Curiae supporting Petitioner, *Brohl v. Direct Mktg. Ass’n*, 135 S. Ct. 1124 (2015) (No. 16-458), 2015 LEXIS at \*19 (urging the Supreme Court to reconsider *Quill*).

rule in the past,<sup>6</sup> preferring instead to pass the buck to Congress,<sup>7</sup> it appears that the Kill Quill movement's day in court has finally arrived.<sup>8</sup>

Despite pressure from the states and industry groups, Congress continually failed to address the physical presence rule since *Quill* was decided,<sup>9</sup> coming closest to replacing the rule with more intricate guidelines in 2013, when the Marketplace Fairness Act passed the Senate before stalling in the House.<sup>10</sup> Given the inaction from Congress, the Kill Quill movement viewed a return to the Supreme Court as the best means of overturning the physical presence rule,<sup>11</sup> and Kill Quill states passed legislation expressly disregarding *Quill* spurring litigation over the physical presence rule.<sup>12</sup> The

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<sup>6</sup> See, e.g., Fla. Dep't of Revenue v. Am. Bus. USA Corp., 191 So. 3d 906 (Fla. 2016), cert. denied, Dkt. No. 16-567 (U.S. Feb. 21, 2017); Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129 (10th Cir. 2016), cert. denied, 137 S. Ct. 591 (2016); Geoffrey Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13 (S.C. 1993), cert. denied, 510 U.S. 992 (1993); KFC Corp. v. Iowa Dep't of Revenue, 792 N.W.2d 308 (Iowa 2010), cert. denied, 132 S. Ct. 97 (2011); Geoffrey, Inc. v. Commissioner of Revenue, 899 N.E.2d 87 (Mass. 2009), cert. denied, 557 U.S. 920 (2009); Capital One Bank v. Commissioner of Revenue, 899 N.E.2d 76 (Mass. 2009), cert. denied, 557 U.S. 919 (2009); Bridges v. Geoffrey, Inc., 984 So. 2d 115 (La. App. 1 Cir. 2008), writ denied, 978 So. 2d 370 (La. 2008); MBNA America Bank, N.A. v. Ind. Dep't of State Revenue, 895 N.E.2d 140 (Ind. Tax Ct. 2008); Lanco, Inc. v. Dir., Div. of Taxation, 908 A.2d 176 (N.J. 2006), cert. denied, 551 U.S. 1131 (2007).

<sup>7</sup> See *Quill*, 504 U.S. at 318 (“[Retaining the physical presence rule] is made easier by the fact 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.”).

<sup>8</sup> Ryan Prete, *U.S. Supreme Court Will Hear Pivotal Digital Tax Case*, Bloomberg Daily Tax Report (BNA) (Jan. 12, 2018).

<sup>9</sup> Edward A. Zelinsky, *The Political Process Argument for the Supreme Court to Overrule Quill*, 82 BROOK. L. REV. 1177, 1178–79 (2017) (“In the federal lawmaking process, defenders of current law have the politically easier task of blocking change in a process which affords them many opportunities to obstruct change. *Quill* gives that advantage to the internet and mail order industries which need merely impede legislation to preserve the status quo — as they have done successfully for over two decades.”); Adam B. Thimmesch, *The Fading Bright Line of Physical Presence: Did KFC Corporation v. Iowa Department of Revenue Give States the Secret Recipe for Repudiating Quill?*, 100 KY. L.J. 339, 340 (2012) (“States have responded to these losses by aggressively and continuously lobbying Congress to legislatively overturn the physical-presence rule. Despite those efforts, however, Congress has not yet given states the recipe that they seek.”).

<sup>10</sup> 160 Cong. Rec. S598 (daily ed. Jan. 29, 2014) (memorializing H.R. Res. 571, 197th Gen. Assemb., 2013 Sess. (Pa. 2013)). Harry J. Reske, *U.S. Senate Approves Marketplace Fairness Act*, 68 ST. TAX NOTES 499 (May 7, 2013) (noting the U.S. Senate's passage of the S.743 by a 69-27 vote “[a]fter more than a decade of deliberation”). The Marketplace Fairness Act of 2017 and other bills addressing the physical presence rule were introduced in April of 2017. Paige Jones, *Remote Sales Tax Bills Reintroduced in Congress*, 2017 ST. TAX TODAY 81-2 (Apr. 28, 2017).

<sup>11</sup> See, e.g., Swain, *supra* note 4; Zelinsky, *supra* note 9; Brian Hamer, *It's Time to Challenge Quill*, 6 ST. TAX NOTES 531 (May 19, 2015).

<sup>12</sup> See *South Dakota v. Wayfair, Inc. et al.*, 2017 S.D. 56 (2017); *Newegg Inc. v. Dep't*

Supreme Court granted certiorari in one such case, *South Dakota v. Wayfair, Inc.*, in January of 2018.<sup>13</sup>

However, it is not clear that the Supreme Court will discard the physical presence rule. Despite the Kill *Quill* movement's arguments otherwise, technical and economic circumstances have not necessarily changed enough since *Quill* to merit reconsidering the holding. *Quill* itself was decided largely on grounds of *stare decisis*; changed circumstances arguments failed to convince the Court to abandon the physical presence rule in 1992.<sup>14</sup> More may be needed to sway the Court this time. This article offers a novel dissection of *Quill*, exposing an additional avenue for challenging the physical presence rule — attacking certain aspects of the reasoning underlying the rule.<sup>15</sup> As Justice Kennedy recently noted, “*Quill* . . . should be left in place only if a powerful showing can be made that its rationale is still correct.”<sup>16</sup> This article adds to the argument that it never fully was correct.

At best, *Quill* was not thorough in providing the analytical basis for the physical presence rule; at worst, its reasoning is fatally flawed. The base problem with *Quill* is two-fold: the Court struggled with what the U.S. Constitution requires for jurisdiction to tax and with when and how the jurisdiction to tax standards apply. More specifically, the *Quill* Court failed to fully consider: (1) the basis for requiring a connection between the taxing state and the taxpayer under the Commerce Clause, (2) all of the burdens a state tax action might place on a taxpayer and the relationship of the taxpayer's physical presence to those burdens, (3) the nature, regulatory or tax, of use tax collection obligations, (4) the substance of those obligations if they are characterized as taxes, and (5) the full scope of use taxes, particularly in relation to sales taxes. Through examining the Court's stated objectives for state and local taxation, this article offers principles to guide jurisdiction to tax analysis. At a high level, these principles are that jurisdiction to tax

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of Revenue, No. S. 16-613 (Ala. Tax Trib. Aug. 26, 2016).

<sup>13</sup> Granting of Petition for Writ of Certiorari, *South Dakota v. Wayfair, Inc.*, No. 17-494 (U.S. Jan. 12, 2018); see also *supra* note 8.

<sup>14</sup> *Quill*, 504 U.S. at 317 (“[T]he 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.”).

<sup>15</sup> To be clear, the changed circumstances arguments are not the only lines of attacks advanced on the *Quill* decision, and commentators have challenged other aspects of the reasoning in *Quill*. See, e.g., Richard D. Pomp, *Revisiting Miller Brothers, Bellas Hess, and Quill*, 65 AM. U. L. REV. 1115, 1144–54 (2016). As Professor Pomp observes, at the time of his 2016 article, “[m]any, many articles have discussed *Quill*. A computer search of only law review articles, notes, and comments that have ‘*Quill*’ in their titles indicates there are more than seventy.” *Id.* at 1120. This article offers an addition to, not a dismissal of, the analyses of those articles and the critiques of *Quill* they offer.

<sup>16</sup> *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).

standards should broadly consider the burdens state tax actions place on interstate commerce and that the jurisdictional standards must consider the type of tax imposed — one size does not necessarily fit all. A close examination of *Quill* shows that the decision failed to adhere to these principles.

This article proceeds in five Parts. The next Part, Part II, describes the Kill *Quill* movement and the *Quill* decision in more depth and argues that technological and economic circumstances have not changed in a constitutionally relevant way since the time *Quill* was decided. Therefore, the physical presence rule is not necessarily suspect on those grounds alone. Part III tackles the first base problem in *Quill*: what the U.S. Constitution demands for jurisdiction to tax. This Part confronts this problem by focusing on the somewhat-novel legal question regarding what type of connection a taxing state must have with a taxpayer before jurisdiction to tax exists. This question is “somewhat-novel” because such a connection is clearly required under the case law, but the basis and extent of that connection have not been fully developed by the Court. Part III argues that this connection between state and taxpayer should ensure that interstate commerce is not unduly burdened by the state’s actions and, to do so, must account for more than just the compliance costs of the tax imposed on the taxpayer. The standard must also ensure that the taxpayer has the ability to draw on funds from the taxed activity to pay the tax. Thus, jurisdiction to tax is dependent on the taxpayer’s connection to the activity taxed. Under such an understanding, the physical presence rule is immediately suspect — does the rule fairly indicate a connection between the taxpayer and the activity taxed?

Part IV then takes up the second base problem in *Quill* — when and how the jurisdiction to tax standards apply to a state action — by zeroing in on the Court’s unexplained application of those standards to use tax *collection* obligations. This Part argues that the standards must consider the type of state action in order to reach an appropriate result, even down to the level of the character of the tax being imposed. This principle derives from the Court’s determination to have substance control the analysis of state actions.<sup>17</sup> Despite this determination, the Court has failed to adequately examine the nature of use tax collection obligations over the course of its jurisprudence, a serious flaw that led the Court to the physical presence rule. A use tax collection obligation could be characterized as a regulatory burden or as a tax in and of itself, and the appropriateness of the physical presence rule is

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<sup>17</sup> See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) (rejecting formalistic labels as controlling the constitutionality of a state tax and instead looking to economic realities of the tax); see also *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787, 1795 (2015) (“We see no reason why the distinction between gross receipts and net income should matter, particularly in light of the admonition that we must consider ‘not the formal language of the tax statute but rather its practical effect.’”) (quoting *Complete Auto*, 430 U.S. at 279).

questionable under either characterization. Regulatory burdens are not necessarily subject to the tax rules; their constitutionality is typically determined by balancing the state's interests against the free flow of the national economy.<sup>18</sup> In the tax realm, assuming the taxpayer's connections with the state must be related to the activity taxed before jurisdiction to tax exists, the activity being taxed in the case of a use tax collection obligation must be uncovered before determining whether the taxpayer is appropriately connected with that activity. If, as seems likely, a use tax collection obligation is characterized as the same thing as a use tax, then the vendor must have an in-state connection with the use of the product. Physical presence might be the correct rule if the sale of a product in the state is the only taxable use of the product, but use taxes fall on a broader range of activities than just sales, something the jurisprudence has failed to recognize. Therefore, by following the principle of considering the type of state action at issue when applying the jurisdiction to tax standards, the Court might determine that use taxes and use tax collection obligations need not rely on the physical presence rule in the same way as sales taxes do.

Part V suggests actions the Kill *Quill* movement might take to place the issues raised by the analysis contained in the earlier Parts squarely in front of the Court and offers an example of what a nexus standard that tracks closer to the goals of the Commerce Clause might look like. The Kill *Quill* movement can confront *Quill* head on by pushing the Court to recognize the large scope of activities use taxes apply to, thereby removing use taxes from the shadow of sales taxes. Alternatively, the movement could alter aspects of use tax collection obligations to clearly differentiate them from those considered in *Quill*, limiting the practical application of the decision. In particular, Kill *Quill* states could act to characterize use tax collection obligations as regulatory burdens instead of taxes or to characterize the obligations as taxes other than use taxes. If the Court were convinced to discard the physical presence rule, a more fundamentally sound nexus rule might ask whether the state imposes compliance costs on the taxpayer out of all appropriate proportion to the taxpayer's activities in the state relating to

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<sup>18</sup> See *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970) ("Where the [state] statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.") (internal citations omitted); see also Philip M. Tatarowicz, *Right to a Refund for Unconstitutionally Discriminatory State Taxes and Other Controversial State Tax Issues under the Commerce Clause*, 41 *TAX LAW.* 103, 106–10 (1987) (discussing the differing constitutional analyses of regulatory burdens and tax burdens).



the activity taxed. Finally, Part VI concludes.

## II. THE KILL QUILL MOVEMENT

Sales taxes and use taxes are closely related. Sales taxes have a rich history in the United States; forty-five states and the District of Columbia impose a sales tax.<sup>19</sup> Generally speaking, sales taxes are consumption taxes on the transfer of title to or possession of a product for consideration.<sup>20</sup> On the other hand, use taxes — also imposed by those forty-five states and the District of Columbia — are consumption taxes levied on the use of the product sold and were adopted subsequent to or contemporaneously with sales taxes, often with the stated goal of balancing the amount of tax owed on products purchased in-state and those purchased out-of-state.<sup>21</sup> Many states refer to their use taxes as “complementary” to their sales taxes,<sup>22</sup> and the states offer credits against their use taxes for other states’ sales taxes applied to the taxed product.<sup>23</sup> In practical understanding then, sales taxes apply only to products purchased in-state, and use taxes apply to products purchased out-of-state sales-tax-free and subsequently brought into the taxing state for use there.<sup>24</sup>

Some states impose legal responsibility for sales taxes and use taxes on the consumer, others on the vendor.<sup>25</sup> However, every state that imposes the taxes either requires vendors to collect the taxes from their customers or permits the vendors to do so, in effect passing the burden of the taxes along

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<sup>19</sup> RICHARD D. POMP, *STATE & LOCAL TAXATION* 6-1 to 6-3 (8th ed. 2015). The five states without general sales taxes are referred to as the NOMAD states — New Hampshire, Oregon, Montana, Alaska, and Delaware. Some of these states do impose specific sales taxes. *Id.*

<sup>20</sup> *Id.* at 6-7.

<sup>21</sup> *Id.* at 6-39 to 6-43; *see also* Paul J. Hartman, *Sales Taxation in Interstate Commerce*, 9 VAND. L. REV. 138, 165 (1956); Robert C. Brown, *The Future of Use Taxes*, 8 LAW & CONTEMP. PROBS. 495, 504 (1941).

<sup>22</sup> *See, e.g.*, CAL. REV. & TAX. CODE § 7203 (“The use tax portion of any sales and use tax ordinance adopted under this part shall impose a complementary tax. . . .”); N.C. GEN. STAT. § 105-164.6 (imposing a “complementary use tax”); W. VA. CODE § 11-15A-1a(1) (“It is the intent of the Legislature that the use tax imposed by the provisions of article fifteen-a and the consumers sales tax imposed by the provisions of article fifteen of this chapter be complementary laws . . .”).

<sup>23</sup> POMP, *supra* note 19, at 6-39.

<sup>24</sup> This is an oversimplification; a use tax can also apply when a product is manufactured or purchased in-state sales-tax-free and is then used in the state in a taxable manner. *Id.* at 6-39.

<sup>25</sup> *Compare, e.g.*, N.Y. TAX LAW § 1133 (imposing liability for the tax on the consumer, *see also* 20 NYCRR 525.2(a)(4) (explaining the nature of the sales tax as a “consumer tax”)) *with, e.g.*, CAL. REV. & TAX. CODE § 6051 (imposing liability for the tax on the vendor).

to consumers.<sup>26</sup> Where responsibility for the taxes is imposed on the customer, if the vendor cannot be made to collect the taxes, the customer remains liable to the state for the uncollected taxes.<sup>27</sup>

In the 1992 *Quill* case, the Supreme Court, relying on its 1967 ruling in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, confirmed that a person must have a physical presence in a state before that state can require the person to collect the state's use tax from its customers in the state.<sup>28</sup> The Court described the physical presence rule as "a means for limiting state burdens on interstate commerce,"<sup>29</sup> and justified it as "firmly establish[ing] the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduc[ing] litigation concerning those taxes."<sup>30</sup> The Court also justified the rule by noting that it "encourages settled expectations and, in doing so, fosters investment by businesses and individuals,"<sup>31</sup> and that without the rule an interstate vendor might be unduly burdened with use tax collection obligations in "the Nation's 6,000-plus taxing jurisdictions."<sup>32</sup>

Nevertheless, according to one study, the physical presence rule, coupled with states' inability to collect use taxes from individual consumers, contributed to an estimated \$11.4 billion in lost revenues among all states in 2012.<sup>33</sup> Additionally, state sovereignty may also be increasingly damaged by

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<sup>26</sup> E.g., CAL. CIV. CODE § 1656.1; CAL. REV. & TAX. CODE § 6203; FLA. STAT. § 212.07; N.Y. TAX LAW § 1131(1); N.C. GEN. STAT. § 105-164.8; TEX. TAX CODE ANN. §§ 151.052, 151.103; UTAH CODE ANN. § 59-12-107(a). Given that sales and use taxes are imposed on a transaction-by-transaction basis, the vendor-collection scheme is viewed as the most administratively effective approach to collecting the taxes. See, e.g., John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century*, 38 GA. L. REV. 343, 345 (2004) ("As between collecting tax from each individual consumer or from the seller, it is more administratively practical to collect the tax from the seller.").

<sup>27</sup> E.g., N.Y. TAX LAW § 1133(b).

<sup>28</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 317-18 (1992).

<sup>29</sup> *Id.* at 313, 314-15.

<sup>30</sup> *Id.* at 315.

<sup>31</sup> *Id.* at 316.

<sup>32</sup> *Id.* at 313 n.6.

<sup>33</sup> See Donald Bruce, William F. Fox & LeAnn Luna, *State and Local Sales Tax Revenue Losses from E-Commerce*, 52 ST. TAX NOTES 537 (Apr. 13, 2009). The researchers expect that such revenue loses "will likely continue to grow rapidly, at least for the next several years." Donald Bruce, William F. Fox & LeAnn Luna, *E-tailer Sales Tax Nexus and State Tax Policies*, 68 NAT'L TAX J. 735, 736 (2015). Some commentators have questioned the accuracy of this estimate. See Joseph Henchman, *The Marketplace Fairness Act: A Primer*, TAX FOUNDATION (July 14, 2014), <http://www.taxfoundation.org/article/marketplace-fairness-act-primer>; Billy Hamilton, *Fox and Friends: The Rest of the Story on E-Commerce Tax Loss Estimates*, 68 ST. TAX NOTES 535 (May 13, 2013); Noah Aldonas, *DOR Disputes E-Commerce Sales Tax Loss Estimates*, 65 ST. TAX NOTES 576 (Aug. 27, 2012). Others have noted the factors that cause estimates like those from the Bruce study to become outdated swiftly. See

the physical presence rule as the amount of remote sales grows.<sup>34</sup> When Maryland, say, decides to impose a certain amount of tax on consumption in the state,<sup>35</sup> Delaware inadvertently frustrates Maryland's legitimate policy by offering a consumption-tax-free base for vendors. Because Maryland cannot impose use tax collection obligations on "remote vendors" (vendors with no physical presence in the state) from Delaware, Maryland's policies are frustrated. These sovereignty harms offer strength to challenges to *Quill* but present their own major weakness, namely that states such as Maryland always have the authority to collect the taxes from their residents. Any frustration to their tax policy from other states harboring remote vendors is also the result of their choosing not to collect from their residents,<sup>36</sup> something which admittedly has proven very difficult on practical and political grounds.<sup>37</sup> Thus, the physical presence rule, and the *Quill* decision by extension, is unpopular in many circles, and many states have long desired jurisdiction to require remote vendors to collect use taxes.<sup>38</sup> The states' calls for such authority have loudened with the continued growth of e-commerce

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Pomp, *supra* note 15, at 1118 n. 8.

<sup>34</sup> Many thanks to Paul Heald for drawing my attention to this concern.

<sup>35</sup> The state policy here appears to be that of ensuring not that everyone who consumes taxable things in the state pays tax *to the state* but that everyone who consumes taxable things in the state pays an equal amount of tax overall. This is borne out by the fact that states with sales taxes offer credits against those taxes for consumption taxes paid in other states. Thus, the use tax becomes not a revenue-raiser, but an equalizer between differently-situated consumers. The use tax is often referred to in these terms.

<sup>36</sup> See Thimmesch, *supra* note 9, at 384 ("The inability of a state to collect its use tax from a remote vendor does not have any impact on the imposition of that tax. The use tax is fundamentally and directly a tax on the in-state consumer. That tax is due regardless of whether the remote vendor collects the tax. Any competitive disadvantage, reduced tax revenue, or inefficiencies are thus caused first and foremost by consumer noncompliance in reporting and paying that tax.").

<sup>37</sup> See Nina Manzi, *Use Tax Collection on Income Tax Returns in Other States*, H.R. Res. Dep't 10 (Apr. 2015), <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf> (noting that the percentage of taxpayers who report use tax in states where that tax can be reported on income-tax returns is approximately 1.9%); Adam B. Thimmesch, *Taxing Honesty*, 118 W. VA. L. REV. 147, 151–60 (2015) (noting difficulties creating the current "use tax gap"); Swain, *supra* note 26, at 353 ("Sales made by remote sellers are subject to a de facto exemption . . . [T]he Supreme Court has required that a seller be physically present in a state before the state can impose its use tax collection obligation, and it is administratively impractical for a state to directly collect use taxes against individual consumers. Individual consumers seldom self-assess use tax, and so the tax goes unpaid."); Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 23–24 (2004) (discussing administrative problems states face in collecting use taxes from individual consumers).

<sup>38</sup> See Hayes R. Holderness, *Taking Tax Due Process Seriously: The Give and Take of State Taxation*, 20 FLA. TAX REV. 371, 414–19 (2017) (surveying efforts to overturn the physical presence rule).

in the United States, spawning the current “Kill *Quill*” movement.<sup>39</sup>

This movement has seen a number of somewhat peripheral legal challenges to the *Quill* physical presence rule,<sup>40</sup> but a few states have taken bold action against *Quill* in recent years by enacting legislation and adopting regulations which directly disregard the physical presence rule.<sup>41</sup> Challenges to these laws, particularly those of Alabama and South Dakota,<sup>42</sup> have been working their way through the courts, and the U.S. Supreme Court granted certiorari in the South Dakota case on January 12, 2018.<sup>43</sup>

Though the Supreme Court has granted certiorari, convincing it to overturn the physical presence rule will be a difficult task. In deciding when to follow its precedent, the Supreme Court has stated that “[o]ur precedent is to be respected unless the most convincing of reasons demonstrates that adherence to it puts us on a course that is sure error” and has identified relevant factors in that determination as “workability, . . . the antiquity of the precedent, the reliance interests at stake, . . . whether the decision was well reasoned[, and] whether ‘experience has pointed up the precedent’s shortcomings.’”<sup>44</sup> The Kill *Quill* movement appears to be largely placing its hopes on convincing the Supreme Court that technology and the economy have changed enough in the twenty-five years or so since *Quill* was decided to render the physical presence rule unworkable with clear shortcomings.<sup>45</sup>

<sup>39</sup> See Doug Sheppard, *Tax Fight of the Year: States’ War on Quill*, 2017 ST. TAX TODAY 3-6 (Jan. 5, 2017); Hamilton, *supra* note 1; Julie Magee (@juliepmagee), Twitter, <https://twitter.com/juliepmagee> (making constant use of “#killquill”).

<sup>40</sup> See, e.g., Fla. Dep’t of Revenue v. Am. Bus. USA Corp., 191 So. 3d 906 (Fla. 2016), *cert. denied*, No. 16-567 (U.S. Feb. 21, 2017) (challenging Florida’s effort to tax out-of-state deliveries by a Florida-based online flower retailer); Direct Mktg. Ass’n v. Brohl, 814 F.3d 1129 (10th Cir. 2016), *cert. denied*, 137 S. Ct. 591 (2016) (challenging a Colorado law requiring information reporting about use tax liabilities from vendors failing to collect the Colorado use tax).

<sup>41</sup> See sources cited *supra* note 3.

<sup>42</sup> See *supra* note 12.

<sup>43</sup> See *supra* note 13.

<sup>44</sup> *Citizens United v. FEC*, 558 U.S. 310, 362–63 (2010) (internal citations omitted).

<sup>45</sup> See S.D. CODIFIED LAWS § 10-64-1 (providing legislative findings regarding the need to enact a law disregarding the physical presence rule including “the general growth of online retail” eroding the state’s sales tax base and “the [falling] costs of [use tax] collection . . . [g]iven modern computing and software options,” as well as noting that the “argument [for requiring remote sellers to collect use taxes] has grown stronger, and the cause more urgent, with time,” given these findings); *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124, 1134–35 (2015) (Kennedy, J., concurring) (urging a reconsideration of *Quill* given technological and economic changes since 1992); *Direct Mktg. Ass’n v. Brohl*, 814 F.3d 1129, 1151 (10th Cir. 2016) (Gorsuch, concurring) (“*Quill* might be said to have attached a sort of expiration date for mail order and internet vendors’ reliance interests on *Bellas Hess*’s rule by perpetuating its rule for the time being while also encouraging states over time to find ways of achieving comparable results through different means”); Andrew J. Haile, *Sales Tax Exceptionalism*, 4

This is an extraordinary gamble for the movement; *Quill* itself relied heavily on *stare decisis* to retain the physical presence rule it found in *Bellas Hess*,<sup>46</sup> despite strong arguments being presented that technological, economic, and legal circumstances had changed enough to abandon the *Bellas Hess* decision.<sup>47</sup> *Quill* thus offers little comfort to those looking to double-down on the changed circumstances argument.

In *Quill*, North Dakota imposed a use tax collection obligation on Quill Corporation, which the North Dakota Supreme Court allowed after concluding that “‘wholesale changes’ in both the economy and the law made it inappropriate to follow *Bellas Hess* today.”<sup>48</sup> As the *Quill* Court noted, “[t]he principal economic change noted by the [North Dakota] 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.’”<sup>49</sup>

There is little qualitatively of substance that has changed since *Quill* regarding how remote vendors operate. Quill Corporation was a remote vendor with respect to North Dakota: it had no property or employees in the state.<sup>50</sup> It sold office equipment and supplies and solicited business through

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COLUM. J. TAX L. 136, 156 (2013).

<sup>46</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 317 (1992).

<sup>47</sup> North Dakota focused its arguments primarily on the evolution of the Supreme Court’s legal standards. See Brief for Respondent at 55–56, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 667 at \*7. The Court recognized these changes and found them powerful enough to disregard *Bellas Hess* on due process grounds but not on Commerce Clause grounds. See *Quill*, 504 U.S. at 308 (“[T]o 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.”); see also *id.* at 311 (“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.”).

<sup>48</sup> *Quill*, 504 U.S. at 303. Many of the amicus briefs filed in *Quill* in support of North Dakota also argued that technological and economic changes merited the abandonment of the physical presence rule. See, e.g., Brief of the National Governor’s Association, National Conference of State Legislatures, Council of State Governments, National Association of Counties, International City/County Management Association, National Institute of Municipal Law Officers, U.S. Conference of Mayors, and National League of Cities as Amici Curiae in Support of Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 666 at \*1; Brief of the Multistate Tax Commission as Amicus Curiae supporting Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 665 at \*1; Brief for the State of New Jersey as Amicus Curiae supporting Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194) 1991 LEXIS 541 at \*1.

<sup>49</sup> *Quill*, 504 U.S. at 304.

<sup>50</sup> *Id.* at 302. No property of consequence that is. Quill Corporation did send floppy disks containing licensed software into the state. The Supreme Court determined that these disks were insignificant. *Id.* at 315, n. 8.

“catalogs and flyers, advertisements in national periodicals, and telephone calls.”<sup>51</sup> In total, its North Dakota sales accounted for approximately \$1 million of its annual \$200 million in national sales.<sup>52</sup> All of its deliveries into North Dakota were made by mail or common carrier from outside of the state.<sup>53</sup> Today’s remote vendors have similar types of connections with their customers and with the states;<sup>54</sup> the primary differences are that websites have taken the place of catalogues and more customers have moved online to place their orders.<sup>55</sup> The internet is simply a means of advertising for sellers akin to a catalogue and of transmitting orders for customers akin to a phone call or mail order slip. If the types of vendor activities in *Quill* — accepting orders outside of the state and fulfilling them by common carrier or mail — were not enough to break the physical presence rule in 1992,<sup>56</sup> it would seem they are not enough to break the physical presence rule today.

However, the shift to internet-based selling may indicate that physical connections are less important for today’s vendors, making physical presence an awkward jurisdictional rule. Even so, Quill Corporation’s only physical presence in North Dakota — that created by its catalogues and diskettes — was deemed inconsequential and held no sway over the Court. Thus, the *Quill* Court seemed unconcerned about the importance of physical connections to vendors’ business model, and convincing the Court to start caring now may be difficult.

Also, today’s technology may have advanced to the point that the administrative burdens that would be placed on remote sellers if they had to collect use taxes in all of the nation’s taxing jurisdictions — over 6,000 by

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<sup>51</sup> *Id.* at 302.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> See Michael Fatale, *State Tax Jurisdiction and the Mythical “Physical Presence” Constitutional Standard*, 54 TAX LAW. 105, 106 (2000) (“Internet vendors substantially resemble mail order vendors, except that their sales are effected through Internet sites and not through the dissemination of catalogs.”).

<sup>55</sup> Sales from e-commerce were \$298.6 billion in 2014, making up 6.4% of retail sales, compared with \$44 billion and 1.4% in 2002, the earliest year on which the U.S. Census Bureau has data. Compare U.S. Census Bureau, *E-Stats 2014: Measuring the Electronic Economy* (June 7, 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/econ/e14-estats.pdf>, with U.S. Census Bureau, *E-commerce 2002 Highlights* (Apr. 15, 2004), <https://www.census.gov/content/dam/Census/library/publications/2004/econ/2002finaltext.pdf>.

<sup>56</sup> In fact, the *Quill* Court appeared almost proud of the economic changes observed between *Bellas Hess* and *Quill*, as though those changes were intended by the *Bellas Hess* Court. See *Quill*, 504 U.S. at 316 (“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*.”).

the *Quill* Court's count<sup>57</sup> — are no longer a significant concern, removing a justification for the physical presence rule.<sup>58</sup> This argument is not bullet-proof. Even assuming that today's technology has advanced to a point where compliance is easier, remote vendors might still have to pay for that technology and would still be subject to the administrative burden of potential audits from the various taxing jurisdictions. The audit concern is a significant one, and was so even in the time of *Quill*.<sup>59</sup> As North Dakota's brief in *Quill* observed, many mail order businesses were already collecting use taxes because they had related companies with physical presence in the taxing states.<sup>60</sup> If those companies could figure out the intricacies of each jurisdiction's tax laws, it is reasonable to expect that all remote vendors could for some reasonable price. Thus, a major reason to stay out of a state would be to avoid that state's authority to audit the remote vendor. Indeed, in 2016, the Tenth Circuit decided in *Direct Marketing Association v. Brohl* that Colorado could require remote vendors that did not collect the state's use tax to issue information reports to the state and to their customers in the state

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<sup>57</sup> *Quill*, 504 U.S. at 313 n. 6.

<sup>58</sup> See generally Swain, *supra* note 4 (arguing that if lower administrative burdens were placed on remote sellers, the physical presence rule could be disregarded); but see Thimmesch, *supra* note 9, at 387 (offering a counter-argument to the reduced burdens rationale for abandoning *Quill*).

<sup>59</sup> See, e.g., *Quill*, 504 U.S. at 313 n. 6 (noting the compliance burdens existing then and in the time of *Bellas Hess*); Brief for Petitioner, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 570 at \*58-67 (detailing the burdens that would be placed on remote vendors if the physical presence rule were not in place); Brief for the States of New Hampshire, Delaware and Maine as Amici Curiae supporting Petitioner, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 661 at \*34 (noting concerns about the burden of audit costs on vendors if the physical presence rule were not adopted); Brief Amici Curiae of the National Association of Manufacturers; the National Association of Broadcasters; the American Advertising Federation; the American Association of Advertising Agencies, Inc.; the Industry Council on Tangible Assets; and Printing Industries of America as Amici Curiae supporting Petitioner, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 564 at \*30-31 (same); Brief of the Coalition for Small Direct Marketers as Amici Curiae supporting Petitioner, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 563 at \*15-32 (same); Brief of the Direct Marketing Association as Amici Curiae supporting Petitioner, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 540 at \*35 (same).

<sup>60</sup> Brief for Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1991) (No. 91-194), 1991 LEXIS 667 at \*55-56 (1991) ("There is no logical reason for differentiating between multistate direct marketing businesses such as Sears or J.C. Penney and their direct marketing competitors . . . . The decisions holding that nationwide retailers like Sears must collect sales or use taxes on their catalog sales further demonstrate that an administrative burden associated with use tax collection is irrelevant to the commerce clause inquiry. If the existence of such a cost were sufficient to establish a commerce clause violation for direct marketers like *Quill*, it should also be sufficient for Sears and J.C. Penney.").

detailing their use tax liabilities.<sup>61</sup> In response to that decision, some remote vendors have stated that they would comply with the reporting rather than voluntarily collect the use taxes in part to avoid the state's audit authority.<sup>62</sup> Though Congress could (relatively) easily address the audit concerns in legislation removing the physical presence rule, the Supreme Court is ill-suited to craft such rules.<sup>63</sup>

On the other hand, there is a quantitative difference between today's world and that of *Quill*'s in the volume of sales made by remote vendors, particularly online vendors.<sup>64</sup> The change in volume may be enough to sway some Justices, such as Justice Kennedy,<sup>65</sup> but it also may not carry the day. If Quill Corporation lacked the appropriate substantive connections with North Dakota, it is an uphill battle to argue that remote vendors today have the appropriate connections simply because there are more remote vendors and more remote sales. The quality of contacts should matter more as a constitutional matter than the quantity of them. If an activity is substantively not nexus-creating, a lot of that activity should still not be nexus-creating.<sup>66</sup> Additionally, though the physical presence rule is harming the states more today than in 1992 by an absolute measure of use taxes uncollected, the state losses from that rule account for only 3.8% of all sales and use tax collections by one measure.<sup>67</sup> This figure would seem a precarious one to base a challenge to *Quill* on. The effects on state sovereignty of changed circumstances are difficult to measure, but recall that the frustrations to state

<sup>61</sup> Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129 (10th Cir. 2016), *cert. denied*, 137 S. Ct. 591 (2016).

<sup>62</sup> See Tripp Baltz, *Overstock, Others Will Report, Not Collect Colorado Tax*, DAILY TAX REP. (BNA), Jan. 2017, at H1 (“[W]e’re not excited about exposing Overstock to another state audit, and by voluntarily collecting, we’d be exposing ourselves to audits by the state of Colorado.”).

<sup>63</sup> *Quill*, 504 U.S. at 318 (noting that Congress “may be better qualified to resolve” issues regarding the allocations of burdens resulting from a change in the physical presence rule); see also George S. Isaacson & Matthew P. Schaefer, *Retail Giants vs. Small Business: The Real Remote Sales Tax Fight*, 83 ST. TAX NOTES 741, 744 (Feb. 27, 2017) (“Congress alone has the expertise and legislative tools to view the issue on a national scale, taking account of the competing interests while ensuring that America’s small businesses can continue to thrive and grow.”); Thimmesch, *supra* note 9, at 387.

<sup>64</sup> See sources cited *supra* note 55.

<sup>65</sup> See Direct Mktg. Ass'n, 135 S. Ct. at 1134–35 (Kennedy, J., concurring).

<sup>66</sup> However, activities that are not nexus-creating because they are de minimis should be expected to create nexus when their quantity increases. For example, if Quill Corporation had inundated North Dakota with floppy disks, perhaps the state would have had nexus over the company.

<sup>67</sup> See Bruce et al., *supra* note 33. The Bruce et al. study determined that unpaid sales and use taxes on online sales contributed to an estimated \$11.4 billion in lost tax revenues among all states in 2012. The uncollected amount represented 3.8% of total sales tax liabilities for 2012.



policy fall partially on the states themselves, making such harms less compelling.<sup>68</sup>

In sum, changed circumstances arguments were a primary basis of the challenge to the physical presence rule in *Quill* but were unsuccessful. While technological and economic circumstances have changed since *Quill* was decided, there are reasons to doubt that the changed circumstances arguments would succeed where they failed in 1992.<sup>69</sup> Fortunately for the Kill *Quill* movement, there are other lines of attack on the physical presence rule that can supplement those arguments.<sup>70</sup> Through engaging in a novel dissection of the *Quill* decision, this article outlines one such alternative line of attack that was not advanced in *Quill*: challenging the reasoning behind the physical presence rule,<sup>71</sup> particularly the basis for requiring that a state have a “substantial nexus” with the taxpayer under the Commerce Clause and the failure of *Quill* and its forerunners to examine the nature and substance of use tax collection obligations. Exploring the weaknesses in the reasoning behind the rule exposes the Court’s struggles with defining the standards for jurisdiction to tax and determining when and how those standards apply. The following Parts address those struggles and, in so doing, demonstrate the fragility of the physical presence rule’s foundations.

### III. THE BURDEN OF JURISDICTION TO TAX: REDUCING UNDUE BURDENS

In *Quill*, the Supreme Court articulated two separate sets of limitations on state tax jurisdiction: those arising from the Due Process Clause and those arising from the Commerce Clause.<sup>72</sup> Generally speaking, “[t]he Due Process Clause demands that there exist “some definite link, some minimum connection, between a state and the person . . . it seeks to tax,” as well as a rational relationship between the tax and the ‘values connected with the taxing State.’”<sup>73</sup> On the other hand, the Commerce Clause requires the existence of a “substantial nexus” between the activity taxed and the taxing

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<sup>68</sup> See *supra* notes 34–37 and accompanying text.

<sup>69</sup> See Thimmesch, *supra* note 9, at 387–88.

<sup>70</sup> See, e.g., Pomp, *supra* note 15, at 1144–54.

<sup>71</sup> See *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring) (“*Quill* . . . should be left in place only if a powerful showing can be made that its rationale is still correct.”); *Citizens United v. FEC*, 558 U.S. 310, 362–63 (2010) (“Beyond workability, the relevant factors in deciding whether to adhere to the principle of *stare decisis* include the antiquity of the precedent, the reliance interests at stake, and of course whether the decision was well reasoned.”) (internal citations omitted) (emphasis added).

<sup>72</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 305 (1992) (“Thus, although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.”).

<sup>73</sup> *MeadWestvaco Corp. v. Ill. Dep’t of Revenue*, 553 U.S. 16, 24 (2008), quoting *Quill*, 504 U.S. at 306.

state.<sup>74</sup> The *Quill* Court provided that there must also be a substantial nexus under the Commerce Clause between the taxpayer and the state.<sup>75</sup> Thus, the Supreme Court has made explicit that the U.S. Constitution requires connections between a taxing state and the taxpayer as well as the taxing state and the activity taxed before jurisdiction to tax exists.

What remains unclear is why there must be a substantial nexus between the state and the taxpayer under the Commerce Clause (rather than just the due process minimum connections) and whether there must also be a connection between the taxpayer and the activity taxed. These uncertainties belie the weakness of the reasoning in *Quill* and *Bellas Hess*. The following parts explain the Court's stated requirements for tax jurisdiction and explore the source and justification — reducing burdens on interstate commerce — for the required substantial nexus between the taxing state and the taxpayer. In order to achieve the goals of this substantial nexus requirement, a broader and more exacting consideration of the burdens state tax actions can place on interstate commerce than that which the Court has offered so far is needed. Under such an approach, the physical presence rule is immediately suspect.

#### A. State Connections with the Taxpayer and with the Activity Taxed

As noted, the Supreme Court has articulated three connections that must exist for a state to have jurisdiction to tax: (1) a due process nexus between the state and the taxpayer, (2) a Commerce Clause nexus between the state and the activity taxed, and (3) a Commerce Clause nexus between the state and the taxpayer. The Due Process Clause is “concerned with the fundamental fairness of governmental activity,” and in the context of state tax jurisdiction, the Supreme Court has “often identified ‘notice’ or ‘fair warning’ as the analytic touchstone of due process . . . analysis.”<sup>76</sup> I have argued elsewhere that the due process nexus standard for state tax jurisdiction is transactional in nature: the requirement that there be a rational relationship between the tax and the values connected with the taxing state demands that the taxing state provide the taxpayer with some benefit, and the requirement that there be a minimum connection between the state and the taxpayer requires that the taxpayer indicate acceptance of the state-provided benefit through purposefully directing activities towards the state's economic market.<sup>77</sup> Given the broad scope of benefits a state could provide a person, the primary jurisdictional limitation under the Due Process Clause is whether

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<sup>74</sup> *Quill*, 504 U.S. at 311.

<sup>75</sup> *Id.* (“*Bellas Hess* . . . 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.”).

<sup>76</sup> *Id.* at 312.

<sup>77</sup> See generally Holderness, *supra* note 38.

the taxpayer has created a minimum connection with the taxing state by sufficiently directing activities towards the state.

The Commerce Clause establishes the connection required between the taxing state and the activity taxed, as well as an additional connection required between the taxing state and the taxpayer. In contrast to the Due Process Clause, the Commerce Clause addresses “structural concerns about the effects of state regulation on the national economy.”<sup>78</sup> To achieve this goal, the Commerce Clause prohibits state tax actions that “unduly burden interstate commerce.”<sup>79</sup> Generally, a state action is deemed to unduly burden interstate commerce when the burdens placed on interstate commerce outweigh the state’s interests in taking the action; a balancing test is used.<sup>80</sup> Taxation certainly is a compelling state action, and the Court has developed a four-part test to guide the analysis of the burden on interstate commerce that a state tax might impose:

[W]e 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.”<sup>81</sup>

The test derives from the 1977 case of *Complete Auto Transit, Inc. v. Brady*,<sup>82</sup> and is thus commonly referred to as the “Complete Auto test.”<sup>83</sup> The first prong of the test establishes the primary Commerce Clause limitation on a state’s jurisdiction to tax. The remaining factors are concerned with the structure of the tax. The precise meaning of “substantial nexus” has not been fully resolved by the Supreme Court, but the Court has provided that the

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<sup>78</sup> *Quill*, 504 U.S. at 312.

<sup>79</sup> *Id.*

<sup>80</sup> See *supra* note 18. The Supreme Court has adopted “a two-tiered approach to analyzing state economic regulation under the Commerce Clause.” *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 578–79 (1986). When a regulatory measure “has only indirect effects on interstate commerce and regulates evenhandedly,” the Court applies a balancing analysis, looking to “whether the State’s interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.” *Id.* at 579 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)). However, “[w]hen a state statute directly regulates . . . interstate commerce,” the Court has “generally struck down the statute without further inquiry.” *Id.* at 579.

<sup>81</sup> *Quill*, 504 U.S. at 311. Many argue that this test incorporates not only Commerce Clause ideals but Due Process Clause ideals as well. See, e.g., Michael T. Fatale, *The Evolution of Due Process and State Tax Jurisdiction*, 55 SANTA CLARA L. REV. 565, 578 (2015).

<sup>82</sup> 430 U.S. 274 (1977).

<sup>83</sup> See John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 WM. & MARY L. REV. 319, 328 (2003).

standard requires more than “the slightest presence” in the taxing state<sup>84</sup> and that physical presence meets the standard in the context of sales and use taxes.<sup>85</sup> Interestingly, the *Quill* Court did not analyze the connection between the taxing state and the activity it determined had been taxed — the use of property<sup>86</sup> — perhaps because the activity clearly took place in the state, making the inquiry (or any challenge to the connection) moot. Instead, the *Quill* Court held that *the taxpayer* must have a physical presence in the taxing state to satisfy the Commerce Clause in the context of use tax collection obligations.<sup>87</sup> It is this physical presence rule that the Kill *Quill* movement is challenging.

The Court failed to explain the basis for the required substantial nexus between the taxpayer and the taxing state. That requirement is not mentioned in the *Compete Auto* test,<sup>88</sup> though the *Quill* Court relied on the first prong of the test when discussing the requirement. With the goals of the Commerce Clause in mind, it is possible to form the justification for the required nexus between the taxpayer and the taxing state, and doing so exposes weaknesses in the reasoning behind the physical presence rule.

#### *B. Justifying Substantial Nexus between the Taxing State and the Taxpayer*

The *Quill* Court endorsed the physical presence rule — and thereby the substantial nexus requirement between the taxpayer and the state — intending to “further the ends of the dormant Commerce Clause.”<sup>89</sup> Thus, the basis of the substantial nexus requirement is to prevent undue burdens on taxpayers engaged in interstate commerce. The primary burdens placed on a taxpayer by a taxing state are complying with the tax law and accessing the tax base. Compliance concerns paying or remitting the correct amount of money and the administrative costs associated with audits. Accessing the tax base refers to the taxpayer’s ability to access funds derived from the activity taxed. For example, a taxpayer tasked with paying a real estate transfer tax would have access to the tax base if she could access the money earned from the transfer of the real estate. Thus, accessing the tax base concerns where the tax money comes from; if the taxpayer cannot access the tax base, then the money used to comply must come from another source, which may

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<sup>84</sup> *National Geographic Soc’y v. Cal. Equalization Bd.*, 430 U.S. 551, 556 (1977).

<sup>85</sup> *Quill*, 504 U.S. at 314.

<sup>86</sup> *Id.* at 301 (“This case . . . 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.”).

<sup>87</sup> *Id.* at 317–18.

<sup>88</sup> See *supra* note 81 and accompanying text.

<sup>89</sup> *Quill*, 504 U.S. at 314.

impose an undue burden on the taxpayer.<sup>90</sup> Accessing the tax base may seem a part of the compliance burden; the two are separated here on the grounds that accessing the tax base does not require any direct interaction with the state, whereas compliance with the law does.

*Quill* and *Bellas Hess* only considered the burden that compliance costs place on interstate commerce,<sup>91</sup> and in both cases the Court failed to explain how a taxpayer's physical presence is related to those costs (other than to say that using physical presence as a rule would limit exposure to the costs, as most any rule would).<sup>92</sup> The Court must expand its analysis of the burdens placed on interstate commerce by state tax actions if the required substantial nexus between the state and the taxpayer is to serve its purpose. The following subparts offer such an expanded analysis by considering how that substantial nexus might address compliance costs and costs of accessing the tax base.

### 1. Mitigating Compliance Costs

Requiring a substantial nexus between the taxing state and the taxpayer does mitigate the aggregate burden compliance costs impose on interstate commerce by ensuring that certain people engaged in interstate commerce are not subject to those costs in every state. The *Quill* Court and the *Bellas Hess* Court attempted to justify the physical presence rule on these grounds,<sup>93</sup> but it is a blunt rule. The Supreme Court has never explained how a taxpayer's physical presence is related to the burden of compliance costs

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<sup>90</sup> Because money is fungible, direct access to the tax base may not be necessary as a constitutional matter; a taxpayer could take funds from one source and replace them later with funds from the activity taxed.

<sup>91</sup> See David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 501 (2012) ("As in *Quill*, the only discussion in the *Bellas Hess* decision about how allowing states to impose use tax compliance obligations on remote vendors might burden interstate commerce relies on the overlapping compliance duties that could be imposed by multiple jurisdictions.").

<sup>92</sup> See Swain, *supra* note 26, at 362 ("What is not apparent from the Court's discussion is how a physical presence test reduces the burden.").

<sup>93</sup> *Id.* at 313 n. 6.

[I]f 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. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements 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.'

imposed on that taxpayer,<sup>94</sup> perhaps because there is little relation between the two.<sup>95</sup> In short, the Court has never fully justified the use of the physical presence rule to mitigate the burden of compliance costs on interstate commerce, it has only justified having a rule.

If the goal is to mitigate *undue* burdens (not just burdens generally), the more appropriate inquiry concerns the size of the vendor:<sup>96</sup> compliance costs burden large vendors to a proportionately lower degree than small vendors.<sup>97</sup> Physical presence is a poor tool for determining the size of a remote vendor: though a small remote vendor is unlikely to have a physical presence in a large number of states, a large remote vendor can avoid having a physical presence in many states.<sup>98</sup> For example, for many years Amazon.com, a giant of online retailing, strategically avoided having a physical presence in most states, even going so far as to issue maps to its employees showing states they could and could not enter.<sup>99</sup> Though it made sales nationwide, Amazon was protected in most states from tax collection obligations due to the physical

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<sup>94</sup> See *supra* notes 29–322 and accompanying text; Pomp, *supra* note 15, at 1145–46 (“One fundamental problem with *Quill* is that the Court never explained what physical presence in a state has to do with limiting state burdens on interstate commerce, retreating into bromides about the value of bright lines and how they can be rough around the edges . . . . [N]owhere does the Court explain why the burden of collecting the use tax is reduced when a mail-order vendor has property in the state, or has engaged the services of ten part-time, independent contractors within the state.”).

<sup>95</sup> See *supra* note 60 and accompanying text; *Bellas Hess*, 386 U.S. at 766 (Fortas, J., dissenting) (“There is no doubt that the collection of taxes from consumers is a burden; but it is no more of a burden on a mail order house such as appellant located in another State than on an enterprise in the same State which accepts orders by mail; and it is, indeed, hardly more of a burden than it is on any ordinary retail store in the taxing State.”); Pomp, *supra* note 15, at 1138; Swain, *supra* note 4.

<sup>96</sup> See Swain, *supra* note 26, at 361–64 (discussing the problems with the physical presence rule as a measure of burdens on the use tax collector).

<sup>97</sup> Donald Bruce & William F. Fox, *An Analysis of Internet Sales Taxation and the Small Seller Exemption*, SMALL BUS. ADMIN., 35–36 (2013); see also Isaacson & Schaefer, *supra* note 63 (detailing the relatively higher burdens that state tax compliance places on smaller vendors); Natasha Varyani, *Taxing Electronic Commerce: The Efforts of Sales and Use Tax to Evolve with Technology*, 39 OKLA. CITY U. L. REV. 151, 172 (2014).

<sup>98</sup> Bruce & Fox, *supra* note 97, at 32–34 (determining that approximately 53% of sales and use taxes go uncollected because large remote vendors lack physical presence in many states into which they sell); Swain, *supra* note 4; Varyani, *supra* note 97, at 173–74, 188.

<sup>99</sup> Steve Wasserman, *The Amazon Effect*, THE NATION, June 18, 2012, <https://www.thenation.com/article/steve-wasserman-amazoncoms-takeover/>. (detailing the growth of Amazon.com and observing that the company relied on the physical presence rule “to avoid collecting hundreds of millions of dollars in state sales taxes, giving Amazon an enormous edge over retailers of every kind, from bookstores to Best Buy and Home Depot.”); Stu Woo, *Amazon Battles States Over Sales Tax*, THE WALL STREET JOURNAL, Aug. 3, 2011 <https://www.wsj.com/articles/SB10001424053111904772304576468753564916130>.

presence rule.<sup>100</sup> Currently, Wayfair, another large internet-based retailer, collects sales taxes in twelve states.<sup>101</sup> Assuming Wayfair has a physical presence in all of those states, is it really reasonable to conclude that the retailer Homage, which has seven brick-and-mortar stores total in three states,<sup>102</sup> is a quarter of Wayfair's size on those facts alone? If the physical presence rule is intended to protect vendors from undue compliance costs, it provides imperfect protections for small vendors (who might have physical presence in multiple states) and permits at least partially elective avoidance for large vendors (who need not have a physical presence in all the states into which they sell).<sup>103</sup>

However, though not addressed by the Supreme Court, the physical presence rule may do a better job of addressing the taxpayer's burden of accessing the tax base by ensuring that the taxpayer has a connection to the activity taxed. To evaluate the rule on these grounds, the Court must establish what type of connection between the taxpayer and the activity taxed the Commerce Clause demands.

## 2. Ensuring Access to the Tax Base

If the taxpayer is to have access to the tax base, presumably some connection must exist between the taxpayer and the activity taxed.<sup>104</sup> However, neither the due process standards provided by the Supreme Court nor the Complete Auto test make any mention of a required connection between a taxpayer and the activity taxed. In fact, the Court has intimated that such a connection may be unnecessary as a matter of constitutional law. In *National Geographic Society v. California Equalization Board*, California imposed a use tax collection obligation on the National Geographic Society,

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<sup>100</sup> As of April 2017, Amazon.com is collecting taxes in all states imposing them. See Paul Jones, *Amazon Finalizes Deals to Collect Taxes in All Remaining States*, 2017 ST. TAX TODAY 55-1 (Mar. 23, 2017).

<sup>101</sup> See *Ordering Information*, WAYFAIR.COM, [http://www.wayfair.com/customerservice/ordering\\_info.php](http://www.wayfair.com/customerservice/ordering_info.php) (last visited June 30, 2017) ("One of the best things about buying through Wayfair is that we do not have to charge sales tax, with a few notable exceptions: orders shipping to Alabama, California, Georgia, Illinois, Kentucky, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Texas, [and] Utah . . .").

<sup>102</sup> See *Retail*, HOMAGE, <https://www.homage.com/pages/retail> (last visited June 30, 2017).

<sup>103</sup> See Swain, *supra* note 83, at 342.

<sup>104</sup> For purposes of this analysis, it will be assumed that the quality of the connection between the taxpayer and activity taxed is only that which would grant the taxpayer straightforward access to the tax base, such that only de minimis costs are incurred to reach the funds related to the activity taxed. The question of the quality of connection is open, and may require more.

which owned and operated two stores in California.<sup>105</sup> Invoking both the Due Process Clause and the Commerce Clause, the Society argued that it should not have to collect use taxes on mail order sales it made to California customers because the Society's activities in California were unrelated to those mail order sales.<sup>106</sup> The Court summarized the argument as follows: "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 within the State."<sup>107</sup>

The Court rejected this argument, establishing that no in-state connection between the taxpayer and the activity taxed must exist, but in so doing, relied solely on due process standards:

[T]he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller 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."<sup>108</sup>

The Court did not make a separate inquiry under the Commerce Clause or note what that clause demanded. Indeed, the Due Process Clause and Commerce Clause analyses were lumped together by the Court until *Quill*, creating a "quagmire" of decisions.<sup>109</sup> The split of the analyses in *Quill* was based on the acceptance that the two clauses had different goals and thus demanded different analyses.<sup>110</sup> Therefore, it is unsurprising that prior to *Quill*, the Court failed to consider the separate goals of the Commerce Clause when addressing the argument for a constitutionally required in-state connection between taxpayer and activity, but this failure left an analytical void in the jurisprudence.<sup>111</sup>

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<sup>105</sup> *National Geographic Soc'y v. Cal. Equalization Bd.*, 430 U.S. 551, 552–53 (1977).

<sup>106</sup> *Id.* at 560.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 561.

<sup>109</sup> See *Quill Corp. v. North Dakota*, 504 U.S. 298, 315–16 (1992); see also Pomp, *supra* note 15, at 1149 ("Prior to *Quill*, the Court never had any reason to specify whether a nexus decision was grounded on one clause or the other.")

<sup>110</sup> *Quill*, 504 U.S. at 305.

<sup>111</sup> Professor Pomp wisely cautions against reading pre-*Quill* nexus cases as being decided solely under the Due Process Clause or solely under the Commerce Clause. Pomp, *supra* note 15, at 1149–50. This article does not take the position that *National Geographic Society* is only a due process decision, rather it observes that the decision only referred to due process concepts in reaching its conclusions. As discussed below, *National Geographic Society* may be good law for Commerce Clause purposes, see *infra* notes 116–118 and



There are three ways to conceptualize the connection the Commerce Clause could require between the taxpayer and the activity taxed: (1) no connection is necessary, (2) a connection is necessary, but the connection need not be based on anything occurring in the taxing state (a “soft connection”), or (3) a connection is necessary, and the connection must be based on something occurring in the taxing state (a “hard connection”). Putting this statement in other terms, if no connection or a soft connection is all that is necessary, the state’s substantial nexus with the taxpayer does not necessarily depend on the taxpayer’s connection with the activity taxed; if a hard connection is required, then the state’s substantial nexus with the taxpayer does depend on the taxpayer’s connection with the activity taxed — that connection forms the basis for the state’s substantial nexus with the taxpayer and must be in-state.

If the Commerce Clause requires no connection between the taxpayer and the activity taxed, then there is no guarantee that the taxpayer will have access to the tax base. In this scenario, a state tax could impose a high burden on a taxpayer that meets whatever substantial nexus standard is in place<sup>112</sup> — physical presence, say — because the taxpayer could be divorced from the activity taxed. At the extreme, a state could require any person with a substantial nexus with the state to collect from others any tax that is levied on an activity within the state’s jurisdiction. For example, Virginia might require me — a physically present resident — to collect my Tennessee colleague’s Virginia income tax on income earned in the state. This result would almost certainly be unduly burdensome on interstate commerce. The costs of finding unrelated (and often out-of-state) people and property to collect taxes from would surely discourage people from other states from establishing nexus with the taxing state. If the tax base could not be accessed, the taxpayer would have to pay out-of-pocket in order to comply with the

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accompanying text, but if it is, it is exceedingly difficult to find a sound basis for the physical presence rule. *See infra* Part III.C.

<sup>112</sup> This connection would presumably be of a higher degree than the Due Process Clause’s required minimum connections. *But see* Rick Handel, *A Conceptual Analysis of Nexus in State and Local Taxation*, 67 *TAX LAW* 623, 630 (2014) (“If the Due Process Clause requires certain minimum contacts with a state, the Commerce Clause does not require a greater number of contacts.”); Adam B. Thimmesch, *The Illusory Promise of Economic Nexus*, 13 *FLA. TAX REV.* 157, 188–91 (2012) (discussing the “gratuitous elevation of the Commerce Clause over the Due Process Clause”); Swain, *supra* note 83, at 372 (“The central conclusion of this Article is that physical presence is not an income tax nexus requirement. Accordingly, substantial nexus for income taxes may approach the due process minimum contacts standard.”); Jesse H. Choper & Tung Yin, *State Taxation and the Dormant Commerce Clause: The Object-Measure Approach*, 1998 *SUP. CT. REV.* 193, 213 (1998) (“We do not interpret the Commerce Clause to require a separate nexus more stringent than that imposed by the Due Process Clause because that is not required to further protect interstate commerce against state taxes that accord a preference to local enterprises.”).

law. Though the states' interest in collecting taxes is a legitimate and important one, it is difficult to imagine that interest outweighing the burden on interstate commerce where no connection between taxpayer and activity taxed is required. There would be less burdensome ways of collecting the taxes, such as requiring taxpayers with connections to the activities taxed to collect and pay the taxes.<sup>113</sup>

It should be noted that *National Geographic Society* did not establish that the Due Process Clause requires *no* connection between a taxpayer and the activity taxed; the case determined only that due process does not require an *in-state* connection.<sup>114</sup> Therefore, it is possible that the Due Process Clause would prohibit the extreme state action proposed in the example in the previous paragraph. Even so, the focus here is on the connection the Commerce Clause requires between a taxpayer and the activity taxed. If the Commerce Clause requires no such connection, then fewer grounds for the physical presence rule exist (i.e., mitigating compliance costs — a suspect justification<sup>115</sup> — would be its primary justification).

Requiring a soft connection between the taxpayer and the activity taxed — essentially following *National Geographic Society* for Commerce Clause purposes<sup>116</sup> — would alleviate the burden on interstate commerce of a no connection regime by ensuring that the taxpayer has access to the tax base, but would still impose a burden on interstate commerce by opening a person up to state taxation based on out-of-state activities. That is to say, a state's jurisdiction to tax could depend not on the in-state activities of the taxpayer but on its out-of-state activities that connect it to the activity taxed. The taxpayer might have some activity inside the state, but as with the taxpayer in *National Geographic Society*, that activity would not be what the state is subjecting to tax. Instead, the Commerce Clause would permit a state to require a taxpayer to rely on its out-of-state activities to collect tax on the in-state activity.<sup>117</sup> Though subtle, this point should not be overlooked given the Supreme Court's historic concerns about extraterritorial taxation.<sup>118</sup>

On the other hand, requiring a hard connection would ensure that the

<sup>113</sup> See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (“[T]he extent of the burden [on interstate commerce] that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.”).

<sup>114</sup> *National Geographic Soc’y v. Cal. Equalization Bd.*, 430 U.S. 551, 560 (1977).

<sup>115</sup> See *supra* Part III.B.1.

<sup>116</sup> Assuming that *National Geographic Society* does not stand for the proposition that no connection is required between the taxpayer and the activity taxed. See *supra* note 114 and accompanying text.

<sup>117</sup> Many thanks to Adam Thimmesch for helping me work through these ideas.

<sup>118</sup> See Holderness *supra* note 38, at 402–04 (surveying the Supreme Court's concerns about extraterritorial state taxation).

state's jurisdiction to tax depends solely on in-state activities. At base, a hard connection regime should be comparable to a soft connection regime with respect to addressing the costs of accessing the tax base — both ensure that the taxpayer has such access.<sup>119</sup> However, a hard connection regime would ease extraterritorial taxation concerns by ensuring that a state could only require a taxpayer to rely on in-state activities to collect the tax imposed. For example, suppose NationalGeographicSociety.com sold online maps to California customers. If NationalGeographicSociety.com hosted those maps on servers in California, then a hard connection might exist. If instead NationalGeographicSociety.com conducted all of its activities relating to the maps — designing, hosting, selling, etc. — in Washington, D.C., there would be no hard connection establishing jurisdiction to tax, even if NationalGeographicSociety.com hosted other data on servers in California. Thus, a hard connection regime would be less permissive to the states than a soft connection regime and would offer the highest protection for taxpayers against the burdens of state tax actions.

The practical difference between a soft connection regime and a hard connection regime is well-illustrated by the current debate over use tax collection with respect to property purchased outside of the taxing state but used in the state. If a soft connection is all that is required, then the collector's physical presence in the taxing state should be irrelevant (assuming the collector purposefully directs her activities towards the state): the state has a substantial nexus with the use of property in the state; the collector has due process minimum connections to the state; and the collector has a connection to the use of the property resulting from the sale and transfer of the property outside of the state. However, if a hard connection is required, then the collector must have some activity in the state related to the use of the property in the state, in-state delivery or advertising perhaps. Here, the physical presence of the taxpayer in the taxing state may be relevant, but not necessarily.

### C. *The Problem with Physical Presence*

The *Quill* Court adopted the physical presence rule as a bright-line test that avoids “case-by-case evaluation[s] of the actual burdens imposed by particular regulations or taxes [in favor of] the demarcation of a discrete realm of commercial activity that is free from interstate taxation.”<sup>120</sup> According to the Court, this bright-line test provides the benefit of clarity as to when the appropriate nexus exists between the taxing state and the

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<sup>119</sup> Again, this analysis assumes that the connection needed between the taxpayer and the activity taxed need rise only to the level of allowing the taxpayer straightforward access to the tax base. See *supra* note 104.

<sup>120</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).

taxpayer.<sup>121</sup> But as the above discussion indicates, the rule, clear as it may appear, suffers from a lack of strong reasoning and as a result may fail to address the burdens a taxing state imposes on a taxpayer engaged in interstate commerce — the physical presence of a taxpayer in the taxing state bears little relation to the burden of compliance costs on the taxpayer and is unnecessary in a no connection or soft connection regime.

Therefore, to begin to justify the *Quill* Court’s adoption of the physical presence rule for use tax collection obligations, a hard connection regime must be assumed; the state’s substantial nexus with the taxpayer is dependent on the taxpayer having an in-state connection with the activity taxed. Under this regime, physical presence may offer a reasonable approximation of when a hard connection exists. A physically present vendor seems likely to facilitate remote sales in some manner — through delivery, advertising, or accepting returns<sup>122</sup> — and thus case-by-case findings of the hard connections between the taxpayers and the activities taxed could give way in favor of the clarity of the rule. But even so, physical presence is not necessary to create a hard connection in the context of use tax collection, as developed in the following Part. As Justice White observed in his *Quill* dissent, “In today’s economy physical presence frequently has very little to do with a transaction a State might seek to tax.”<sup>123</sup>

#### IV. BESPOKE JURISDICTION TO TAX: ONE SUBSTANTIAL NEXUS RULE DOES NOT FIT ALL

Assuming substantial nexus between the taxing state and the taxpayer demands a hard connection between the taxpayer and the activity taxed,<sup>124</sup> what constitutes such substantial nexus can be expected to differ depending on what is taxed. The Supreme Court demands that the substance of a tax control the analysis of its constitutionality,<sup>125</sup> and has indicated that the factors of the Complete Auto test do not necessarily apply uniformly to all

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<sup>121</sup> *Id.*

<sup>122</sup> In *National Geographic Society*, the Court noted many of these types of activities that a physically present vendor might conduct. See *National Geographic Soc’y*, 430 U.S. 551, 560–61 (1977).

<sup>123</sup> *Quill*, 504 U.S. at 328 (White, J., dissenting).

<sup>124</sup> This assumption is made because a hard connection regime is the only regime under which a physical presence rule is justified, see *supra* Part III.C., and therefore appears to be the approach the Supreme Court favors.

<sup>125</sup> Perhaps surprisingly, this was not always the case, but an exploration of the “quagmire” of state and local tax jurisprudence leading to the current standard is beyond the scope of this article. See POMP, *supra* note 19, at 1-1 to 1-21 (discussing the evolution of jurisdictional requirements for state taxes under the Commerce Clause and noting the swings between the formalistic and substantive analyses required).

taxes.<sup>126</sup> It follows that the substance of the tax should determine the type of activities that will establish a substantial nexus between the state and the taxpayer; substantial nexus might be established differently for each alternative type of tax. For example, substantial nexus in the case of an income tax might depend on the ownership of income-generating assets, tangible or intangible, in a state; substantial nexus in the case of a sales tax might depend on being a party to the sales transaction in the state. This Part applies this principle of “bespoke jurisdiction to tax” to use tax collection obligations, further demonstrating the analytical shortcomings of the *Quill* decision.

A major omission of the Supreme Court in *Quill* was its failure to analyze the nature of a use tax collection obligation. What is such a thing? Is it a regulatory burden placed on vendors to act for the benefit of the state? Or is it the same as a *payment* obligation (i.e., equivalent to a tax itself)? If it is a tax, what is the substance of that tax? The answers to these questions are not necessarily clear, but the basis for physical presence as a jurisdictional rule is questionable regardless of the answers. The following parts analyze the appropriate jurisdictional standards for use tax collection obligations as regulatory burdens and as taxes; though, as developed below, it should be expected that the Court will view use tax collection obligations as taxes, necessitating an understanding of what the activity taxed is in order to develop appropriate substantial nexus rules.

#### A. Use Tax Collection Obligations as Regulatory Burdens

A tax collection obligation can be fairly characterized as a regulatory burden imposed on people doing business in the state — particularly the business of selling things subject to the tax — separate from the tax to be collected. Indeed, in *National Geographic Society*, the Supreme Court determined that a vendor’s presence in the taxing state could be wholly unrelated to selling the products on which use tax was to be collected and the state would still have jurisdiction to impose the use tax collection obligation on the vendor.<sup>127</sup> That Court even stated that “the sole burden imposed upon the out-of-state seller by [use tax collection statutes] is the administrative one

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<sup>126</sup> See Walter Hellerstein, Michael J. McIntyre, & Richard D. Pomp, *Commerce Clause Restraints on State Taxation After Jefferson Lines*, 51 TAX L. REV. 47, 107–08 (1995). Professors Hellerstein, McIntyre, and Pomp argue that a pure reading of the Supreme Court’s 1995 decision in *Oklahoma Tax Commission v. Jefferson Lines* indicates the form, rather than the substance, of the tax may control the application of the Complete Auto test. For its own part, the *Jefferson Lines* Court determined that the taxes it was considering were different in substance. *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 190–91 (1995).

<sup>127</sup> *National Geographic Soc’y*, 430 U.S. at 551.

of collecting [the use tax].”<sup>128</sup> This opinion did not clearly ground its holding in the Commerce Clause,<sup>129</sup> and jurisdiction to tax standards have evolved since the case,<sup>130</sup> but the holding does indicate that a use tax collection obligation is different from the tax itself.<sup>131</sup>

If a use tax collection obligation is a regulatory burden and not a tax, a state’s authority to impose regulations on a business should be sufficient to impose such an obligation, and it is not clear that the substantial nexus requirement for state tax actions (and thus the physical presence rule) would have any role to play in the analysis. The Commerce Clause would limit the state’s authority if the state’s interest in the use tax collection obligation did not outweigh the resulting burden on interstate commerce from the obligation.<sup>132</sup> As tax collection is a compelling state interest, this balancing test may be more permissive than the current physical presence rule.<sup>133</sup>

However, the burden of the regulatory requirement is not trivial; the collector must undertake the cost of collecting the tax, and a major component of the burden is the exposure to audit by the taxing state.<sup>134</sup> Audits can be costly and time-consuming, and may result in additional liability for the collector.<sup>135</sup> These burdens are not necessarily greater in scope than any other regulatory requirements, save one major detail with respect to use tax collection obligations: Under current state laws, if a vendor fails to collect the use tax, the vendor becomes jointly and severally liable for the tax not collected, potentially increasing the burden on vendors greatly.<sup>136</sup> Though the consumer also remains liable for the tax,<sup>137</sup> this penalty on a non-collecting vendor effectively shifts the burden of the tax to the vendor because states are loath to compel consumers to pay the tax and individual

<sup>128</sup> *Id.* at 558.

<sup>129</sup> *See id.* at 552–53.

<sup>130</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992) (observing that “contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today”).

<sup>131</sup> *See Hartman*, *supra* note 21, at 171 (“The tax itself is a burden on one engaged in local use, but coerced collection has a direct impact only on one engaged in interstate transactions . . . . [T]his collection aspect of the use tax has not given the Court much pause, but in arriving at its conclusion that the collection method imposes no constitutional difficulty, the Court often confuses valid taxability with constitutional collectability.”).

<sup>132</sup> *See Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 578–79 (1986).

<sup>133</sup> *Quill*, 504 U.S. at 314 (observing that the state tax jurisprudence has moved in favor of “more flexible balancing tests”).

<sup>134</sup> *See id.* at 313 n. 6.

<sup>135</sup> *See Baltz*, *supra* note 62 and accompanying text.

<sup>136</sup> *E.g.*, FLA. STAT. § 212.12(5)(b); MINN. STAT. § 289A.31, Subd. 7(a); N.Y. Tax Law § 1133(a); WASH. REV. CODE § 82.08.050(3).

<sup>137</sup> *E.g.*, N.Y. TAX LAW § 1133(b).

consumers typically do not pay the taxes on their own.<sup>138</sup> The Court would have to weigh these potential burdens — to which the vendor’s physical presence appears to have no relation<sup>139</sup> — against the state’s compelling interest in tax collection to determine the validity of the use tax collection obligation imposed.

### B. Use Tax Collection Obligations as Taxes

Despite the argument for characterizing use tax collection obligations as regulatory burdens and the Supreme Court’s history of doing so, the Court seems unlikely to do so today. The Court appears to have accepted that a tax collection obligation (and the resulting potential for joint and several liability for another person’s tax liability) is the substantive equivalent of a tax itself, at least for jurisdictional purposes. *Quill* applied tax standards to the use tax collection obligation at issue, and Justice Scalia observed in his concurrence that “[a]s 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.”<sup>140</sup> This assumed equivalence is not wholly unjustified; the collector is subject to audit risk by the state taxing authority, and in a worst-case scenario, will bear the burden of the tax to be collected.<sup>141</sup> Therefore, under the assumption that a use tax collection obligation is the same in substance as a tax, the substance of that tax becomes critical for jurisdictional purposes.

As noted, the Supreme Court demands that the substance of the tax control the analysis of its constitutionality.<sup>142</sup> To this end, the Court examines who or what bears the economic burden of the tax.<sup>143</sup> *Quill* and its forerunners failed to examine the substance of use tax collection obligations when reaching their conclusions — an analytical flaw throwing the reasoning of those cases into question. Who the tax (i.e., the tax collection obligation) burdens appears relatively straightforward; the burden of the tax is placed on the collector.<sup>144</sup> What bears the burden of the tax is less clear and could be

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<sup>138</sup> See *Manzi*, *supra* note 37.

<sup>139</sup> See discussion in Part III.B.1.

<sup>140</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992) (Scalia, J., concurring).

<sup>141</sup> See FLA. STAT. § 212.12(5)(b); MINN. STAT. § 289A.31, Subd. 7(a); N.Y. TAX LAW § 1133(a); WASH. REV. CODE § 82.08.050(3).

<sup>142</sup> See *supra* note 125.

<sup>143</sup> See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

<sup>144</sup> Of course, the collector may pass that tax along to the consumer through increased prices, but because the collector is not required to, it will be assumed for the purposes of this analysis that the burden falls on the collector. For discussions of how demand and supply elasticities can affect the ability of a vendor to pass taxes along to customers, see Hayes R. Holderness, *The Unexpected Role of Tax Salience in State Competition for Businesses*, 84 U.

answered in at least two ways. First, it could be viewed as a tax on the privilege of selling taxable things into the state. Second, it could be characterized the same as the use tax itself, as a tax on the use of the thing sold. Neither characterization demands a physical presence rule for jurisdiction.

### 1. A Tax on the Privilege of Selling into the State

Characterizing a use tax collection obligation as a tax on the privilege of selling into a state may seem odd at first glance, but there is a strong case to make for such a characterization. The obligation on the vendor results not from using the thing sold, but rather from the act of selling. As the *National Geographic* court recognized, the burden of collecting the tax is separate from the tax itself.<sup>145</sup> In addition, the measure of the value of the tax is not the actual use of the thing but rather its purchase price, which further separates the tax from the use of the thing.<sup>146</sup>

Taxes on the privilege of engaging in interstate commerce — here, engaging in selling over state lines — have had a schizophrenic constitutional experience.<sup>147</sup> The Supreme Court has waffled from denying the states any right to impose such taxes to permitting the taxes subject to the prongs of the Complete Auto test.<sup>148</sup> As much as a quagmire as this area of jurisprudence may have been, it is now clear that taxes on the privilege of engaging in interstate commerce are not *per se* unconstitutional.<sup>149</sup>

Characterizing use tax collection obligations as privilege taxes would present the Supreme Court with an unresolved legal question. The Court has not addressed the substantial nexus standard for privilege taxes, but a physical presence rule ignores many of the aspects of selling into a state, such as advertising and delivery in the state. Recognizing this, many state courts have determined that a vendor's economic presence in the taxing state

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CHI. L. REV. 1091, 1135–36 (2017); Walter Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 TAX LAW. 405, 438–39 (1986).

<sup>145</sup> *National Geographic Soc'y v. Cal Equalization Bd.*, 430 U.S. 551, 558 (1977).

<sup>146</sup> One might suspect an apportioned value of the actual use as the tax base if actual use were the target of the tax. *But see Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995) (finding that sales taxes did not need to be levied on an apportioned tax base to meet the fair apportionment requirement of the Complete Auto test). Using purchase price as the tax base may indicate that the tax is more closely linked to the act of selling. To be fair, this same argument could be made against use taxes as taxes on the use of the product.

<sup>147</sup> See POMP, *supra* note 19, at 1-1 to 1-21.

<sup>148</sup> *Id.*; see also *Complete Auto*, 430 U.S. at 279–87 (detailing the evolution of the Court's approach to state taxes on the privilege of engaging in interstate commerce).

<sup>149</sup> See *Complete Auto*, 430 U.S. at 288–89 (“[W]e now reject the rule . . . that a state tax on the ‘privilege of doing business’ is *per se* unconstitutional when it is applied to interstate commerce . . .”).



satisfies the substantial nexus standard for privilege or income taxes.<sup>150</sup> Thus, having intangible property or business activities in the state or having a significant amount of sales into the state may be sufficient to create the requisite nexus over the vendor.<sup>151</sup> Further, even assuming a hard connection is necessary, the activities of the vendor in the state would not need to be related to the actual use of the thing sold in the state, any type of activity in the state relating to selling, such as advertising or delivery, might justify the imposition of a use tax collection obligation.<sup>152</sup>

## 2. A Tax on the Use of the Thing Sold

Alternatively, a use tax collection obligation could be characterized as substantively a tax on the use of the thing sold. Given the mechanics of the collection obligation, this characterization seems less grounded in reality; the state is not compelling the vendor to collect the tax because the vendor used the thing, rather the state imposes tax on the consumer because the consumer uses the thing. Even so, the jurisprudence has tangled use tax collection obligations and use taxes sufficiently enough to make such a characterization likely.<sup>153</sup>

Characterizing a use tax collection obligation as a use tax for jurisdictional purposes appears to strengthen the case for the physical presence rule. The physical presence rule is the jurisdictional standard for the imposition of sales taxes and seemingly for the imposition of use taxes (as

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<sup>150</sup> See *supra* note 6; see also generally Thimmesh, *supra* note 112 (analyzing the states' economic presence nexus standards).

<sup>151</sup> See, e.g., *Geoffrey Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993) (finding Commerce Clause nexus as the result of earning income from intellectual property used in the state); *Tax Commissioner v. MBNA America Bank, N.A.*, 640 S.E.2d 226, 232 (W. Va. 2006) (finding Commerce Clause nexus as the result of having a substantial economic presence in the state). This article expresses no opinion regarding the validity of either of these approaches.

<sup>152</sup> A potential constitutional snag for such a privilege tax is that the measure of the tax is the purchase price of the thing sold, which may appear arbitrary. However, the Supreme Court has declared that, pursuant to the fourth prong of the Complete Auto test, the measure of a tax is constitutional so long as it is fairly related to the protections or benefits the taxpayer receives from the state. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 625–26 (1981). To say that this requirement is forgiving to the states is an understatement at best; the states are given great flexibility to craft the measure of their taxes. See Edward A. Zelinsky & Brannon P. Denning, *Debate, The Future of the Dormant Commerce Clause: Abolishing the Prohibition on Discriminatory Taxation*, 155 U. PA. L. REV. PENNUMBRA 196, 206 (2007) (“Courts have heretofore been so reluctant to . . . apply . . . the ‘fairly related’ prong of Complete Auto [that it] has become a dead letter.”) (comments of Brannon P. Denning). Measuring a tax on the privilege of selling into a state by the purchase price of things sold into the state can hardly be expected to run afoul of the Complete Auto test.

<sup>153</sup> See *Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992).

detailed in the next part).<sup>154</sup> If physical presence is the correct rule for use taxes, then it would be the correct rule for a use tax collection obligation. Though the case for physical presence as the rule with respect to the imposition of sales tax is relatively clear — the tax is on the in-state transfer of title or possession, thus requiring some in-state presence<sup>155</sup> — the case for physical presence as the rule for use taxes is less clear.

This lack of clarity results from the lack of thorough analysis justifying the extension of the physical presence rule for sales taxes to use taxes. Instead, the Supreme Court brought about this extension by assuming the equivalence of sales taxes and use taxes for jurisdictional purposes, effectively ignoring the full range of activities that use taxes fall on and focusing the jurisdictional inquiry on only that portion of taxable “use” that corresponds with sales — the in-state transfer of title or possession. With this assumption in place, the physical presence rule for use taxes was basically a foregone conclusion.

Thus, the Supreme Court turned a condition it had deemed sufficient for use tax jurisdiction — physical presence — into one necessary for such jurisdiction. Challenging the reflexive tying of the substance of use taxes to that of sales taxes and highlighting the full range of activities that a use tax covers further exposes weaknesses in the reasoning behind the physical presence rule. The next part examines how use taxes were pushed into the legal shadow of sales taxes, resulting in the physical presence rule for use taxes.

### C. Trivializing Use Taxes

Use taxes and sales taxes are undeniably related.<sup>156</sup> Use taxes were adopted subsequent to or contemporaneously with sales taxes as an equalizer of tax burdens on products purchased in-state and those purchased out-of-state and as a backstop against lost sales tax revenues.<sup>157</sup> To prevent double taxation of the same product, states allow a credit against use taxes for any

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<sup>154</sup> See *McLeod v. JE Dilworth Co.*, 322 U.S. 327 (1944) (requiring a sale to take place in the taxing state before it can be subjected to a sales tax); *Gen. Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335 (1944) (finding the appropriate nexus to levy a use tax on property when the property is used within the taxing state).

<sup>155</sup> See *JE Dilworth*, 322 U.S. 327; see also, e.g. N.Y. TAX LAW §§ 1101(b)(5), 1105 (defining sale as the transfer of title or possession and imposing sales tax on retail sales).

<sup>156</sup> See *supra* notes 19–24 and accompanying text.

<sup>157</sup> See POMP, *supra* note 19, at 6–39; see also E.E. McLees, *The Use Tax After One Year*, 4 ARK. L. REV. 337, 337–39 (1950) (describing the intention and operation of the then newly-adopted Arkansas Use Tax). This backstop also serves to protect states’ ability to pursue their policy goals unimpeded by the actions of other states. See *supra* note 35 and accompanying text.

other sales taxes and use taxes applied to the product.<sup>158</sup> As a technical matter then, both a sales tax and a use tax apply to the product when constitutionally permissible, but the use tax is diminished by the sales tax imposed.<sup>159</sup> Therefore, sales taxes rise to the primary level of taxation between the two, in the sense that use taxes give way to sales taxes through the credit mechanisms.<sup>160</sup>

Given that use taxes were designed as complements to sales taxes, it may appear completely benign, even appropriate, for use tax jurisdictional standards to exist in the shadow of sales tax standards. However, as the following discussion indicates, the Supreme Court has only explicitly demanded equivalence between sales taxes and use taxes in the context of deciding whether the taxes discriminate against interstate commerce.<sup>161</sup> Though the Court ultimately pronounced the same nexus standard for both types of taxes — physical presence — it has never stated that the taxes must be considered equivalent for jurisdictional purposes. There is room for different nexus standards for sales taxes and use taxes because the two taxes have a significant difference: sales taxes typically fall only on the transfer of title to or possession of a taxable item, whereas use taxes fall on all uses of the taxable item, including the delivery, storage, and consumption of the item.<sup>162</sup> In short, use taxes fall on a broader range of activities. Even if the

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<sup>158</sup> POMP, *supra* note 19, at 6–39.

<sup>159</sup> *Id.*

<sup>160</sup> Whether this arrangement should be so has long been a topic of debate. *See, e.g., Int'l Harvester Co. v. Dep't of Treasury*, 322 U.S. 340, 361 (1944) (Rutledge, J., concurring in part and dissenting in part) (“If . . . it were necessary to choose between the state of origin and that of market for the exercise of exclusive power to tax, or for requiring allowance of credit in order to avoid the cumulative burden, in my opinion the choice should lie in favor of the state of market rather than the state of origin.”).

<sup>161</sup> *See* Sandra B. McCray, *Commerce Clause Sanctions Against Taxation on Mail Order Sales: A Re-Evaluation*, 17 URB. LAW. 529, 562–64 (1985) (discussing the complementary nature of sales and use taxes and the resulting demands of the Commerce Clause).

<sup>162</sup> *E.g., compare* N.Y. TAX LAW § 1105 (imposing sales tax on “every retail sale of tangible personal property”), *with* N.Y. TAX LAW § 1110 (imposing use tax on “the use within this state . . . of any tangible personal property”). N.Y. Tax Law § 1101(b)(5) defines “sale” as “[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.” N.Y. Tax Law § 1101(b)(7) defines “use” as “[t]he exercise of any right or power over tangible personal property . . . and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property . . . .” *Compare also* the definitions of “sales tax” and of “use tax” contained in the Multistate Tax Compact, an agreement among certain states to standardize their tax systems. A “sales tax” is defined as “a tax imposed with respect to the transfer for a

two types of taxes should be characterized as equivalent taxes on consumption, use taxes would seem the appropriate taxes to set the substantial nexus rule as the taxes that more accurately map onto consumption. However, the Supreme Court's use tax jurisprudence has effectively ignored the full scope of use taxes for jurisdictional purposes by shifting use taxes from the perceived equal of sales taxes to the ward of sales taxes, dependent on such taxes for their substance and existence.

### 1. The Foundational Sales and Use Tax Cases — Sales Taxes and Use Taxes Are Different

Three Supreme Court cases did much to lay the foundation for how the constitutional jurisprudence characterizes the substance of use taxes, with two primary views informing that substance arising: first, a view of use taxes as anti-sales-tax-avoidance measures; and second, a view of use taxes as independent taxes on the use of property or the right to use property.<sup>163</sup> These cases are *Henneford v. Silas Mason Co.*,<sup>164</sup> *McLeod v. JE Dilworth Co.*,<sup>165</sup> and *General Trading Co. v. State Tax Commission of Iowa*.<sup>166</sup>

*Silas Mason* arguably did little to define the substance of use taxes, at best giving credence to either formulation and instead focusing on whether the interaction between Washington's "compensating [use] tax" and its retail sales tax resulted in unconstitutional taxation. To begin, the Court clearly affirmed that use taxation is a valid form of taxation, the use of property being a part of the bundle of property rights which a state has the authority to tax (provided the use occurs in the state).<sup>167</sup> The Court did indicate that a use tax is something independent of a sales tax, except perhaps when the use taxed

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consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered . . . ." MULTISTATE TAX COMPACT, art. II, cl. 7. A "use tax" is defined as

a nonrecurring tax, other than a sales tax, which (a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property and (b) is complementary to a sales tax.

*Id.* at art. II, cl. 8.

<sup>163</sup> See John E. Nowak & Ronald D. Rotunda, *Sales and Use Tax Credits, Discrimination Against Interstate Commerce, and the Useless Multiple Tax Concept*, 20 U.C. DAVIS L. REV. 273, 278 (1987) (describing the two justifications for use taxes).

<sup>164</sup> 300 U.S. 577 (1937).

<sup>165</sup> 322 U.S. 327 (1944).

<sup>166</sup> 322 U.S. 335 (1944).

<sup>167</sup> *Silas Mason*, 300 U.S. at 582.

is “so closely connected with delivery as to be in substance a part thereof,” in which case the tax “might be subject to the same objections that would be applicable to a tax upon the sale itself.”<sup>168</sup> However, in describing the Washington tax, the Court observed that “[e]quality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing.”<sup>169</sup> This description painted the Washington use tax as an anti-sales-tax-avoidance measure, with the Court concluding that “[i]n substance what [Washington] says is this: You may ship your goods in such amounts and at such prices as you please, but the goods when used in Washington after the transit is completed, will share an equal burden with goods that have been purchased here.”<sup>170</sup> Even so, this description was made in the context of deciding that Washington’s system of taxation did not discriminate against interstate commerce, and the Court clarified that Washington’s system of sales and use tax credits may not have been necessary to meet the constitutional standard: “A taxing act is not invalid because its exemptions are more generous than the state would have been free to make them by exerting the full measure of her power.”<sup>171</sup>

The *JE Dilworth* and *General Trading* cases are often thought of as companions and address when a state has the constitutional nexus required to impose a sales tax or a use tax on a transaction.<sup>172</sup> Both cases had similar fact patterns: the taxing state sought to impose a tax — a sales tax in the case of *JE Dilworth* and a use tax in the case of *General Trading* — on property sold outside of the state and then sent into that state for use there.<sup>173</sup> The sales

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<sup>168</sup> *Id.* at 583.

<sup>169</sup> *Id.* at 583–84. The Court continued:

No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere. Everyone who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington. When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed . . . . If the sales tax were abolished, the buyer in Washington would pay at once upon the use. He would have no longer an offsetting credit.

*Id.* at 584.

<sup>170</sup> *Id.* at 586.

<sup>171</sup> *Id.* at 587.

<sup>172</sup> See Pomp, *supra* note 15, at 1125–26.

<sup>173</sup> *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 328 (1944); *Gen. Trading Co. v. State Tax Comm’n of Iowa*, 322 U.S. 335, 337 (1944).

were solicited, at least partially, by travelling salesmen of the vendors in the taxing states. Fully displaying that sales taxes and use taxes are different types of taxes, the Supreme Court found in *JE Dilworth* that Arkansas had no authority to impose a sales tax on sales of property made in Tennessee<sup>174</sup> but found in *General Trading* that Iowa could impose a use tax on the use of property sold in Minnesota.<sup>175</sup>

Indeed, the Court's discussion in *JE Dilworth* demonstrates a view that sales taxes and use taxes must be analyzed independently of each other for nexus purposes (i.e., that a use tax should not be viewed solely as an anti-sales-tax-avoidance measure in this context):

It is suggested, however, that Arkansas could have levied a tax of the same amount on the use of these goods in Arkansas by the Arkansas buyers, and that such a use tax would not exceed the limits upon state power derived from the United States Constitution. Whatever might be the fate of such a tax were it before us, the not too short answer is that Arkansas has chosen not to impose such a use tax, as its Supreme Court so emphatically found. A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds. A sales tax is a tax on the freedom of purchase — a freedom which wartime restrictions serve to emphasize. A use tax is a tax on the enjoyment of that which was purchased . . . . Thus we are not dealing with matters of nomenclature even though they be matters of nicety.<sup>176</sup>

In contrast, the discussion in *General Trading* did not even approach the comparison between sales taxes and use taxes on the nexus issue, as the Court clearly was comfortable with Iowa's right to impose a use tax on the property purchased in Minnesota and used in Iowa.<sup>177</sup> The *General Trading* Court relied on earlier decisions to find that the solicitation of business in the state was sufficient to establish Iowa's right to require the Minnesota vendor to

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<sup>174</sup> *McLeod*, 322 U.S. at 330 (“We would have to destroy both business and legal notions to deny that under these circumstances the sale — the transfer of ownership — was made in Tennessee. For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.”).

<sup>175</sup> *Gen. Trading Co.*, 322 U.S. at 338–39.

<sup>176</sup> *McLeod*, 322 U.S. at 330–31.

<sup>177</sup> *Gen. Trading Co.*, 322 U.S. at 337 (“In view, however, of the clear understanding by the court below that the facts we have summarized bring the transaction within the taxing power of Iowa, there is little need for elaboration.”).

collect use taxes on the products it sold into the state.<sup>178</sup> Interestingly, the Court's remaining discussion in the case focused heavily on Iowa's right to impose a use tax and less on the state's right to require the out-of-state vendor to collect the tax:

[T]he mere fact that property is used for interstate commerce or has come into an owner's possession as a result of interstate commerce does not diminish the protection which he may draw from a State to the upkeep of which he may be asked to bear his fair share . . . . The exaction is made against the ultimate consumer — the Iowa resident who is paying taxes to sustain his own state government. To make the distributor the tax collector for the State is a familiar and sanctioned device.<sup>179</sup>

Justice Jackson, in dissent, picked up on this apparent analytical brush over, criticizing the Court for cavalierly extending the state's power to "subject persons to its taxing power who are not within its jurisdiction and have not in any manner submitted themselves to it."<sup>180</sup> Justice Jackson admitted that a "state may make tax collectors of those who come in and do business within its jurisdiction,"<sup>181</sup> but disagreed that the precedents the Court relied on supported the decision in *General Trading*. In his view, an out-of-state vendor that "never qualified in Iowa and has no office, branch, warehouse, or general agent in the State" does not receive any benefit or right from the state sufficient to create nexus with the state.<sup>182</sup> Justice Jackson did not explain why he thought the presence of the vendor's salesmen in Iowa was not enough to create nexus, but presumably he believed the salesmen were not "general agent[s]" of the vendor, and that their presence in Iowa thus could not be attributed to the vendor.<sup>183</sup>

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<sup>178</sup> *Id.* at 337–38 ("We agree with the Iowa Supreme Court that *Felt & Tarrant Co. v. Gallagher*; *Nelson v. Sears, Roebuck & Co.*; and *Nelson v. Montgomery Ward & Co.* are controlling. The *Gallagher* case is indistinguishable — certainly nothing can turn on the more elaborate arrangements for soliciting orders for an intricate machine for shipment from without a State as in the *Gallagher* case, compared with the apparently simpler needs for soliciting business in this case.") (internal citations omitted).

<sup>179</sup> *Id.* at 338–39.

<sup>180</sup> *Id.* at 339 (Jackson, J., dissenting).

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*; accord *Holderness*, *supra* note 38 (arguing that the Due Process Clause requires that a person receive benefits from a state before the state may constitutionally subject it to tax).

<sup>183</sup> This conclusion would be precarious under current precedent, which permits the presence of an in-state person to be attributed to an out-of-state person if the in-state person is acting in the state on the behalf of the out-of-state person to establish and maintain a market in the state for the out-of-state person. See *Tyler Pipe Indus., Inc. v. Wash. State Dep't of*

## 2. A Strict Rule of Equality: *Halliburton*

In 1963, the Supreme Court returned to the issue of use taxes in *Halliburton Oil Well Cementing Co. v. Reily*.<sup>184</sup> *Halliburton* was not a nexus case, instead the question presented was whether the Louisiana use tax, which followed the “basic pattern” of the Washington use tax considered in *Silas Mason*,<sup>185</sup> discriminated against interstate commerce. In finding that the tax did discriminate against interstate commerce, the Court interpreted *Silas Mason* as requiring “equal treatment for instate and out-of-state taxpayers similarly situated [as] the condition precedent for a valid use tax on goods imported from out-of-state.”<sup>186</sup> Because the Court found — perhaps mistakenly<sup>187</sup> — that the Louisiana use tax placed a higher burden on out-of-state people than the sales tax placed on in-state people, it concluded that there was “no reason to depart from *the strict rule of equality adopted in Silas Mason*, and . . . that the Louisiana use tax as applied to the appellant’s specialized equipment discriminates against interstate commerce.”<sup>188</sup> Though the result, given the findings, appears facially justified, it requires an assumption that underlies how many view use taxes today: they are assumed to be solely complements to sales taxes and thus must be considered together with them. This assumption led to the “strict rule of equality” between sales taxes and use taxes that the Court believed *Silas Mason* adopted.

The concurrence and dissent in *Halliburton* appear to take varying degrees of issue with this assumption and the resulting strict rule of equality. Justice Brennan, in concurrence, observed that the unconstitutionality of the application of Louisiana’s use tax did not “flow from any duty upon the States to ensure absolute equality of economic burden as between sales and use taxpayers.”<sup>189</sup> However, Justice Brennan did conclude that the states could not impose different rates of taxation on the use and sale of property without discriminating against interstate commerce.<sup>190</sup> Most importantly, Justice Brennan stated that to fix the discrimination he found in Louisiana’s tax

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*Revenue*, 483 U.S. 232, 250 (1987) (“[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales.”) (internal citations omitted); see also *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

<sup>184</sup> 373 U.S. 64 (1963).

<sup>185</sup> *Id.* at 65.

<sup>186</sup> *Id.* at 70.

<sup>187</sup> The Court’s analysis failed to consider how a vendor might price parts and labor into a good; if it had, it might have concluded that the burdens of the Louisiana sales tax and use tax were substantially the same.

<sup>188</sup> *Halliburton*, 373 U.S. at 73 (emphasis added).

<sup>189</sup> *Id.* at 76 (Brennan, J., concurring).

<sup>190</sup> *Id.* at 77.



scheme, the state did not have to equalize the two taxes' bases; it only had to apply the taxes to all similarly-situated taxpayers. In so saying, he noted that there was a second justification for use taxes beyond merely "offset[ting] the effect of sales taxes imposed on in-state purchasers, and thereby to deter domestic consumers from seeking to evade the sales tax by purchasing out of state."<sup>191</sup> That justification was that a use tax is a valid levy on "the privilege of use after commerce is at an end."<sup>192</sup> Thus, Justice Brennan exposed the conflict between viewing use taxes as anti-sales-tax-avoidance measures and independent taxes. Justice Clark, on the other hand, dissented from the Court's holding, further rejecting the notion that use taxes are solely complements to sales taxes. "The fallacy of the Court's holding is that it ignores the incidence of the tax in Louisiana's Tax Act. That incidence is the moment that the product becomes a part of the mass of property within the State."<sup>193</sup> Under Justice Clark's view, the use tax is separate from the sales tax and the use tax should apply to property when it is first used in the state, regardless of what the sales tax is applied to. Justice Clark accused the majority of changing the incidence of the use tax by requiring uniformity with the sales tax, which would necessitate taxing each component part of the product used separately rather than simply taxing the product used in its entirety.<sup>194</sup>

The tension between the two potential views of use taxes is evident in *Halliburton*, but the Court stuck with the view that use taxes primarily serve a complementary role to sales taxes and must follow their lead. This move easily may have been the result of the states presenting their use taxes as complementary to their sales taxes.<sup>195</sup> But as the concurrence and dissent in *Halliburton* demonstrate, this did not have to be the case; use taxes could be viewed as a form of taxation independent from sales taxes which would have allowed the jurisdictional standard for imposing use taxes to develop on its own. Tied to sales taxes, use taxes never had a chance.

### 3. The Resulting Physical Presence Rule

Though not directly evident in the holdings, the strict rule of equality

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<sup>191</sup> *Id.*

<sup>192</sup> *Id.* (internal citations omitted).

<sup>193</sup> *Id.* at 79 (Clark, J., dissenting).

<sup>194</sup> *Id.* at 79–80.

<sup>195</sup> *See, e.g.*, CAL. REV. & TAX. CODE § 7203 ("The use tax portion of any sales and use tax ordinance adopted under this part shall impose a complementary tax . . ."); N.C. GEN. STAT. § 105-164.6 (imposing a "complementary use tax"); W. VA. CODE § 11-15A-1a(1) ("It is the intent of the Legislature that the use tax imposed by the provisions of article fifteen-a and the consumers sales tax imposed by the provisions of article fifteen of this chapter be complementary laws . . .").

arising from the assumption that the nature of use taxes was the prevention of the erosion of sales tax bases informed the adoption of the physical presence test for use tax collection nexus through *Bellas Hess*<sup>196</sup> and *Quill*.<sup>197</sup> In *Bellas Hess*, the Court considered the authority of Illinois to require an out-of-state taxpayer to collect use taxes on property sold into the state.<sup>198</sup> The taxpayer was a mail-order vendor with no physical buildings, salesmen, or other property in the state, other than catalogs and other mailings to Illinois residents.<sup>199</sup> It shipped all of its products to its Illinois residents through mail or common carrier.<sup>200</sup> In language that served as the genesis for the physical presence rule, the Court determined that:

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, is a valid one, and we decline to obliterate it.<sup>201</sup>

By simply relying on earlier use tax cases involving vendors with physical presence in the taxing state to reach its conclusion, the Court passed up an opportunity to more intricately consider the type of contacts with a state that could establish use tax nexus.<sup>202</sup> The Court was correct to observe that physical presence was found in almost all of these earlier cases, but failed to explain that only once before *Bellas Hess* had it considered a vendor without traditional physical presence.<sup>203</sup> In that case, *Miller Brothers v. Maryland*, the Court did not find due process nexus, so the physical presence question

<sup>196</sup> Nat'l *Bellas Hess v. Dep't of Revenue*, 386 U.S. 753 (1967).

<sup>197</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

<sup>198</sup> For an excellent dissection of the *Bellas Hess* case, see Pomp, *supra* note 15, at 1133–40.

<sup>199</sup> *Bellas Hess*, 386 U.S. at 754–55.

<sup>200</sup> *Id.* at 754.

<sup>201</sup> *Id.* at 758.

<sup>202</sup> See Morey Stephen Rosenbloom, *Use Taxation—A “National” Dilemma*, 41 TEMP. L.Q. 240, 245–46 (1968) (noting the missed opportunity in *Bellas Hess* to fully analyze the company's connections with the taxing state).

<sup>203</sup> See Hartman, *supra* note 21, at 172 (“It was a ‘familiar and sanctioned device’ to make the out-of-state seller serve as a collector when he had localized himself by operating through a retail outlet within the taxing state . . . but it was neither familiar nor had it been sanctioned when this was not the situation.”).

was moot.<sup>204</sup> The *Bellas Hess* Court instead relied on its conclusion that “this basic distinction . . . has been generally recognized by the state taxing authorities.”<sup>205</sup> No doubt this conclusion was eased by the perception of use taxes as mere complements to sales taxes embraced by *Halliburton* — under *JE Dilworth*, physical presence was clearly necessary for the imposition of a sales tax.

The result in *Bellas Hess* may have been the same had the Court given the question of use tax nexus without traditional physical presence a harder look, but it very well could have been different, as Justice Fortas’s dissent in the case indicates. Justice Fortas was unconvinced by the Court’s standard, observing that “[t]here should be no doubt 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.”<sup>206</sup> In his view, National *Bellas Hess* had received numerous benefits from Illinois, which justified the state’s jurisdiction over the company. National *Bellas Hess* “regularly and continuously engaged in ‘exploitation of the consumer market’ of Illinois” and “could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities.”<sup>207</sup> In short, “*Bellas Hess* enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein.”<sup>208</sup>

In effect, the refusal of the majority in the *Bellas Hess* case to consider more rigorously the substance of use taxes limited the substance to that of sales taxes — taxes on the immediate sales transaction in the state for the good sold. But use taxes apply to a larger range of activities; the activity taxed is not merely the transfer of title to or possession of the product but also the other uses of the product.<sup>209</sup> A remote vendor might have the requisite connection with those other activities to constitutionally be required to collect the use taxes, but the *Bellas Hess* Court’s dismissive opinion prevented the

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<sup>204</sup> *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 347 (1954) (finding no due process nexus between the taxpayer and taxing state and observing that therefore “we need not consider whether the statute imposes an unjustifiable burden upon interstate commerce”). For a dissection of the *Miller Brothers* case, the faults within it, and what might have been equal in excellence to his dissection of the *Bellas Hess* case, see Pomp, *supra* note 15, at 1121–32. Of particular relevance here, Pomp — as well as the dissent in *Miller Brothers* — chides the majority’s characterization of the continued presence of *Miller Brothers*’ own truck in Maryland, which should have been more than enough to establish a physical presence in the state, as “occasional.” See *id.* at 1130–31, 1154–55.

<sup>205</sup> *Bellas Hess*, 386 U.S. at 758.

<sup>206</sup> *Id.* at 761 (Fortas, J., dissenting).

<sup>207</sup> *Id.* at 762.

<sup>208</sup> *Id.*

<sup>209</sup> See *supra* note 162.

analysis of that question. Physical presence may be necessary for a sale, but it is not clear that physical presence would be necessary for other taxable uses.

*Quill* represents the current law with respect to states' jurisdiction to impose use taxes (as well as jurisdiction to impose use tax collection obligations).<sup>210</sup> In *Quill* the Court considered whether North Dakota could require Quill Corporation, a remote vendor,<sup>211</sup> to collect the state's use tax on the products it sold into the state. Relying heavily on the principle of *stare decisis*, the Court ultimately sustained the physical presence rule it gleaned from *Bellas Hess* but characterized the rule as flowing from the requirements of the Commerce Clause, not the Due Process Clause, again failing to consider the substance of the tax.<sup>212</sup> This result changed little as a practical matter for remote vendors, but did clearly open the door for Congress to change the rule.<sup>213</sup> Needless to say, if Justice Fortas's view in *Bellas Hess* had prevailed, *Quill* would not exist today in its current form.

#### V. REEXAMINING PHYSICAL PRESENCE

The above analysis demonstrates weaknesses in the reasoning underlying the Supreme Court's conclusion that the Commerce Clause requires a person to have a physical presence in a state before the state can require the person to collect and pay the state's use tax. The Court failed to explain why the Commerce Clause requires any type of connection between the taxing state and the taxpayer, failed to consider the nature of use tax collection obligations, and relied on a conclusory assumption of the equivalence of sales taxes and use taxes in adopting the physical presence rule. These analytical gaps offer strength to the Kill *Quill* movement's calls to reexamine the rule.<sup>214</sup>

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<sup>210</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 317–18 (1992) (“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.”) (emphasis added).

<sup>211</sup> *Quill Corp.*'s status as a remote vendor is not entirely evident from the facts of the case, but the Supreme Court treated *Quill* as having no physical presence in North Dakota. See *supra* note 50 and accompanying text.

<sup>212</sup> *Quill*, 504 U.S. at 317–18.

<sup>213</sup> *Id.* at 318 (“[I]n recent years Congress has considered legislation that would ‘overrule’ the *Bellas Hess* rule. 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, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”).

<sup>214</sup> See *supra* note 71 and accompanying text.

However, the Supreme Court will not necessarily be quick to change the physical presence rule despite the weaknesses in its foundations. As noted, the Court has articulated reasons for the rule beyond those that flow from reducing undue burdens on interstate commerce under the Commerce Clause.<sup>215</sup> Perhaps the strongest rationale for continuing to leave the rule in place is the Court's opinion that Congress is the appropriate federal actor to dismantle the physical presence rule.<sup>216</sup> Critics of this position have argued that the Court cannot abdicate its responsibility for correcting harmful decisions by passing the buck to a Congress that is unwilling or unable to act.<sup>217</sup> Given that the Court has granted certiorari in the *Wayfair* case,<sup>218</sup> it appears that those critics have won the Court over. The following parts suggest potential actions the Kill Quill movement could take to convince the Court reexamine the physical presence rule, and then suggest what a more fundamentally sound substantial nexus rule might look like.

#### A. Getting the Supreme Court's Attention

To bring the Supreme Court's attention to the physical presence rule's problems, the Kill Quill movement could take steps to highlight *Quill*'s analytical gaps and facilitate a direct challenge to the rule, or alternatively could attempt to play off of the gaps to make current use tax obligations distinguishable from those considered in *Quill*. In any direct challenge to the *Quill* decision, the Kill Quill movement should assume that use tax obligations will be considered the same as use taxes and that the Commerce Clause requires a hard connection between the taxpayer and the activity taxed, as these are the positions most adverse to overturning the physical presence rule (a no connection or soft connection regime would clearly not necessitate physical presence, and the alternative characterizations of use tax collection obligations pull them away from *Quill*'s reach). Having made these assumptions, the movement must attack the assumption that use taxes are subordinate to sales taxes and could take actions to upset the balance between sales taxes and use taxes in order to facilitate that attack. Alternatively, if the current direct challenge or others fail, the Kill Quill

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<sup>215</sup> See Swain, *supra* note 26, at 357–65 (articulating three “faces of *Quill*” — “stare decisis *Quill*, burdens *Quill*, and disappearing ink *Quill* — which depend on different rationales); Thimmesch, *supra* note 9, at 381–88 (examining and critiquing Professor Swain's three faces of *Quill*).

<sup>216</sup> See *Quill*, 504 U.S. at 318 (“[Retaining the physical presence rule] is made easier by the fact 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.”).

<sup>217</sup> Brief of Interested Law Professors as Amici Curiae supporting Petitioner at 19, Brohl v. Direct Mktg. Ass'n, 137 S. Ct. 593 (2016) (No. 16-458).

<sup>218</sup> See *supra* note 8.

movement could attempt to move past *Quill* by altering aspects of use tax collection obligations. For instance, states could alter the burdens associated with the obligations to collect their use taxes in order to more clearly demonstrate that such obligations are regulatory burdens, not taxes. Additionally, if use tax collection obligations are characterized as taxes, states could take action to indicate that such taxes are privilege taxes, not taxes on the use of the property sold. These potential actions are considered further in the following subparts.

### 1. Use Taxes as Their Own Thing

Removing use taxes from the shadow of sales taxes would offer the Supreme Court the opportunity to reexamine the nexus standard that applies to use taxes. Assuming a hard connection between the taxpayer and the activity taxed is required under the Commerce Clause, the Kill *Quill* movement can open the door to the examination of a vendor's potential in-state activities relating to the use of a product sold by returning the Court's attention to use taxes as stand-alone taxes. These activities are not necessarily dependent on the vendor having a physical presence in the state — for instance, delivery from out-of-state or advertising in the state may qualify; therefore, focusing on the substance of use taxes may provide a strong path for challenging the physical presence rule.

Perhaps the most palatable and promising actions the Kill *Quill* movement could take would be actions attempting to establish use taxes as not wholly dependent on sales taxes. Potentially, the Kill *Quill* movement need not do anything other than draw attention to the analytical gaps in the jurisprudence. As noted earlier, two primary views of the nature of use taxes emerge in the jurisprudence: first, as anti-sales-tax-avoidance measures; and second, as stand-alone taxes on the use of property or the right to use property.<sup>219</sup> By the time *Bellas Hess* was decided, the first view had arisen as the dominant view. Thus, the *Bellas Hess* Court showed no desire to evaluate the use tax nexus standard separate from that for sales taxes: physical presence. The view of use taxes as primarily anti-sales-tax-avoidance measures went unchallenged in *Quill*. In fact, only five of the twenty-two briefs filed in *Quill*, including those of the litigants and the amici curiae, even alluded to that characterization at all.<sup>220</sup> No briefs argued that

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<sup>219</sup> See *supra* Part IV.C.1.

<sup>220</sup> Brief for Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (No. 91-194), 1991 LEXIS 667; Brief of the National Governor's Association, National Conference of State Legislatures, Council of State Governments, National Association of Counties, International City/County Management Association, National Institute of Municipal Law Officers, U.S. Conference of Mayors, and National League of Cities as Amici Curiae supporting Respondent, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (No.91-194), 1991 LEXIS 666; Brief of the

use taxes are substantively a separate form of taxation from sales taxes and should be considered that way when determining the nexus standard that applies to them. The Court did not raise the issue in its decision. The Kill Quill movement could raise it now.<sup>221</sup>

If the movement fails to get the result it wants in *South Dakota v. Wayfair, Inc.*, and wanted to enhance its ability to raise this issue, Kill Quill states could drop sales taxes altogether,<sup>222</sup> cementing the substance of their use taxes as independent from sales taxes. If states had taken this approach from the beginning, one wonders if the physical presence rule would ever had arisen or if individual consumers would not comply with their use tax

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International Council of Shopping Centers, Inc., National Association of Retail Druggists, Inc., National Association of Retail Dealers of America, Inc., National Home Furnishings Association, Inc., Jewelers of American, Inc., American Floorcovering Association, Marine Retailers Association of America, Arizona Retailers Association, Colorado Retail Council, Connecticut Retail Merchants Association, Florida Retail Federation, Idaho Retailers Association, Michigan Retailers Association, Inc., Nebraska Retail Federation, North Dakota Retail Association, Ohio Council of Retail Merchants, South Dakota Retailers Association, Texas Retailers Association, Volunteer Office Products Association, Inc., Fortunoff Department Stores, Plunkett Furniture Co., Wayside Furniture Store, A&W Office Supply, B&B Office Supply, Inc., Creswell Office Supply Co., Inc., Office Supply & Equipment Co., Phillips Office Supplies, Inc., Smith Office Products, and Smith Office Supply, Inc., as Amici Curiae supporting Respondent, Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (No. 91-194), 1991 LEXIS 664; Brief for the State of New Mexico as Amicus Curiae supporting Respondent, Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (No. 91-194), 1991 LEXIS 662; Brief Amicus Curiae for the State of New Jersey supporting Respondent, Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (No. 91-194), 1991 LEXIS 541.

<sup>221</sup> As of this writing, it does not appear that the issue has been raised in the *South Dakota v. Wayfair, Inc.* case which has been granted certiorari, see *supra* note 13.

<sup>222</sup> Though eliminating sales taxes in favor of use taxes may seem radical, the idea was suggested and discussed in the early days of the use tax.

[I]t has been suggested that the sales tax should be given up and the use tax taken as the sole method of collecting this class of revenue . . . . If then the choice is between these two taxes, it seems more desirable to retain the use tax and do away with the sales tax . . . . The choice which has been discussed seems, however, a quite unrealistic one. Why, as between a sales and a use tax, may not a state choose both? While a sales tax has perhaps no theoretical advantage over a use tax, yet experience makes it fairly clear that it is under some circumstances practically more desirable, at least from the standpoint of collection procedure. It is submitted, therefore, that the states should retain the use tax, and furthermore that there is no necessity of their giving up the sales tax, which may at times have important advantages . . . . To give up either is not necessary or desirable.

Brown, *supra* note 21, at 505. See also Eugene Greener, Jr., The Use Tax: Its Relationship to the Sales Tax, 9 VAND. L. REV. 349, 355 (1956); Herbert David Blair, Comment, Compensating Use Taxes: Past and Present Constitutional Problems in Imposition and Collection, 18 ARK. L. REV. 321, 323 (1964).

obligations when vendors do not collect the taxes. Use taxes are already collected today at the point of sale on the assumption that they will be used in the taxing state,<sup>223</sup> so there appears to be little technically standing in the way of a state eliminating sales taxes and only applying use taxes to products sold (though one expects the political obstacles may be quite large). This observation further demonstrates that use taxes have substance beyond their connection to sales taxes.

A less extreme action would be to shift the use tax credit scheme the states currently employ. Rather than offering credits against the use tax for sales taxes collected, states could offer credits against sales taxes for use taxes collected. Practical difficulties might arise under this course of action when the use tax is collected on a use after the sale, but refund mechanisms could be developed to ease those difficulties.<sup>224</sup> This action should have the effect of elevating use taxes to the primary tax between sales taxes and use taxes, removing use taxes from the sales tax shadow.<sup>225</sup>

At a minimum, a state wishing to challenge *Quill* should stop calling its use tax complementary to its sales tax.<sup>226</sup> Such semantics would not change the underlying substance of sales taxes and use taxes, but should add to the credibility of a state seeking to reexamine the substance of use taxes.

## 2. Changing the Burdens of Use Tax Collection Obligations

Alternatively, the Kill *Quill* movement could leave *Quill* alone should it survive the *Wayfair* case and alter use tax collection obligations enough to remove them from the decision's scope. Changing the burdens associated with use tax collection obligations has the potential to significantly affect their characterization. In order to paint such obligations as regulatory burdens subject to *Pike* balancing and not the Complete Auto test (and thus not *Quill*), states could change the penalties imposed on noncollecting vendors and lighten the audit burden placed on vendors.<sup>227</sup> Decoupling the penalties imposed on a noncollecting vendor from the uncollected taxes would send a strong signal that the substance of the obligation is not the same as the tax itself. However, such an action would likely be resisted by states; it would grant vendors the ability to avoid tax collection if the penalties were too low

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<sup>223</sup> See Pomp, *supra* note 15, at 1129.

<sup>224</sup> See *id.*

<sup>225</sup> See *supra* note 160 and accompanying text.

<sup>226</sup> See *supra* note 22.

<sup>227</sup> See Rosenbloom, *supra* note 202, at 247–49 (advocating the reduction of burdens on the collector to achieve a more appropriate balance under the Commerce Clause of the states' interests and the burden on the national economy (Rosenbloom's piece was written before the Complete Auto test was adopted, so presumably the Court was expected to take a balancing approach)).



or it would impose a greater burden than the taxes themselves if the penalties were too high. Even so, imposing criminal penalties for intentionally failing to obey the law may lead to more compliance than would be expected if civil penalties were the only ones imposed.

States could also relieve vendors of audit risks by providing a safe harbor set of activities for vendors to meet, shifting the audit risk to customers. For instance, the state could provide a set of guidelines — or compliance software — that if used would immunize a vendor from audits for uncollected taxes. States could demand information reports from vendors similar to those in Colorado’s reporting regime,<sup>228</sup> and use such information to audit customers instead of the vendor. True, some administrative costs would remain as vendors would need to show they met the safe harbors, but removing the tax audit risk from vendors would remove one of the primary tax-like burdens placed on them, and thus would cause use tax collection obligations to more closely resemble regulatory burdens. Such actions might also meet resistance from the states, but may be more palatable than the current situation because there would be some minimum level of use tax collection.

### 3. Use Tax Collection Obligations as Privilege Taxes

Assuming that the Kill Quill movement is unable or unwilling to make changes to clarify that use tax collection obligations are regulatory burdens and not taxes, the movement could take actions to characterize the taxes as privilege taxes and not use taxes, potentially removing the obligations from the scope of *Quill*.<sup>229</sup> One way to accomplish this goal would be to remove any statutory imposition of use taxes on customers, while retaining the vendor’s ability to pass the tax along. The use tax itself thus could be recharacterized as a tax owed by the vendor for selling into the state. A slightly less aggressive action would be to remove provisions relieving customers of their obligations to pay use tax when the vendor pays the tax. These actions would indicate that the tax imposed on the vendor is separate from that imposed on the customer’s use of the goods sold.

These actions are likely to be difficult to achieve, particularly the first set. In essence, the first set of actions would impose new taxes on vendors and thus may be met with strong political resistance. The second set of actions may be more palatable, however. Customers may be upset at the idea that they would not get credit for use taxes paid by the vendor, but there is little to indicate that states would begin enforcing customers’ tax obligations after such a change. States currently find themselves unable to do so,<sup>230</sup> and

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<sup>228</sup> See COLO. REV. STAT. §39-21-112.3.5 (2017).

<sup>229</sup> See *supra* note 150 and accompanying text.

<sup>230</sup> See Manzi, *supra* note 138.

in this changed scenario, they would be receiving the taxes they are missing out upon now. This fact might lower — and possibly eliminate — the states' motivation to pursue consumers for their taxes owed, though the states' complicity in taxpayer noncompliance may raise civic concerns.<sup>231</sup>

A further difficulty with these actions is that the courts may view them as simple slights of hand — formalistic actions that have no substantive legal effect. Under the first set of actions, the taxes collected would be the same and would presumably continue to be passed along to customers, changing little in substance. Under the second set of actions, unless the states started taking action against customers, the substance of the tax burdens would also remain the same. Therefore, the changes may ultimately prove ineffective in front of courts determined to allow substance to control the analysis of state taxes.<sup>232</sup>

### B. Fundamentally Sound Substantial Nexus

Assuming the Court is convinced to fashion a substantial nexus rule that better aligns with the Commerce Clause's goal of preventing undue burdens on interstate commerce, what might that rule look like? This article has outlined two principles for the Court to follow: jurisdiction to tax standards under the Commerce Clause should broadly consider the burdens state tax actions place on interstate commerce and must consider the type of tax imposed. Recall that there are two primary burdens state tax actions place on taxpayers engaged interstate commerce: compliance costs and costs of accessing the tax base.<sup>233</sup> As argued, a taxpayer's physical presence in a state bears almost no relation to the taxpayer's cost of complying with the state's tax law; thus, the physical presence rule does little to address the *undue* burdens of state tax actions.<sup>234</sup> The physical presence rule is more justifiable as a proxy for a hard connection between the taxpayer and the activity taxed, though there is not necessarily any difference in the abilities of a hard connection regime and a soft connection regime to protect against undue burdens on interstate commerce.<sup>235</sup> Both regimes ensure the taxpayer has access to the tax base; a hard connection regime adds additional protection — perhaps unnecessary in light of *National Geographic Society* — against taxation based on extraterritorial activities.<sup>236</sup>

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<sup>231</sup> See Holderness, *supra* note 144, at 1143–46 (discussing possible ramifications of complicit nonenforcement of use tax laws by the states for economic development incentives purposes).

<sup>232</sup> See *supra* note 17.

<sup>233</sup> See Part III.B.

<sup>234</sup> See Part III.B.1.

<sup>235</sup> See Part III.B.2.

<sup>236</sup> *Id.*

Taking these observations into account, any substantial nexus rule should consider the compliance costs associated with the particular tax imposed as well as the taxpayer's connections with the activity taxed. The burdens of compliance costs are likely to differ by tax, taxpayer, and industry, and one can imagine any number of detailed rules to prevent undue burdens. Many such rules — such as tying undue compliance costs to a percentage of profit margin — are clearly in the domain of Congress and not the Court.<sup>237</sup> Given that the burdens of compliance costs are relatively lower the larger a taxpayer is, a reasonable rule would be that a taxpayer has a substantial nexus with a state when the value of the taxpayer's activities relating to the taxed activity exceeds the compliance costs of the tax by an "appropriate proportion."<sup>238</sup> This rule is vague, as many constitutional rules are, but it would allow lower tribunals to determine appropriate measures in specific circumstances and permit a state to reach any taxpayer (that is otherwise within the state's jurisdiction to tax) by fully bearing the compliance costs of the taxpayer.<sup>239</sup> The limits of "appropriateness" could be established through further litigation or Congressional action.<sup>240</sup> Most importantly, the rule would target undue burdens on interstate commerce, unlike the physical presence rule, by using the taxpayer's activities as a proxy for the size of the taxpayer.

Further, in line with the second principle of this article, the activity taxed would establish the taxpayer's activities to be considered under the rule. Flexibility again would be desirable to account for the differences in activities taxed, so a reasonable approach would be to consider the taxpayer's activities which are "reasonably related" to the activity taxed.<sup>241</sup> This would allow tribunals to determine the types of activities that would ensure a taxpayer has appropriate access to the tax base depending on what the activity

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<sup>237</sup> See *supra* note 63.

<sup>238</sup> State and local taxation buffs will recognize this "appropriate proportion" language from the standard for determining when a state has allocated too much of a multistate tax base to itself, so as to unduly burden interstate commerce — when the allocation is "out of all appropriate proportion" to the taxpayer's activity in the state. See *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (citing *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931)).

<sup>239</sup> See Swain, *supra* note 4.

<sup>240</sup> Cf. *Container Corp.*, 463 U.S. at 184 (establishing that the allocation of a tax base was appropriate when the value of the tax base exceeded the value of the taxpayer's specific activities in the state by 14%, but not when the proportion was 250%).

<sup>241</sup> However, courts have been reluctant to give teeth to the fourth prong of the Complete Auto test, which requires that the tax be "fairly related to the services provided by the State," effectively rendering the prong worthless as a check on state actions. See Zelinsky & Denning, *supra* note 152. A "reasonably related" test may also prove toothless if experience with the forth prong is any guide.

taxed is.<sup>242</sup> In the case of a use tax, all activities relating to the use or consumption of the product, including perhaps advertising and delivery, could be considered; in the case of an income tax, things such as the use of intangible property or franchising could be considered.<sup>243</sup> In a soft connection regime, all of the taxpayer's activities could be considered; under a hard connection regime, only the in-state activities reasonably related to the activity taxed would be considered. Under these proposed rules, the danger of extraterritorial taxation presented by a soft connection regime appears to loom large, so a hard connection regime may be the better option.

These proposed rules are offered only as a suggestion of a way to promote the Commerce Clause's goal of preventing undue burdens on interstate commerce in a more fundamentally sound way than the physical presence rule currently does. The Court's ultimate decisions in the *Wayfair* case or other Kill *Quill* cases may go in a number of directions. But if the Court retains the physical presence rule, it should at least admit that the rule does little to target undue burdens on interstate commerce in a principled way. Doing so may even offer Congress additional motivation to address the rule.

## VI. CONCLUSION

The Kill *Quill* movement has put great effort into placing *Quill* and the physical presence rule before the Supreme Court.<sup>244</sup> Now that the movement has been successful on that front,<sup>245</sup> presenting the Court with a number of reasons why the physical presence rule is improper should increase the movement's chances of succeeding in having the rule be discarded. This article has argued that any attack on the physical presence rule should highlight certain weaknesses in the reasoning behind the rule, specifically the analytical gaps both with respect to the basis for the substantial nexus required under the Commerce Clause between the taxing state and the taxpayer and with respect to the substance of use tax collection obligations. Two principles for crafting a better approach to jurisdiction to tax rules emerge from examining these weaknesses in depth: first, the rules should broadly consider the burdens state tax actions place on interstate commerce, and second, the rules should take into account the type of tax to be imposed.

The Supreme Court may ultimately fall back on the *Quill* justification of

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<sup>242</sup> See *supra* note 104.

<sup>243</sup> See *Geoffrey Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993); *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308 (Iowa 2010).

<sup>244</sup> See *supra* notes 12, 13; Brief of Interested Law Professors as Amici Curiae Supporting Petitioner in *Brohl v. Direct Marketing Ass'n*, at 19 (U.S. Supreme Court, filed Nov. 4, 2016) (advocating for the Supreme Court to reconsider *Quill*).

<sup>245</sup> See *supra* note 8.

the physical presence rule as clearly establishing the line of legitimate state tax authority and thereby reducing litigation.<sup>246</sup> This would be a disappointing result; as the states' efforts and Kill Quill litigation have shown,<sup>247</sup> the physical presence rule is not as clear or as litigation-reducing as the *Quill* Court may have expected. If the Court is convinced to move past such base justifications then pressing the Court on the reasoning behind the rule may at least lead to a better understanding of the purpose of the rule. Combined with the changing technological and economic circumstances that increasingly exacerbate the shortcomings of the physical presence rule, an attack on the reasoning behind the rule may even lead to the realization of the Kill Quill movement's goal of eliminating the rule. If so, former Alabama Revenue Commissioner Magee could lead less macabre cheers in the future.

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<sup>246</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).

<sup>247</sup> See authorities cited *supra* note 6; see also Holderness, *supra* note 38 (detailing the Kill Quill efforts and cases).