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Virtual Reality: Quill's Physical Presence Requirement Obsolete When Cogitating Use Tax Collection in Cyberspace

Julie M. Buechler

VIRTUAL REALITY: QUILL'S "PHYSICAL PRESENCE" REQUIREMENT OBSOLETE WHEN COGITATING USE TAX COLLECTION IN CYBERSPACE

I. INTRODUCTION

Current constitutional jurisprudence and tax nexus standards governing use tax collection duties are arguably ill-prepared for reaching cyberspace commerce. As commerce continues to shift from the real world to the virtual world, state governments stand to lose crucial tax revenue if cyberspace purchases escape taxation as a result of the application of the antiquated "physical presence" requirement. The physical presence requirement, compelled by the Commerce Clause, currently governs use tax collection in postal space. Historical justifications for maintaining the traditional physical presence requirement no longer comport with cyberspace's new and rapidly changing technologies and commercial methodology.

This Note will contemplate constitutional limitations on sales and use taxes and the duty to collect use taxes in the emerging virtual environment of cyberspace. Specifically, this Note will discuss the evolution of the existing Due Process and Commerce Clause requirements and recommend change in the application of the Commerce Clause requirement to cyberspace commerce. Furthermore, this Note will propose a modernization of the Commerce Clause requirement allowing for the fair application to evolving cyberspace commerce.

Part II of this Note discusses the general background of sales and use taxes and presents the traditional constitutional nexus barriers to state taxation and collection. Part III proposes that the judicially imposed physical presence requirement compelled by the Commerce Clause is obsolete when applied to cyberspace commerce. Part IV urges Congress to establish a Commerce Clause nexus requirement based on an "economic presence" rather than a physical presence. Alternatively, in the event Congress fails to act, Part IV advocates a judicial modernization of the substantial nexus requirement by the United States Supreme Court.

II. CONSTITUTIONAL BARRIERS TO STATES' IMPOSITION OF USE TAX COLLECTION

State governments must have the authority to collect their fair share of sales and use tax revenues in cyberspace. However, current state taxation structures appear ill-prepared for reaching cyberspace commerce. Thus, new tax schemes must be cultivated. Presumably, states

must then reconcile these proposed tax schemes with existing constitutional nexus requirements. State governments must ensure that these tax schemes, specifically the imposition of a duty of use tax collection, do not violate either the Due Process Clause or the Commerce Clause.

A. SALES AND USE TAXES IN GENERAL

The concept of sales and use taxes is primitive.[1] These primitive taxes were enacted for the most part in the 1930s[2] and designed for a much simpler era.[3] Most early state sales and use tax structures were designed for the day when our nation's economy was based primarily on the manufacturing and selling of goods, rather than the technologically advanced, service-oriented economy encountered today.[4] This simpler era plainly did not contemplate the advanced methodologies of cyberspace. The statutes governing sales and use taxes were created prior to the contemplation of cyberspace, yet they presumably govern and control this emerging environment. Therefore, the inherent problem currently exists of having law which is premised on out-of-date assumptions and notions of a commercial enterprise system controlling the technologically advanced commercial system of today.

States impose sales taxes on the sales of tangible goods and services. A sales tax is a tax on the retail sale of specified property or services and is a percentage of the cost of the property or service.[5] Sales of tangible goods are typically subject to sales tax, but sales of intangibles are not.[6]

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1. *See* Orrin Tilevitz, *Dealing with Sales and Use Tax in Internet Transactions*, 2 NO. 9 MULTIMEDIA STRATEGIST 1 (July 1996). The author indicated that sales and use taxes were designed for the horse-and-buggy era. In other words, a customer walks to a store in State A, buys merchandise and takes it home. The merchant collects sales tax. If, instead, the customer rides his horse into State B and buys the item, he avoids State A's sales tax and pays State B's, if any. In theory, the customer must then pay State A's use tax (receiving a credit for State B's sales tax generally) when the customer brings the item home. *Id.*

2. Sales taxes became popular methods of raising revenue after World War II when states took on a greater municipal burden and began providing increased services to citizens in the wake of the Depression. *See* Adam L. Schwartz, Note, *Nexus or Not, Orvis v. New York, SFA Folio v. Tracy and the Persistent Confusion Over Quill*, 29 CONN. L .REV. 485, 520 n.28 (citing RICHARD POMP & OLIVER OLDMAN, ST. AND LOC. TAX'N 775 (1996)).

3. Tilevitz, *supra* note 1, at 4.

4. R. Scott Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. L.A. ENT. L.J. 603, 605 (1996). As our economy becomes increasingly service-oriented, a phenomenon accelerated by the advent of the information superhighway, state tax coffers will suffer. *Id.* State tax revenues will suffer because, generally, intangible services are not taxed. As consumers begin to engage in commerce on the information superhighway in rising numbers, it is inevitable that in addition to services, more products will be delivered online. *Id.* at 617. Accordingly, developing a tax scheme for information services to recapture lost sales as a result of electronic conversion is necessary. *Id.*

5. BLACK'S LAW DICTIONARY 1339-40 (6th ed. 1990).

6. *See, e.g.*, N.D. CENT. CODE § 57-39.2-02.1(1)(a) (1993 & Supp. 1997) (stating that "[t]angible personal property, consisting of goods, wares, or merchandise . . ." is subject to a five percent sales tax). *Cf.* N.D. CENT. CODE § 57-40.2-02.1(1) (1993 & Supp. 1997) (stating that "[e]xcept as otherwise

Generally, as in a "consumer levy" tax jurisdiction, the purchaser pays the tax and the seller, as an agent for the government, collects and remits the tax.[7]

A companion levy to the sales tax is the use tax. A use tax is a sales tax that is collectible by the seller when the purchaser is domiciled in a different state.[8] Specifically, a use tax is a "tax of the use, consumption, or storage of tangible property, usually at the same rates as the sales tax, and levied for the purpose of preventing tax avoidance by the purchase of articles in a state or taxing jurisdiction which does not levy sales taxes or has a lower rate."[9] Use taxes were primarily implemented by states to address concerns about the potential loss of revenue from out-of-state purchases.[10] Accordingly, residents who shop out-of-state are required to pay a use tax, usually equal to sales tax savings. In theory, the use tax is intended to protect state sales tax revenues and put local merchants, subject to the sales tax, on a competitive parity with foreign merchants exempt from the sales tax.[11]

Unlike the federal government, state governments rely heavily on the total revenue from sales and use taxes.[12] The importance of the sales and use tax base to state and local governments is evidenced by the 200 billion dollars in revenue the taxes generate annually nationwide.[13]

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expressly provided in subsections (2) and (3), . . . an excise tax is imposed on the storage, use, or consumption in this state of tangible personal property purchased at retail for storage, use, or consumption in this state, at the rate of five percent of the purchase price of the property.")

7. David C. Blum, *State and Local Taxing Authorities: Taking More than Their Fair Share of the Electronic Information Age*, 14 J. MARSHALL J. COMPUTER & INFO. L. 493, 522 n.6 (1996); *see also* ROBERT J. FIELDS, UNDERSTANDING AND MANAGING SALES AND USE TAX 205 (3d. ed. 1994) (outlining the "consumer tax levy" states such as: Louisiana, Maine, Maryland, Mississippi, Nebraska, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Utah, Vermont, Washington, West Virginia, and Wyoming). In a consumer levy jurisdiction, the purchaser is liable for the tax, however, the seller, acting as an agent or trustee for the state, is responsible for collecting and remitting the tax to the State. Blum *supra.*

8. *See* White Oak Corp. v. Department of Revenue Servs., 503 A.2d 582, 585 (Conn. 1986).

9. BLACK'S LAW DICTIONARY 1543 (6th ed. 1990).

10. *See* PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION §10:1 (1981). Although the primary concern of a use tax is combating loss of revenue from out-of-state purchases, use taxes serve other important purposes as well. Use taxes serve to: 1) eliminate avoidance of sales tax by simply making purchases in a different state; 2) achieve a fair balance between state and federal taxes; and 3) alleviate discrimination in favoring foreign merchants over local merchants. *See* ALL ST. TAX GUIDE (CCH) 5003, 5011 (1994).

11. Steven J. Forte, *Use Tax Collection on Internet Purchases: Should the Mail Order Industry Serve as a Model?*, 15 J. MARSHALL J. COMPUTER & INFO. L. 203, 206 (1977) (citing National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 555 (1977)).

12. Stewart A. Baker, *Beware, the Taxman Cometh to Cyberspace; Communications: States See a Gold Mine in Online-Sales*, L.A. TIMES, Oct. 5, 1995, at 9. Since state and local governments rely so heavily on sales and use taxes, they will be battling to collect their fair share of taxes in cyberspace. *Id.* State and local governments lose more than $3 billion per year as a result of the judicially created safe-harbor that the physical presence or "something more" requirement governing the imposition of the use tax collection duty in postal space creates. *Id.* Arguably, states will not passively stand by and allow additional tax dollars to be lost to another protected class of foreign merchants— cyberspace merchants. *See id.*

13. R. Scott Grierson, *Legal Potholes Along the Information Superhighway*, 16 LOY. L.A. ENT. L.J. 541, 573 (1996).

That is roughly thirty-five percent of state and local governments total revenue-generating potential.[14] Thus, the concern over lost revenues is easily justifiable.

Traditionally, the state government's perspective on the reason behind collecting sales and use taxes was simple. Arguably, the state's fiscal health and the erosion of the tax base provided sufficient incentive for pursuing sales and use taxes. Today, the same perspective persists as the Internet and other on-line transactions attempt to further erode the state's tax base by, for example, escaping taxation as a result of the digitization of tangible goods and their delivery in intangible forms.[15]

The United States Supreme Court has consistently supported states' efforts to impose use tax collection duties on foreign merchants.[16] However, critical exceptions to this Court policy can be found.[17] Consequently, when state governments attempt to impose collection duties on foreign merchants in cyberspace, traditional constitutional barriers will presumably restrain those states' efforts.

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14. *Id.*

15. *Id.* The potential erosion of a state's tax base may come, in part, as a result of the digitization of music, movies, software, shareware, and video games. *Id.* Arguably, digitization may erode the tax base because goods will be delivered in intangible forms not normally subject to sales and use taxation. *Id.*

16. *See* Scripto Inc. v. Carson, 362 U.S. 207, 211-12 (1960) (holding that the solicitation of orders by a nonresident salesman was sufficient presence to impose use tax collection responsibilities on a foreign corporation); *see also* Goldberg v. Sweet, 488 U.S. 252, 267-68 (1989) (noting that tax on interstate telephone calls was required to be called by a long distance telephone carrier); D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33-34 (1988) (imposing use tax on catalogs printed outside the state and mailed directly to prospective customers within the state); Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560, 563-64 (1975) (noting that an engineer/consultant working out of his home in Washington constituted sufficient business activity to impose a tax on a manufacturer whose plants and offices were located in Pennsylvania and California).

17. The author advances two exceptions to the Supreme Court's policy of supporting states' efforts to impose use tax collection duties on foreign merchants. *See* Forte, *supra* note 11, at 208. The first exception is that of the solicitation of business via advertising. *See id.* (citing National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 753 (1967); Quill Corp. v. North Dakota, 504 U.S. 298 (1992)). In *Bellas Hess*, the Supreme Court found that a foreign merchant who only communicated with customers in Illinois by mail or common carrier would not be constitutionally required to collect and remit use tax in Illinois. 386 U.S. at 758. The Court was unclear as to whether the holding was based on the Commerce Clause or the Due Process Clause. *Id.* at 756. In *Quill*, the Court held that the imposition of a tax collection duty on a mail-order merchant who did not have a physical presence in the state violated the Commerce Clause. 504 U.S. at 318-19.

The second exception is that of the regular delivery of goods by a foreign merchant into the taxing jurisdiction. Forte, *supra* note 11, at 208-09. (citing Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954)). A Delaware store made over-the-counter sales to Maryland residents and periodically delivered the merchandise by truck into Maryland. *See Miller Bros. Co.*, 347 U.S. at 341. The Supreme Court held that the state of Maryland could not impose a tax collection duty on the Delaware store because Maryland could not satisfy due process requirements. *Id.* at 347. Thus, the Commerce Clause and the Due Process Clause pose constitutional hurdles that state governments must overcome when seeking to impose a use tax collection duty on foreign merchants. *Id.*

B. TRADITIONAL CONSTITUTIONAL BARRIERS

State governments may not impose a use tax collection duty on a foreign merchant unless the imposition of the obligation meets certain constitutional requirements.[18] Under existing constitutional analysis, the United States Supreme Court requires the existence of some minimum threshold of contact with the state, some "nexus," in order for a state to impose a tax upon an entity.[19] In other words, a business entity is subject to state and local tax laws only when it has the requisite "nexus" with the taxing jurisdiction. Nexus, a nebulous concept, is described as the "degree of business activity that must be present before a taxing jurisdiction has the right to impose a tax, or an obligation to collect a tax, on an entity."[20] When cogitating nexus in light of the use taxing powers, state governments must focus on clearing particular constitutional hurdles. Specifically, state governments must be poised to overcome the nexus requirements compelled by the Due Process Clause and the Commerce Clause. Since each clause protects different concerns, a bifurcated glance at these traditional constitutional barriers is appropriate.

1. Due Process Clause Generally

The Due Process Clause[21] requires the fundamental fairness of governmental activity. Under due process, persons receive protection from deprivation of "life, liberty, or property."[22] Traditionally, the Due Process Clause requires a person to have minimum contacts with a forum "such that the maintenance of [a] suit does not offend the 'traditional

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18. *See* discussion *infra* Parts II.B.1., B.2.

19. Steven C. Salch & Alvin L. Thomas II, *Taxation of Internet Services and Transactions—A Few 'FAQS,'* 34 OCT. HOUS. LAW. 33 (1996). The United States Constitution and the interpretive case law prescribe limits upon a state's ability to impose a tax collection duty. *Id.* The existence of a sufficient "nexus" poses such a limit. *Id.* A sufficient nexus exists if there is a "definite link or minimum connection" between the state and the foreign merchant. *Id.* Therefore, a primary issue that states must consider when imposing a use tax collection duty on a foreign merchant is the existence of a requisite nexus. *Id.; see also Miller Bros. Co.*, 347 U.S. at 344-45 (holding that "the Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax").

20. Karl A. Frieden & Michael E. Porter, *State Taxation of Cyberspace*, THE TAX ADVISER, Nov. 1, 1996.

21. The Due Process Clauses of the United States Constitution state: "No person shall . . . be deprived of life, liberty, or property, without due process of law." U.S. CONST. amend. V. "[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . . ." U.S. CONST. amend. XIV, § 1.

22. U.S. CONST. amend. V; U.S. CONST. amend. XIV, § 1.

notions of fair play and substantial justice.'"[23] In the context of this traditional notion, Due Process focuses on whether a person's contacts with the forum are reasonable enough to give notice to the person that he or she may be brought into court in that forum.[24]

2. *Commerce Clause Generally*

Unlike the Due Process Clause, the Commerce Clause and its nexus requirement are concerned "about the effects of state regulation on the national economy."[25] The Commerce Clause is an express grant of power[26] and is more restrictive than the Due Process Clause.[27] However, the Commerce Clause is more than an express grant of power; it has a negative sweep as well.[28] The United States Constitution does not expressly prohibit a state from impeding interstate commerce, but the judicially-created "dormant" Commerce Clause does.[29] Therefore, any state laws

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23. International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945) (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)). In *International Shoe*, the State of Washington brought an action against International Shoe Co. (Shoe) to collect Washington State unemployment taxes based on the commissions paid to the salesmen located in the State. *Id.* at 311. Shoe manufactured and sold shoes and other footwear. *Id.* at 313. Shoe was a Delaware corporation with its principal place of business in Missouri. *Id.* Shoe employed commissioned salespersons who lived in Washington, but who reported directly to the St. Louis sales office. *Id.* Shoe did not have an office in Washington. *Id.* Solicitations of footwear orders via the commissioned salespersons were the key activities by Shoe in Washington. *Id.* The Supreme Court held that Washington could exercise jurisdiction over Shoe and not violate the Due Process Clause. *Id.* at 320. The Court reasoned that due process requires only that a defendant have certain minimum contacts with the forum such that the maintenance of a suit does not offend "traditional notions of fair play and substantial justice." *Id.* at 316. The Court concluded that Shoe's activities were systematic, continuous, and resulted in a large volume of interstate business. *Id.* at 320.

24. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985). The Supreme Court held that when a defendant deliberately engages in significant activities or continues obligations between himself and the forum state, the defendant "manifestly [avail[s]] himself of the privilege of conducting business there, and because his activities are shielded by the "benefits and protections" of the forum's laws it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well." *Id.*

25. Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992).

26. U.S. CONST. art. I, § 8, cl. 3 (stating "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States . . . .").

27. *Quill*, 504 U.S. at 313 n.7.

28. *Id.* at 309.

29. *Id.* The United States Supreme Court's interpretation of the "negative" or "dormant" Commerce Clause relative to state taxing powers has evolved substantially over time. *Id.* The early interpretative cases swept broadly and declared that "no State has the right to lay a tax on interstate commerce in any form." *Id.* (citing Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888)). The Court later narrowed this rule and distinguished between direct or prohibited burdens on interstate commerce and indirect or allowable burdens on interstate commerce. *Id.* (citing Adams Express Co. v. Ohio St. Auditor, 165 U.S. 194, 220 (1897)). Subsequently, in *Western Livestock v. Bureau of Revenue*, 303 U.S. 250, 256-258 (1938) and ensuing cases, this formal direct/indirect categorical analysis was rejected for a "multiple-taxation doctrine" that focused on whether a tax subjected interstate commerce to the risk of multiple taxation. *Id.* However, the Court reembraced the formal direct/indirect distinctions in 1946. *Id.* (citing Freeman v. Hewit, 329 U.S. 249, 256 (1946)). However, in 1977, in *Complete Auto Transit v. Brady*, 430 U.S. 274, 285 (1977), the *Freeman* approach was renounced as "attaching constitutional significance to a semantic difference." *Id.* at 310. *Complete Auto* stressed the need to look past "the formal language of the tax statute [to] its practical effect." *Id.*

hindering the free flow of goods between states may be deemed unconstitutional.

Unlike the "fair play and substantial justice" interests protected by the Due Process Clause that apply only to the individual, interstate commerce affects all United States citizens because all are sustained by a stable national economy.[30] No state or federal government can legislate a change in the Due Process Clause, short of changing the Constitution. However, under the dormant Commerce Clause, Congress has the right to regulate interstate commerce and therefore can legislatively authorize state action that may burden interstate commerce.

C. GOVERNING SUPREME COURT DECISIONS

The United States Supreme Court has held that it is unconstitutional for a state to impose a use tax collection duty on a foreign merchant who lacks a "physical presence" in, or a "substantial nexus" with the taxing state.[31] In both *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*[32] and *Quill Corp. v. North Dakota*,[33] the two seminal cases on the issue, foreign merchants lacking physical presence in the taxing state were marketing and selling their products through mail-order catalogs.[34] Consequently, the bright-line rule requiring physical presence in the taxing state attempting to impose a use tax collection duty on a foreign merchant was established. Though seemingly ill-fated, this existing law governing "postal space" will likely govern the emerging cyberspace commerce due to nonexistent or insufficient state laws.

1. National Bellas Hess, Inc. v. Dep't of Revenue of Ill.

For the first time, the United States Supreme Court in *Bellas Hess* analyzed the issue of interstate mail-order sales.[35] The Court was asked

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The four pronged test set forth in *Complete Auto* still governs the validity of state taxes under the Commerce Clause today. *Id.*

30. Christina R. Edson, *Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce*, 49 TAX LAW. 893, 937 (1996). The author noted that the distinct concern of the Commerce Clause is the protection of national economic interests. *Id.* The Commerce Clause protects national economic interests by prohibiting state impediments on interstate commerce such as burdensome tax impositions. *Id.* Since the Commerce Clause protects crucial and widespread interests, a higher nexus standard may be appropriate. *Id.*

31. *See Quill*, 504 U.S. at 307-08; National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 756-60 (1967).

32. 386 U.S. 753 (1967).

33. 504 U.S. 298 (1992).

34. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 302 (1992); National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 754 (1976).

35. Schwartz, *supra* note 2, at 492. The author noted that numerous cases in the 1930s challenged the application of the use tax. *See id.* Cases dealt with such diverse questions as the problem of "border stores," Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954), the true location of a traveling salesman, McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944), and the issue of manufacturers who build or buy their equipment in one state but use it in another, Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963); Henneford v. Silas Mason Co., 300 U.S. 577 (1937). These cases did much

to contemplate the jurisdictional tests under both the Due Process Clause and the Commerce Clause.

National Bellas Hess, Inc. (Bellas Hess) was a national mail-order company incorporated in Delaware with its principal place of business in Missouri.[36] Bellas Hess did not maintain any office, had no agents or solicitors to sell or take orders, take payments, or deliver or service its merchandise, owned no property, and had no telephone listing in Illinois.[37] Nor did Bellas Hess advertise its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois.[38] The only contact Bellas Hess had with Illinois was through the United States mail.[39] Catalogs were mailed semiannually to the company's active or recent customers throughout the nation.[40] Supplementing the catalog mailings were occasional advertising flyers mailed to past or potential customers.[41] Orders for merchandise were mailed by customers to Bellas Hess and accepted at its Missouri plant.[42] The ordered merchandise was then sent to Bellas Hess customers either by United States mail or by common carrier.[43]

Illinois argued that Bellas Hess' manner of doing business was sufficient under the state statute requiring Bellas Hess to collect and pay the tax imposed on consumers who purchase the company's merchandise for use within the state of Illinois.[44] This tax was based on an Illinois statute that defined a "retailer maintaining a place of business" as including any retailer "[e]ngaging in soliciting orders within this State from users by means of catalogs or other advertising, whether such orders are received or accepted within or without this state."[45] Illinois implicitly argued that by maintaining an economic infrastructure which would aid foreign merchants in their solicitation of local sales, the state had provided a service to Bellas Hess "for which it can ask (for something in) return."[46] Conversely, Bellas Hess argued that the liabilities

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to develop the Court's understanding of the use tax and its proper operation. However, for the mail-order industry, there was no case directly addressing the status of catalog sales in relation to a state's effort to impose the duty to collect its use tax. In *Bellas Hess*, the Supreme Court at last directly dealt with this issue. 386 U.S. at 753. Bellas Hess was a large direct catalog marketer with sales in Illinois, but no property or personnel in the state. *Id.* at 753-54. The Court denied Illinois the power to deputize the foreign merchant as a tax collector for the state. *Id.* at 758.

36. *Bellas Hess*, 386 U.S. at 753-54.
37. *Id.* at 754.
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 754-55.
43. *Id.* at 755.
44. *Id.*
45. *Id.* (quoting 120 ILL. COMP. STAT. 439/2 (West 1965)).
46. *Id.* at 756.

which Illinois imposed were in violation of the Due Process Clause.[47] Further, Bellas Hess argued that the liabilities created an unconstitutional burden upon interstate commerce, thus violating the Commerce Clause as well.[48]

The *Bellas Hess* Court engaged in a dual analysis of Illinois's claim.[49] First, the Court considered the Commerce Clause. Generally, in a taxing venue, the Commerce Clause test represents a balance between the view that interstate commerce enjoys a "free trade" immunity from state taxation and the view that business merchants engaged in interstate commerce may be required to pay their own way.[50] To withstand a Commerce Clause challenge, the Supreme Court in *Complete Auto Transit v. Brady*[51] held that a state tax must: 1) apply to an activity with a "substantial" nexus with the taxing state; 2) be fairly apportioned; 3) not discriminate against interstate commerce; and 4) be fairly related to the services provided by the state.[52] Arguably, the use of the four-pronged *Complete Auto* test attempts to address this needed balance.

The *Bellas Hess* Court sought to assure itself that the Illinois use tax was designed to make interstate commerce bear its fair share of the tax burden, and avoid prejudicial or discriminatory application.[53] The substantial nexus requirement imposed by the Commerce Clause on a state's ability to tax a foreign entity is not like the "minimum contacts" requirement imposed by the Due Process Clause.[54] In essence, the Com-

47. *Id.*

48. *Id.*

49. Schwartz, *supra* note 2, at 493. The author noted that on the one hand the *Quill* Court sought, under the Commerce Clause, to assure itself that the Illinois use tax was designed in such a manner that interstate commerce would bear its fair share of the tax burden. *Id.* at 493-94. On the other hand, the Court sought, under the Due Process Clause, to answer the controlling question of "whether [Illinois had] given anything for which it can ask in return such that the foreign [merchant] pays its fair share of the cost of local government whose protection it enjoys." *Id.* at 494.

50. Goldberg v. Sweet, 488 U.S. 252, 259 (1989). The tension between these two concepts accounts for the wavering doctrinal lines of earlier cases. *Id.* In *Complete Auto Transit v. Brady*, the United States Supreme Court attempted to resolve this tension by expressly rejecting the view that state governments cannot tax interstate commerce, while at the same time placing limitations on state taxation of interstate commerce. 430 U.S. 274, 288 (1977).

51. 430 U.S. 274, 279 (1977).

52. Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977).

53. Schwartz, *supra* note 2, at 494 (citing *Bellas Hess*, 386 U.S. at 756). The Commerce Clause was operative in *Bellas Hess* because Illinois's taxing efforts could not be allowed to impermissibly burden interstate commerce. *Id.* While the State of Illinois could not be taxing a sale because of its interstate character, the interstate character of the sale itself was sufficient to trigger scrutiny under the Commerce Clause. *Id.* The author noted that under a physical presence standard, the interstate aspect of a sale was balanced by a specific intrastate relationship. *Id.* at 520 n.45. The relationship was between two state residents—the seller who was physically present in the state, and the resident consumer. *Id.* Accordingly, Illinois was entitled to tax the transaction. *Id.*

54. Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992).

merce Clause requirement is not "a proxy for notice," but rather a means for limiting state burdens on interstate commerce.[55]

Second, the Court considered the Due Process Clause. The Court emphasized that the Due Process Clause required fairness.[56] The Court went on to state that the controlling question was whether the state has given anything for which it can ask in return, such that the foreign merchant would pay its share of the cost of local government whose protection it enjoys.[57] Further, the Court noted that the Due Process Clause required "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax."[58]

The *Bellas Hess* Court rejected Illinois' argument and demanded some physical presence beyond mail solicitation and common carrier delivery to justify taxation, even though the foreign merchant may have availed itself of the static infrastructure of the state in order to exploit the consumer market there.[59] Relying on both the Due Process Clause and the Commerce Clause,[60] the Court struck down the Illinois use tax collection claim against Bellas Hess. The Court explicitly held that the Due Process Clause and the Commerce Clause required that the foreign merchant maintain some sort of physical presence within the taxing state in order to establish a sufficient nexus to impose a collection duty.[61] The Court refused to abolish the distinction between foreign merchants having a physical presence within a state and foreign merchants having a connection only by mail or common carrier.[62] This lingering distinction provides a "safe harbor" for those foreign merchants who do no more than communicate with their customers by mail or common carrier.[63]

2. *Quill Corp. v. North Dakota*

Approximately twenty-five years later in *Quill Corp. v. North Dakota*,[64] the United States Supreme Court declined to renounce the

55. *Id.* at 313.

56. National Bellas Hess, Inc., v. Dep't of Revenue of Ill., 386 U.S. 753, 756 (1967).

57. *Id.*

58. *Id.* at 756 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954)).

59. *Id.* at 762-63.

60. *Id.* at 756-60; *see also* Timothy Gillis, Comment, *Collecting the Use Tax on Mail-Order Sales*, 79 GEO. L.J. 535, 536-43 (1991). Commentators, however, disagree on whether *Bellas Hess* relied on the Due Process Clause, the Commerce Clause, or both. *Id.* at 536.

61. *Bellas Hess*, 386 U.S. at 758-60.

62. *Id.* at 758.

63. Schwartz, *supra* note 2, at 494. The *Bellas Hess* Court found a sharp distinction between mail-order merchants with retail outlets, solicitors, or property within a state, and those mail-order merchants who merely communicate with their customers by mail or common carrier as part of interstate business. *Id.* A "pure" mail order merchant, such as Bellas Hess, who maintains no physical presence in the state, cannot be required to collect and remit use taxes to the state. *Id.*

64. 504 U.S. 298 (1992).

bright-line rule established by *Bellas Hess* and adhered to settled precedent creating an explicit safe harbor for "postal space" merchants.

Quill was a Delaware corporation that sold office equipment and supplies nationwide, with warehouses and offices in Illinois, California, and Georgia.[65] The Quill Corporation had no employees who worked or resided in North Dakota, nor did it own any significant tangible property in North Dakota.[66] Quill solicited business in North Dakota by catalogs, flyers, advertisements in national periodicals and trade journals, and telephone.[67] The merchandise purchased by North Dakota customers was delivered by mail or common carrier.[68]

In 1987, the North Dakota Legislature passed legislation which effectively imposed a use tax upon property purchased for storage, use, or consumption within the State,[69] and required every "retailer" maintaining a place of business in the State to collect the tax from the consumer and remit it to the State.[70] In other words, North Dakota sought to require Quill to collect and remit use tax on its sales to North Dakota customers.[71] In an effort to compel Quill to comply with the use tax statutes, North Dakota sought a declaratory judgment that Quill was a "retailer maintaining a place of business" in North Dakota.[72] The North

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65. Quill Corp. v. North Dakota, 504 U.S. 298, 302 (1992).

66. *Id.* The North Dakota Supreme Court noted the presence of a licensed computer software program that Quill made available to some of its North Dakota customers. *Id.* Quill licensed Quill Service Link (QSL) to some of its North Dakota customers. North Dakota v. Quill Corp., 470 N.W.2d 203, 216 (N.D. 1991). QSL was a computer software program that allowed customers to check Quill's available inventory and current prices, order merchandise, and engage in other communications through an electronic bulletin board. *Id.* Since Quill retained all rights to QSL, including the right to terminate the license "without prior notice and without cause," the North Dakota Supreme Court agreed with the State's assertion that Quill owned property in North Dakota. *Id.* This finding further supported Quill's nexus with the State. *Id.* at 216-17. However, Quill's interests in the licensed software did not affect the United States Supreme Court determination that the disks did not comprise the "substantial nexus" required by the Commerce Clause. *Quill*, 504 U.S. at 302 n.1. The Court stated that although "title to 'a few floppy diskettes' . . . might constitute some minimal nexus . . . [it] does not meet the 'substantial nexus' requirement of the Commerce Clause." *Id.* at 315 n.8.

67. *Quill*, 504 U.S. at 302. Quill had annual national sales exceeding $200 million, of which nearly $1 million was made to roughly 3,000 customers in North Dakota. *Id.* Quill was the sixth largest vendor of office supplies in North Dakota. *Id.*

68. *Id.*

69. N.D. CENT. CODE § 57-40.2-02.1(1) (1993 & Supp. 1997). "[A]n excise tax is imposed on the storage, use, or consumption in this state of tangible personal property purchased at retail for storage, use, or consumption in this state, at the rate of five percent of the purchase price of the property." *Id.*

70. N.D. CENT. CODE § 57-40.2-07 (1993 & Supp. 1997). In 1987, the statutory definition of the term "retailer" was amended to include every person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, by means of print, radio or television media, or by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system for the purpose of effecting retail sales of tangible personal property. *Id.* § 57-40.2-01(6) (1993 & Supp. 1997). State regulation defines "regular or systematic solicitation" to mean three or more advertisements within a 12 month period. N.D. ADMIN. CODE § 81-04.1-01-03.1(3) (1995).

71. *Quill*, 504 U.S. at 303.

72. North Dakota v. Quill Corp, 470 N.W.2d 203, 205 (N.D. 1991).

Dakota statutes defined such a retailer as "every person who engages in regular or systematic solicitation of a consumer market in this state."[73]

Quill conceded that its solicitation of sales in North Dakota satisfied the statutory definition of a "retailer maintaining a place of business" in the state, but challenged the constitutionality of the state's use tax collection duty on the premise that Quill had an insufficient nexus with the State of North Dakota.[74] The North Dakota District Court entered judgment for Quill,[75] but the North Dakota Supreme Court reversed the lower court decision.[76] Ultimately, the United States Supreme Court granted a writ of certiorari and reversed the North Dakota Supreme Court's decision.[77]

While in agreement with much of the North Dakota Supreme Court's reasoning, the United States Supreme Court inaugurated a novel approach that bifurcated the constitutional nexus analysis associated with the Due Process and Commerce Clauses.[78] Traditionally, the Due Process Clause and the Commerce Clause required a physical presence in the taxing state.[79] However, the *Quill* Court acknowledged the Due Process Clause's progression away from the rigid physical presence requirement.[80] In that spirit, the *Quill* Court retreated from the formalistic constrictions in favor of a more flexible substantive approach.[81]

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73. *Quill*, 504 U.S. at 311; *see* N.D. CENT. CODE § 57-40.2-01(6) (1993 & Supp. 1997).

74. *Quill*, 470 N.W.2d at 206.

75. *Quill*, 504 U.S. at 303 (stating that the trial court held that because the State had not shown that it had spent tax revenue for the benefit of Quill's mail-order business, Quill did not have the required nexus with North Dakota to allow the State to include Quill in the statutory definition of retailer). The trial court relied primarily on *Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, which found that there was not a sufficient nexus to satisfy the Due Process Clause and the Commerce Clause when a mail-order company lacked physical presence in the taxing state. 386 U.S. 753 (1967).

76. *Quill*, 470 N.W.2d at 219. The North Dakota Supreme Court found that *Bellas Hess* was no longer controlling and that *Bellas Hess* was obsolete based on economic changes in contemporary society, including the rapid growth of the mail-order industry, as well as relevant technological advances. *Quill*, 504 U.S. at 303. The court held that the substantial nexus prong of the *Complete Auto* test does not require a physical presence and that Quill's significant economic presence in North Dakota was sufficient to impose use tax collection duties on Quill. *Quill*, 470 N.W.2d at 219. The court concluded that the relevant inquiry for determining sufficient nexus is whether the state has provided "protection, opportunity, or benefit for which it can expect a return." *Id.* at 216. In reaching this conclusion, the North Dakota Supreme Court emphasized that the State maintained an infrastructure that created and maintained the market and created an economic climate that fostered a demand for Quill's products. *Id.* at 218. Quill's economic presence in North Dakota depended on services and benefits provided by the state. *Id.*

77. *Quill*, 504 U.S. at 302-03.

78. *Id.* at 305 (stating that the Due Process Clause and the Commerce Clause, although closely related, "pose distinct limits on the taxing powers of the States").

79. *Bellas Hess*, 386 U.S. at 756-758.

80. *Quill*, 504 U.S. at 312.

81. *Id.* at 314. The United States Supreme Court agreed with the assessment of the North Dakota Supreme Court that recent Commerce Clause decisions signaled a retreat from a formalistic approach to a more balanced approach. However, the Court did not share the North Dakota Supreme Court's conclusion that this evolution indicated the Commerce Clause ruling of *Bellas Hess* was no longer good law. *Id.*

For the first time, the Court found that the Due Process Clause did not require the physical presence of a foreign merchant within the taxing state to create the needed nexus.[82] The *Quill* Court stated that under modern day due process, "the requirements of due process are met irrespective of a [foreign merchant's] lack of physical presence in the taxing State."[83] The Court reasoned that the "touchstone" of due process analysis is "the fundamental fairness" of government activity on the individual.[84] As such, a tax may satisfy due process if a merchant "purposefully" directs activities of a "sufficient" magnitude at the state's residents, provided the tax is "related to the benefits [the foreign merchant] receives from access to the State."[85] Therefore, Quill's purposefully directed activities at North Dakota residents, magnitude of the contacts with those residents, and benefits Quill received from the State, were sufficient to justify imposition of a use tax collection duty by the State.[86]

However, more portentously, the *Quill* Court held that under the Commerce Clause analysis a physical presence was still required.[87] Specifically, the Court held that "a [foreign merchant] whose only contact with the taxing State is by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."[88] Consequently, the North Dakota use tax as applied to Quill was deemed unconstitutional.[89] In essence, the Court pronounced that a state tax may violate the Commerce Clause even though it is consistent with the Due Process Clause.[90]

D. SUBSTANTIAL NEXUS FACTORS

Traditionally, to establish a sufficient nexus to impose a use tax collection duty, the foreign merchant must have a physical presence in the taxing jurisdiction greater than just the "slightest presence."[91] Courts consider various factors in determining whether a sufficient

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82. *Id.* at 308.
83. *Id.*
84. *Id.* at 312.
85. *Id.* at 308.
86. *Id.* The Court acknowledged that the Due Process Clause does not bar imposition of a use tax duty when a foreign merchant annually mailed 24 tons of catalogs and flyers into a state, had annual sales approaching $1 million to in-state customers, and received social and commercial benefits from the state. *See id.* at 302, 304.
87. *Id.* at 311.
88. *Id.* The Court reaffirmed the "continuing vitality of *Bellas Hess*' 'sharp distinction between mail-order [merchants] with a physical presence in a taxing state'" and those without such a presence. *Id.* However, the Court did state that "contemporary commerce clause jurisprudence might not dictate the same result were the issue to arise for the first time today." *Id.*
89. *See id.* at 309-19.
90. Forte, *supra* note 11, at 211 (citing Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987)).
91. National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 556 (1977).

presence exists to meet the Commerce Clause nexus requirement, including: 1) whether the merchant maintains an office or other places of business in the taxing state;[92] 2) whether the merchant places sales people or other representatives in the taxing state;[93] 3) whether the merchant owns property within the taxing state;[94] 4) whether the merchant maintains a local telephone listing within the taxing state;[95] and 5) whether the merchant regularly engages in delivering or servicing property in the state.[96]

Not limiting their scope, courts have considered a variety of other factors as well.[97] Courts have considered factors such as whether the merchant advertised in the local media, printed or published catalogs in the taxing state, was licensed to do business in the taxing state, had a bank account in the taxing state, retained a security interest in any goods sold in the taxing state, or enlisted the aid of a collection agency in the taxing state.[98] These factors have not been dispositive, but where they are absent they usually are cited as support for the fact that a sufficient nexus is lacking.[99] Still, the courts are notably unclear as to the exact extent of the physical presence required. Arguably, in *Bellas Hess*, the Court did not clearly articulate what level of physical presence would justify the imposition of tax collection duties, leaving that determination to be made

92. Generally, the continuous presence of an office or other place of business will create a sufficient nexus for taxation. *See* D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24, 32-34 (1988) (finding a nexus for taxation of out-of-state mail order business of a Louisiana Corporation with, among other things, 13 department stores in-state); *National Geographic Soc'y*, 430 U.S. at 560 (finding a nexus where company had two in-state offices, even where the operation of those offices was unrelated to the out-of-state mail-order business).

93. *Quill*, 504 U.S. at 315.

94. De minimis or small amounts of property have been found to be insufficient to create the necessary Commerce Clause nexus. *Id.* at 315 n.8. (holding that a company's licensing of small amounts of software to clients in the state was not sufficient to create the substantial nexus required for taxation); *see also* Cally Curtis Co. v. Groppo, 572 A.2d 302, 306 (Conn. 1990) (finding that the mere leasing of films by Cally Curtis Co., an out-of-state company, to its customers for a short period of time, did not create a sufficient nexus with the state to be subject to the state's use tax).

95. *See* Goldberg v. Sweet, 488 U.S. 252, 263 (1989) (finding that a telephone call initiated or terminated in a state and either charged to a service address in the state or billed or paid within the state supports a nexus for purposes of an excise tax on interstate telephone calls). SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 671 (Conn. 1991) (finding that the use of a toll-free telephone number by an out-of-state company for the benefit of its customers does not create a sufficient nexus for the imposition of sales and use taxes).

96. B.L. Key, Inc. v. Utah State Tax Comm'n, 934 P.2d 1164, 1168 (Utah Ct. App. 1997) (arguing that a permanent physical presence in a state may not be required to impose sales and use tax collection duties on out-of-state merchants, and that repeated trips into the state, along with significant business activities in the state, constitute regularly engaging in delivery or servicing sufficient to create a nexus for taxing purposes).

97. *See SFA Folio Collections*, 585 A.2d at 669; L.L. Bean Inc. v. Pennsylvania Dep't of Revenue, 516 A.2d 820, 825 (Pa. Commw. Ct. 1986).

98. *See, e.g., SFA Folio Collections*, 585 A.2d at 669-70; *L.L. Bean*, 516 A.2d at 822-23, 825-26.

99. *See, e.g.*, Quill Corp. v. North Dakota, 504 U.S. 298, 301-04 (1992); National Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 754 (1967); Pledger v. Troll Book Clubs, Inc., 871 S.W.2d 389, 390 (Ark. 1994); *SFA Folio Collections*, 585 A.2d at 669-70; *L.L. Bean*, 516 A.2d at 822-23; Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13, 15 (S.C. 1993).

on a case-by-case basis.[100] Consequently, the physical presence may not necessarily need to be "substantial."[101] Rather, the physical presence may only need to be "demonstrably more than a 'slightest presence.'"[102] Yet, currently state governments seemingly must reconcile proposed tax schemes with the Commerce Clause's physical presence requirement, whatever its true import.[103]

III. QUILL'S RIGID PHYSICAL PRESENCE REQUIREMENT OBSOLETE IN CYBERSPACE

The traditional use tax structure arguably disintegrates when it meets the inhabitants of cyberspace. "This is true mainly because [the] activities are virtual, not real, and involve multiple parties."[104] By their very nature, the Internet and on-line services are not designed with geographical boundaries in mind.[105] With the right equipment, cyberspace commerce is accessible to anyone, anywhere, and at anytime.[106]

The types of goods and services currently being sold in cyberspace are clouding the lines between tangible and intangible goods and services.[107] Generally, intangibles are not subject to sales and use tax schemes.[108] To cloud the issue even further, traditionally tangible products, such as videos or music CD-ROMs, can now be downloaded electronically.[109] Although these issues may present challenges to a

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100. *B.L. Key, Inc.*, 934 P.2d at 1167. The Utah Court of Appeals looked to legislative intent in determining the appropriate standard reflected by the physical presence language of *Bellas Hess*. *See id.* The court confirmed that "the legislative history reflects an intent to impose tax collection duties on vendors that conduct a considerable amount of business in Utah, although they may not have a permanent physical presence in this state." *Id.* at 1168.

101. *See Quill*, 504 U.S. at 330 (White, J., dissenting) (stating that under the *National Geographic* "bright-line" rule, mail-order sellers will be subject to use tax collection if they have some presence in that taxing state even if that activity has no relation to the transaction being taxed). The other "bright-line" rule governing mail-order sellers requires a physical presence in the taxing state); Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954, 960-61 (N.Y. 1995) (noting that *Quill's* physical presence requirement may be met "by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf"), *cert. denied*, 516 U.S. 989 (1995).

102. *Orvis*, 654 N.E.2d at 961 (citing National Geographic Soc'y v. California Equalization Bd., 430 U.S. 551, 556 (1977)). While the physical presence of a foreign merchant is required, the true import of the physical presence requirement does not demand a substantial presence. *See id.* at 960.

103. *Quill*, 504 U.S. at 311-18; *see also Bellas Hess*, 386 U.S. at 758 (holding that states have no power to impose liability on an out-of-state mail order firm to collect use taxes, where all contacts which the firm had with the state were via United States mail or other common carrier).

104. Tilevitz, *supra* note 1, at 4.

105. Interactive Services Association, *Executive Summary of "Logging on to Cyberspace Tax Policy,"* Nov. 1996, at 4.

106. Deloitte & Touche L.L.P. & Information Technology Association of America (ITAA), *Internet Transactions, in* TAXATION OF CYBERSPACE 36 (1997) [hereinafter *Internet Transactions*].

107. *Id.* at 38.

108. *See supra* text accompanying note 6 (stating that tangible personal property is subject to sales and use taxes, whereas intangible property is not).

109. Deloitte & Touche L.L.P., *supra* note 106, at 38.

cyberspace merchant's ability to comply with collecting sales and use taxes,[110] these challenges are arguably insufficient to limit a state government's ability to administer sales and use taxes on emerging cyberspace commerce.

State governments view the taxation of cyberspace as fiscally necessary as cyberspace commerce continues to evolve and expand into a vast tax base.[111] Admittedly, relatively small amounts of tax are currently at stake, but the projected growth of the Internet and on-line services is substantial.[112] Regardless, foisting a physical presence requirement on a geographically indifferent commercial methodology seems illogical.

Arguably though, the *Quill* Court displayed less than complete enthusiasm for retaining the Commerce Clause substantial nexus requirement articulated in *Bellas Hess*. Indeed, the Court's defense of the physical presence requirement was based largely on pragmatic considerations.[113] The Court acknowledged the artificiality of the requirement and suggested that it might well have approached the matter differently had it been one of first impression.[114] Rather than defending the doctrinal justification for the substantial nexus requirement, the Court pointed to several key considerations in its decision to reaffirm *Bellas Hess*: 1) the administrative advantages of the old rule; 2) the reliance interests it had engendered; 3) the principle of stare decisis; 4) concerns about retroactive application of a new rule; and 5) the superior ability of Congress to address the problem.[115]

For the most part, the Court's historical considerations in *Quill* can systematically be eliminated when contemplating cyberspace commerce. The Court first defended its decision by looking to the administrative advantage of the old rule. Arguably, administration of the myriad of possible cyberspace taxing venues poses a challenging task, but advances

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110. Interactive Services Association, *supra* note 105, at 4.

111. *See* Karl A. Frieden & Michael E. Porter, *The Taxation of Cyberspace: State Tax Issues Related to the Internet and Electronic Commerce, in* STATE TAX NOTES 1390-91 (1996).

112. Forte, *supra* note 11, at 204. Internet use grows at the rate of 10% to 20% per month, with 30 million users on the Internet worldwide. 56 St. Tax Rev. (CCH) 33, Aug. 14, 1995, at 8. In 1994, there were 10,000 vendors on the Internet with expert projections seeing this number reaching 1 million by the year 2000. *Id.* at 13. According to Forrester Research of Cambridge, Massachusetts, corresponding sales estimates for the year 2000 exceed $6.5 billion. *See* Deloitte & Touche L.L.P. & Information Technology Association of America (ITAA), *The Internet, in* TAXATION OF CYBERSPACE 19 (1997). Each day roughly 120 new companies sign up for Internet addresses. *See* Saba Ashraf, *Virtual Taxation: State Taxation of Internet and On-Line Sales*, 24 FLA. ST. U. L. REV. 605, 609 (1997) (citing Ilana DeBare, *Cyber-Shopping Costly for Counties*, SACRAMENTO BEE, Aug. 17, 1995, at F1). Additionally, the number of World Wide Web pages devoted to business ads and product ads is growing at a rate of 12% a month. *Id.*

113. Walter Hellerstein, *Supreme Court Says No State Use Tax Imposed on Mail-Order Sellers . . . For Now*, 77 J. TAX'N 120, 124 (1992).

114. *Id.*; *see also* Quill Corp. v. North Dakota, 504 U.S. 298, 310-11 (1992).

115. Hellerstein, *supra* note 113, at 124; *see generally Quill*, 504 U.S. at 315-17.

in technology and software make the task manageable for merchants.[116] Therefore, rationale that administrative burdens of a collection duty are too heavy proves unpersuasive.

The Court provided further justification for adhering to the physical presence requirement based on the presumed reliance of the industry on a bright-line rule.[117] The majority in *Quill* asserted that the reliance interest promoted stability and fostered growth.[118] Stare decisis was also offered as a justification.[119] The justification for stare decisis was grounded in settled expectations and fostered investment resulting in "dramatic" growth.[120] Notably however, cyberspace commerce is in its infancy and too young to claim a long-term reliance on an existing rule. Further, the Court has overruled precedents under the Commerce Clause, "when they have become anachronistic in light of later decisions."[121] Thus, neither stare decisis nor the concern of retroactivity of a new rule need play any role in the maturing of cyberspace commerce. "*Quill* may therefore plausibly be read to have established a bright-line physical presence standard for the mail-order industry alone, relegating other industries to the 'more flexible balancing analyses' the Court's Commerce Clause jurisprudence now favors."[122] However, "the creation of a constitutional safe harbor for only one industry [mail-order] has the feel of a legislative rather than an adjudicative determination."[123] Yet, *Quill's* constitutional safe harbor has not been applied to cyberspace commerce.

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116. *See* Amy Hamilton, *On-Line Demonstration of Netscape's Tax Tracking Software Coming Soon*, 9 STATE TAX NOTES 1613, 1613 (1995). The author noted that a new software package (AVPTAXWARE) is being marketed by Netscape Communications, Corp. and AVP Systems that tracks sales over the Internet for merchants. *Id.* Mr. Dan Sullivan (CEO of AVP) states that the software can determine whether a product is taxable for 65,000 jurisdictions. *Id.*

117. *Quill*, 504 U.S. at 315-16.

118. *Id.* at 316-17.

119. *Id.* at 316. Stare decisis is defined as the "[p]olicy of courts to stand by precedent and not disturb settled point." *See* BLACK'S LAW DICTIONARY 1406 (6th ed. 1990).

120. *Quill*, 504 U.S. at 316.

121. *Id.* at 331. (White, J., dissenting).

122. Hellerstein, *supra* note 113, at 124. The author advanced that many of the reasons the Court formulated for adhering to the physical presence requirement relate principally, if not exclusively, to the mail-order industry. *Id.* Moreover, throughout the *Quill* Court's opinion, references to the *Bellas Hess* rule were explicitly confined to sales and use taxes. *Id.* The Court referred to the "bright-line rule in the area of sales and use taxes," to the fact that "we have never intimated in our review of sales or use taxes that *Bellas Hess* was unsound," (emphasis added) and that "the *Bellas Hess* rule . . . has become part of the basic framework of a sizeable industry." *Id.* In fact, the *Quill* Court declared that "we have not, in our review of other types of taxes, articulated the same physical presence requirement that *Bellas Hess* established for sales and use taxes." *Id.*

123. *Id.*

IV. MODERNIZATION OF NEXUS REQUIREMENT

Cyberspace commerce should be taxable and unburdened by the obsolete constitutional nexus requirement compelled by the Commerce Clause. Applying the traditional anachronistic physical presence requirement to cyberspace may lead to further erosion of a state's essential tax base. One commentator has noted that "[w]ith the advent of computer technology, the movement toward 'home shopping' and 'home offices,' and the increasing reliance on computers and telecommunications for transmitting and delivering a company's products and services, states risk losing local warehouses, offices, and sales representatives that would have assuredly created taxing jurisdictions."[124] States need the ability to adjust to emerging technologies unburdened by an obsolete taxing system. One analyst opined that "[w]hen the economy shifts from one [technology] to another, the tax system must shift with it or it becomes obsolete."[125]

State governments appear to be preparing to make the shift, but unquestionably lack uniform direction[126] and contemporary constitutional guidance. Therefore, in order to avoid the same use tax collection

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124. Edson, *supra* note 30, at 942.

125. Neil Munro & Gene Koprowski, *Tax Man to On-Line: Cough Up On-Line Taxes are Following Fast in the Wake of Electronic Commerce*, 1995 WL 4979339, at 4 (quoting Don Bucks, executive director of the Washington based Multistate Tax Commission). Bucks also stated that without shifts in the tax system, "county and state laws still would be based on revenue from horses and gas lights." *Id.*

126. As state governments prepare to make the tax shift to accommodate the geographically indifferent commercial transactions of cyberspace, they currently lack uniform guidelines to direct and assist their efforts. *But see, e.g., Second Initial Public Participation Working Group Draft of the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business* (last visited Sept. 1997) <http://www.mtc.gov/ppwgs/ppwglist.html>. Currently, a Multistate Tax Commission Public Participation Working Group is exploring constitutional nexus requirements for state sales and use taxes. This exploration has led to initial guidelines being drafted, however, these guidelines do not represent a "proposal" by either the Working Group or the Multistate Tax Commission. These initial guidelines, open to continuing comment, differentiate the nexus requirements compelled by the Due Process Clause and that of the Commerce Clause, thus partnering the proposed guidelines with the bifurcated Supreme Court position established in *Quill*. *See id.* Generally, this second initial draft of the guidelines advance the "minimum contacts nexus" concept for the Due Process Clause and the "substantial nexus" concept for the Commerce Clause. *Id.* Both proposed nexus requirements advance language that allows for a non-physical presence based on a purposeful business connection with a taxing state that is more than de minimis. *Id.* The guidelines being proposed have given some thought to application to cyberspace commerce, but appear to lack any real substantive direction at this time.

muddle of the mail-order industry, the states need assistance from either federal legislators or the United States Supreme Court.[127]

A. LEGISLATIVE MODERNIZATION

Ideally, Congress should assume the leading role in eliminating the obsolete physical presence requirement presumably applicable to cyberspace commerce. In fact, the United States Supreme Court in *Quill* issued such an invitation to Congress to take on this role and resolve the Commerce Clause issue.[128] In dictum, the *Quill* majority explained that reaching its Commerce Clause conclusion was less difficult due to the fact that Congress may disagree and alter the outcome of the case.[129] Further, the Court's dictum currently rings louder in Congress's ears, given the wide ranging use and issues of the Internet and on-line commerce.[130] Thus, Congress should no longer hesitate to step in.

Congress has plenary power under the Commerce Clause to authorize state actions that burden interstate commerce.[131] By exercising this

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127. Forte, *supra* note 11, at 214-15. The problem states have with the mail-order industry is that a consumer can price a product at a local store that is obligated to collect tax, and then compare that product to the identical product offered by a mail-order company who does not collect the tax. *Interstate Sales Tax Collection, Before the Subcomm. on Procurement, Taxation & Tourism of the House Comm. on Small Business*, 103rd Cong. (1994) [hereinafter *Interstate Sales Tax*] (statement of James H. Bilbray, Representative). During the subcommittee hearing, several small businessmen revealed the impact that non-collection of taxes by out-of-state mail-order companies has on their companies. *Id.*

The owner of a 41 year old appliance and video store headquartered in Carson City, Nevada offered testimony about the non-collection of taxes. *Id.* (statement of Joe Bookwalter, Owner, Baker Appliance & Video). The owner stated that his business survived by providing exceptional service and knowledgeable salesmen. *Id.* The owner noted that the proliferation of mail-order catalogs had caused an increasing number of people to use his store's trained salesmen to select their product, but then buy the product out-of-state to avoid paying sales tax. *Id.* Although the purchaser is obligated to pay a use tax when the goods are purchased out-of-state, the purchaser rarely complies. *Id.* Then when the equipment needs repair, the purchaser brings the equipment to his store and he is obligated by manufacturer agreement to provide warranty repair at the store owner's expense. *Id.*

128. Quill Corp. v. North Dakota, 504 U.S. 298, 318-19 (1992). In dictum, the Court noted that Congress may be better qualified to resolve the Commerce Clause issue and has the ultimate power to do so. *Id.* at 318. Specifically, the Court stated that "[i]n this situation, it may be that 'the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.'" *Id.* at 319 (citing Commonwealth Edison Co. v. Montana, 453 U.S. 609, 637 (1981)) (White, J., concurring).

129. *See id.* at 318 (dictum). Realizing that Congress has the final say, Justice Stevens admitted that Congress is likely more capable of settling this issue. *Id.*

130. Gregory A. Ichel, Comment, *Internet Sounds Death Knell for Use Taxes: States Continue to Search for Lost Revenues*, 27 SETON HALL L. REV. 643, 657 (1997). The wide range use and growth of the Internet and online services promises to continue in the years ahead. *See* Richard S. Zembek, Comment, *Jurisdiction and the Internet: Fundamental Fairness in the Networked World of Cyberspace*, 6 ALB. L.J. SCI. & TECH. 339, 344 (1996) (giving a rough estimate of on-line users near a maximum of 100 million); Saba Ashraf, *supra* note 112, at 609 (stating that the number of World Wide Web pages devoted to commercial ads is growing at a rate of 12% each month).

131. *Quill*, 504 U.S. at 305 (quoting International Shoe Co. v. Washington, 326 U.S. 310, 315 (1945) (pronouncing that it is no longer questionable that Congress may permit state actions that would otherwise violate the Commerce Clause)); *see* Western & S. Life Ins. Co. v. State Bd., 451 U.S. 648, 652-53 (1980) (noting that congressional authority exists to authorize what would otherwise constitute

power, Congress could preempt many potential constitutional challenges to state statutes while ensuring that a uniform state tax solution would become national law.[132] Additionally, federal legislation presumably would allow for a quicker resolution to the problem, saving years of unneeded costly litigation.[133] In the past, however, when states have asked Congress for help against taxing the mail-order industry, they have received nothing.[134] Since the Commerce Clause only bars state action where Congress has not legislated otherwise,[135] the lack of governing legislation triggers the Commerce Clause challenge to a state tax. It seems the only legal barrier to a solution is political will.[136]

Critics may argue that federalism provides Congress with a compelling reason not to legislate in the sales and use tax domain. The United States Constitution is based upon an understanding that the federal government and the states coexist as separate sovereigns with their own respective spheres of responsibility.[137] Strong opposition exists to the

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state violations of interstate commerce, which insulates particular state actions from potential Commerce Clause attack); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 258 (1964) (explaining that congressional authority exists to govern local occurrences adversely affecting interstate commerce).

132. For example, under a "reverse engineering" of the current physical presence standard, Walter Hellerstein suggests establishing a nexus over a foreign merchant in the purchaser's state by merely referencing the purchaser's billing address or other locational information (e.g., the area code and local exchange from which the purchaser accessed the merchant's Web site). *See* Walter Hellerstein, *State Taxation of Electronic Commerce: Preliminary Thoughts on Model Uniform Legislation*, 12 STATE TAX NOTES 1315, 1317-18 (1997). In essence, the nexus standard embraced by this proposal is an economic standard, whereby if the merchant exploits a state market, federal law could compel the merchant to collect the use taxes for that state subject to site using rules. *See* Kendall L. Houghton, *How Do We Impose and Collect Sales and Use Taxes on Electronic Commerce? An Analysis of Three Substantive Suggestions* (last visited Dec. 3, 1997) <http://www.nhdd.com/taxforum/tfart9.htm#pagetop>. Finding a nexus requirement based on the proposed site using rule would be a substantial departure from existing nexus principles and clearly unconstitutional. *Id.* Given this, it would be necessary for Congress to legislate a new nexus standard under its plenary Commerce Clause authority. *Id.* Arguably, as a result of this Congressional intervention, states could achieve the uniformity necessary to successfully reach their fair share of the revenue streams of cyberspace commerce. Further, states would avoid having to haphazardly revisit antiquated state statutes.

133. R. Scott Grierson, *Constitutional Limitations on State Taxation: Sales and Use Tax Nexus on the Information Superhighway*, 10 STATE TAX NOTES 589, 589-90 (1996). Grierson stressed that information service providers should be forewarned that states will aggressively pursue alternative arguments in order to acquire a nexus over out-of-state vendors, despite the apparent "safe harbor" provided under the physical presence requirement. *Id.* States will argue that, given changes in technology and the imminent social and economic changes produced by the information superhighway, it is simply unrealistic to apply the physical presence requirement to cyberspace transactions. *Id.* at 590.

134. Baker, *supra* note 12, at 9. The article made veiled reference to the invitation issued by the *Quill* Court to Congress in which it welcomed congressional resolution of the Commerce Clause barrier hindering state government attempts to impose use tax collection duties on postal space merchants. *Id.* Federal legislators failed to respond successfully. *Id.* One state official remarked to the author that "Congress will never vote to raise taxes it can't spend." *Id.*

135. Tilevitz, *supra* note 1, at 4.

136. *Id.*

137. This sentiment concerning the importance and relativity of federalism was expressed by the Executive Committee of the Multistate Tax Commission when contemplating the taxation of electronic commerce. On January 17, 1997, the Executive Committee of the Multistate Tax Commission adopted a "Statement of Direction on Electronic Commerce Issues." The Multistate Tax Commission (MTC) is an umbrella organization of states which formulates uniform state legislation and policy. The Commis

encroachment upon state sovereignty by legislating in an area traditionally controlled by the states.[138] Undeniably, the power to tax is an important element of state sovereignty and federalism basically prevents Congress from establishing state tax rates and tax policy.[139] Notwithstanding, the Commerce Clause reserves for Congress the power to regulate interstate commerce.[140] This exclusive province results from a desire to avoid disputes among states.[141]

Arguably, Congress recognizes the importance of maintaining the dynamic growth of cyberspace commerce.[142] However, Congress is faced with the challenge of preventing state resource-intensive conflict and unilateral solutions that may unreasonably burden this multi-jurisdictional commerce. Congress would be ill-advised to allow the creation of a mail-order type "interstate tax shelter" for cyberspace merchants because of a lack of uniformity and compatibility in state law. Therefore, the policies behind Congress' exclusive power over interstate commerce outweigh any federalism concerns.[143]

Of course, Congress may wonder why it should raise taxes that someone else will spend.[144] One answer is for states to earmark cyberspace taxation revenues for something that national leaders of both parties want but cannot afford.[145] The earmarked revenues could be used, in part, to improve access to the information infrastructure, to underwrite Internet accounts for schools and libraries, or to fund fiber optic lines in rural areas.[146] The States should be allowed to set priorities concerning the use of the earmarked funds, but Congress can take credit for the overall policy.[147] Nonetheless, Congress should be the one to preempt adherence to the antiquated Commerce Clause concept of physical

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sion adopted this statement to encourage cooperation and dialogue between business and government so that state and local tax issues can be successfully resolved as readily as possible.

138. The National Governors' Association issued a resolution opposed to federal preemption of a state's right to tax electronic commerce. The governors support state review of existing state tax policies to ensure that outdated and inconsistent tax treatment does not hinder growth of competition. There appears a readiness to consider development of uniform guidelines for state and local governments to follow.

139. W. Carl Spining, Comment, *Forcing Mail-Order Houses to Collect Use Taxes in the Wake of Quill Corp. v. North Dakota*, 60 TENN. L. REV. 1021, 1037 (1993) (citing Timothy Gillis, Comment, *Collecting the Use Tax on Mail-Order Sales*, 79 GEO. L.J. 535, 557-58 (1991)).

140. U.S. CONST. ART. I, §8, cl. 3 (stating "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States . . . .").

141. Spining, *supra* note 139, at 1037.

142. *See* Internet Tax Freedom Act of 1997, S. 442, 105th Cong. (attempting to create a moratorium on state and local Internet taxes to allow time for the development of a comprehensive national Internet tax policy). Under the terms of the proposed bill, state governments would no longer be able to place new taxes on such things as Internet access or online computer services, while retaining the ability to tax online sales. *Id.*

143. *Id.*

144. Baker, *supra* note 12, at 9.

145. *Id.*

146. *Id.*

147. *Id.*

presence by passing legislation establishing an "economic presence" requirement for cyberspace commerce.[148]

1. "First Sale" Creates Sufficient Economic Presence

Congress could establish an economic presence based on a "first sale" with a consumer in the taxing jurisdiction via the cyberspace merchant's virtual catalog.[149] Under such legislation, a merchant's web page, when accessed, would merely establish an informational presence, insufficient to satisfy the economic presence requirement.[150] The informational presence would continue until the first actual sale or transaction between the merchant and the consumer in the taxing jurisdiction took place.[151] The first sale would act as the "trigger," transforming the cyberspace merchant's status from an informational presence to an economic presence.[152] This economic presence would then satisfy the substantial nexus requirement of the Commerce Clause and permit the taxing jurisdiction to impose tax collection duties on the cyberspace merchant.[153] This federally legislated economic presence requirement equitably serves the interests of local and foreign merchants and state governments. The "first sale" requirement removes a competitive disad-

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148. Forte, *supra* note 11, at 225 (indicating that, although unenforceable, 25 states already require mail-order merchants to collect use tax if they have an "economic presence"). The following states require collection of tax by mail-order merchants if they regularly or systematically exploit an in-state market: Alabama, Arizona, California, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Massachusetts, Minnesota, Mississippi, Missouri, Nebraska, Nevada, North Carolina, North Dakota, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, and Virginia. *Id.*

149. *Id.* at 225. The author stated that state governments should seek federal legislation to aid their tax collection efforts in cyberspace. *Id.* The proposed legislation should focus on the Internet vendor's economic presence in a taxing state rather than a physical presence in the taxing state. *Id.* The United States Supreme Court stated that an "economic presence" depends on the services and benefits provided by a State. *See* Quill Corp. v. North Dakota, 504 U. S. 298, 304 (1992). Arguably, an economic presence can be entirely non-physical or intangible such as when a foreign merchant exploits a state market by soliciting sales from a state's residents via an "800" telephone number or a computer on-line service. *See* Edson, *supra* note 30, at 943. Conversely, economic presence may manifest itself through "slight" physical presence as in a situation where a foreign merchant retains minimal property rights in the taxing state through its software licenses or satisfaction guarantee period. *Id.* at 942.

A "consumer" for purposes of this Note is an individual rather than a business organization. Sales to business organizations are beyond the scope of this Note.

150. Forte, *supra* note 11, at 225. In essence, a web page is a piece of software with text, pictures, graphics, sounds, and/or videos which is stored on a computer that makes use of hypertext transfer protocol (HTTP) and which is, in some fashion, linked to the Internet. *See* Deloitte & Touche LLP & Information Technology Association of America (ITAA), *The Internet*, TAXATION OF CYBERSPACE, ch. I, p. 18 (1997). A web page site may be defined as "a collection of files stored on a file server that is accessible to users of the World Wide Web, a network of servers and information available on the Internet." *See* Susan A. Dunn, *Negotiating Web Site Agreements*, 444 PRAC. L. INST. 467, 469 (1996).

151. Forte, *supra* note 11, at 225.

152. *Id.*

153. *Id.*

vantage for local merchants, creates a bright-line rule to aid foreign merchants, and enables state governments to access their fair share of a growing revenue source.[154]

However, potential critics of the first sale approach may argue otherwise. Critics may contend that a single sale is clearly de minimis and insufficient to create an adequate nexus with a taxing jurisdiction. Further, potential critics may assert that defining economic presence to include such a tenuous contact would deter foreign merchants from doing business in a state, thus impeding interstate commerce. Granted, the economic presence may appear slight, but it is by choice that the foreign cyberspace merchant creates its web page, accepts the purchase order, delivers the goods in the taxing state, and reaps the benefits of the cyberspace transaction.[155]

Cyberspace commerce will continue to evolve as Internet and online merchants voluntarily choose to create an economic presence in the taxing states.[156] The enormous potential for reducing customer costs and improving business productivity will draw both the savvy and the small unsophisticated business owner. Consequently, the foreign cyberspace merchant will receive significant benefits from the taxing state, obligating the merchant to shoulder its fair share of the tax collection burden.[157]

2. *"Substantial" Economic Presence Offers Something More*

Opponents of the fundamental first sale "non-physical" approach to creating a Commerce Clause nexus sufficient to trigger sales and use tax duties may look for "something more." In response, federal legislators might alternatively establish a substantial economic presence requirement. Accordingly, such a requirement would take the required nexus a step beyond the "first sale."

Similar to the first sale requirement, a substantial economic presence requirement could be established without physical presence, but would involve the examination of both the quality and quantity of a foreign merchant's economic presence in the taxing state.[158] A substantial

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154. *Id.* at 226.

155. *See id.*

156. *Id.*

157. Some of the benefits the cyberspace merchant will receive are a court system in which to pursue delinquent accounts, waste disposal for packaging materials, consumer protection laws, telecommunication support, and an infrastructure with which to move his merchandise. *Id.*

158. *Cf. Edson*, *supra* note 30, at 944. The author advanced a substantial economic presence standard for direct tax (i.e. income tax, franchise tax) situations, while suggesting that the physical presence standard adopted in *Quill* should be restricted to use tax collection decisions, if applied at all in the future. *Id.* The author stated that this bright-line "physical presence" rule served to lessen the oppressive administrative burden associated with filing state sales and use tax returns in thousands of

economic presence would have to be more than tenuous. A substantial economic presence would characteristically fall somewhere between *Quill's* Due Process requirement and its more onerous Commerce Clause physical presence requirement. Thus, this proposed requirement would command something beyond due process "minimum contacts," evidenced by purposeful, direct, and frequent exploitation of a taxing state's market, but less than the requisite office or place of business, agent or representative relationship, or other property needed to establish physical presence.[159] Due to the heightened economic level required under this proposed Commerce Clause nexus requirement, it would be necessary to examine the frequency, quantity, and systematic nature of a cyberspace merchant's economic contacts with the taxing state.[160]

Further, a substantial economic presence may require contemplation of a foreign merchant's economic activity in the state relative to its size.[161] Interstate commerce concerns suggest that the term "substantial" be defined vis-a-vis the merchant's business as a whole rather than the state's revenue generated from the merchant taxpayer.[162] A cyberspace merchant will not be deterred from doing business in a taxing state if it is cost-beneficial to do so.[163]

A de minimis exception should be a meaningful aspect of any contemplated legislation.[164] An equitable de minimis rule would establish a minimum number of transactions or a minimum dollar amount in sales derived from the state before the state could require cyberspace merchants to collect the use tax.[165] This hybrid approach provides an

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nonuniform tax jurisdictions. *Id.* at 943. Conversely, the physical presence standard is not an appropriate standard for analyzing income tax nexus, especially in today's high-tech society, due to the less cumbersome nature of administering income tax compliance. *Id.* Additionally, the author noted that direct taxes have typically applied a "substance over form" doctrine that scrutinizes the economic reality of a transaction rather than what it appears to be on the surface to prevent manipulation and avoidance of justly imposed taxes on income earned within a state's borders. *Id.* Whereas, historically, sales and use tax analysis consisted of a "form-over-substance" doctrine requiring taxpayers to jump through hoops to obtain a certain tax-based result. *Id.* Thus, the author concluded that a substantial economic presence standard was more appropriate for direct tax scenarios and furthers the evolution towards an economic nexus standard that state courts and society appear to be endorsing. *Id.*

159. *Id.* at 945.

160. *Id.*

161. *Id.* For example, a foreign one-man company that generates $50,000 in sales from a state in which it has no physical presence may be considered "substantial" in contrast to a large multinational company that generates $50,000 in sales in the taxing state when its overall sales are $100 million. *Id.* However, most attempts at federal legislation have focused on the total annual sales of a foreign merchant, rather than the percentage of overall business the merchant conducted in the taxing state. *See infra* text accompanying note 167 (citing numerous federal efforts attempting to determine a threshold for imposition of tax collection duty).

162. *Id.*

163. *Id.*

164. Spining, *supra* note 139, at 1036.

165. *Id.* This proposed rule may seemingly discourage expansion, but directly addresses the Commerce Clause concerns outlined in *Quill*. *Id.* at 1037. Additionally, this approach more accurately reflects the foreign merchant's connection to a taxing state. *Id.* Further, a foreign merchant would be responsible for contributing to the state creating its market. *Id.* Some may suggest a de minimis excep

accurate reflection of the benefits received by the merchant.[166] Similarly, such a de minimis rule would protect the merchant whose economic presence is created solely from an "occasional" small dollar sale in the taxing state.[167]

B. JUDICIAL MODERNIZATION

Congress may choose not to legislate. Although the Court has indicated that it would welcome Congressional action, federal legislators have failed to respond successfully to the Court's open invitation to act on the Commerce Clause issue.[168] Conversely, Congress may choose to legislate, but it may be unsuccessful. Congress has made at least thirteen unsuccessful attempts to grant states the power to require foreign

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tion for foreign merchants with less than a particular amount of annual income or with fewer than a stated number of sales within a taxing state. *Id.* However, this approach discourages company growth for those merchants just below the designated amounts and places strains on merchants at or just over this designated amount. *Id.*

166. *Id.*

167. *Id.* A foreign merchant making a few small sales in a taxing state would shoulder no compliance burden because it lacks enjoyment of the full benefits of the taxing state's market. *Id.* at 1034.

168. Quill Corp. v. North Dakota, 504 U.S. 298, 318-19 (1992). However it should be noted that Congress, when facing another situation of regulation of state taxation, enacted PUB. L. NO. 86-272, 73 Stat. 555 (1959)(codified at 15 U.S.C. § 381 (1994)). *Id.* at 316 n.9. Pub. L. No. 86-272 was enacted in response to the United State Supreme Court's indication in *Northwestern States Portland Cement v. Minnesota*, 358 U.S. 450, 452 (1959), that, "so long as the taxpayer has an adequate nexus with the taxing State, 'net income from the interstate operations of a foreign corporation may be subjected to state taxation.'" *Id.* Pub. L. 86-272 provides that, "a State may not impose a net income tax on any person if that person's 'only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled . . . outside the State.'" *Id.* Section 381 was an effort by Congress, "to allay the apprehension of businessmen that 'mere solicitation' would subject them to state taxation . . . designed to define clearly a lower limit for the exercise of [the State's power to tax]." *Id.* Congress's goal was one of clarity in an effort to remove uncertainty. *Id.*

merchants to collect use taxes.[169] Likewise, the States may attempt to legislate, but ineffectively and non-uniformly.

Consequently, the responsibility of "modernizing" the Commerce Clause's physical presence requirement may fall solely with the United States Supreme Court. Granted, notable judicial modernization may take longer than congressional action. However, the Court has been the locus of this area of the law in that it represents the forum in which the existing tax nexus requirements were created. Thus, the Court stands poised to establish an equitable alternative to federal legislation.

Ideally, the Court would step in and hear a case that would simply and clearly establish that an "economic presence" in a taxing state establishes a sufficient nexus to impose use tax collection duties on cyberspace merchants. Realistically, however, the Court would likely hear a

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169. *See* S. 545, 104th Cong. § 3845 (1995); S. 1825, 103rd Cong. (1994); H.R. 2230, 101st Cong. § 2 (1989) (granting states the power to require collection of use taxes by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual sales exceeding either $12.5 million in the United States or $500,000 in the taxing state); S. 480, 101st Cong. § 2 (1989) (granting states the power to require collection of use taxes by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding $12.5 million in the United States or $500,000 in the taxing state); S. 2368, 100th Cong. § 3 (1988) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding $15 million in the United States or $750,000 in the taxing state); H.R. 3521, 100th Cong. § 2 (1987) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding $12.5 million in the United States or $500,000 in the taxing state); H.R. 1891, 100th Cong. (1987) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding $12.5 million in the United States or $500,000 in the taxing state); H.R. 1242, 100th Cong. (1987) (granting states the power to require use tax collection by out-of-state retailers with annual nationwide sales exceeding $5 million and requiring retailers to file annual information returns); S. 1099, 100th Cong. § 2 (1987) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and had annual gross sales exceeding $12.5 million in the United States or $500,000 in the taxing state); S. 639, 100th Cong. (1987) (granting states the power to impose a sales or use tax on interstate sales by out-of-state retailers); S. 2913, 99th Cong. (1985) (granting states the power to require use tax collection by an out-of-state vendor if the vendor engages in regular or systematic solicitation, has annual gross sales exceeding $100,000 in the United States or $25,000 within the taxing state, and requires one uniform sales tax and use tax rate per state); H.R. 3549, 99th Cong. (1985) (granting states the power to require use tax collection by an out-of-state vendor if the vendor engages in business in that state, has annual national gross sales exceeding $5 million, and requires one uniform sales tax and use tax rate per state); S. 1510, 99th Cong. (1985) (granting states the power to require use tax collection by out-of-state retailers on any interstate sale); S. 983, 96th Cong. (1979); S. 282, 93rd Cong. (1973). These unsuccessful attempts were due, in part, to strong lobbying efforts by the mail-order industry and Congressional insecurity about the constitutionality of such legislation. Forte, *supra* note 11, at 218 (citing Pamela M. Krill, *Quill Corp. v. North Dakota: Tax Nexus Under the Due Process and Commerce Clause No Longer the Same*, 1993 WIS. L. REV. 1405, 1429). Notably, Congressional hesitancy in enacting legislation was likely the result of deference to the judiciary branch. *See Quill*, 504 U.S. at 318. However, the *Quill* Court in essence removed any legitimate Congressional insecurity when the Court acknowledged that Congress was better qualified to evaluate tax burdens on interstate commerce. *Id.* (stating that "[C]ongress 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."). *Id.*

mail-order case that allots the opportunity to redefine the substantial nexus requirement that *Quill* failed to quantify outside of the "physical presence" realm.[170] Evidence of the judicial systems flexibility and willingness to interpret the Due Process Clause and Commerce Clause nexus requirements in accordance with current technological and societal values is found in varying tax cases over the last ten years.[171] Ratification by the United States Supreme Court of viable lower court approaches to modernizing the rigid physical presence requirement would establish a foundation for state governments in supporting their efforts to maintain the state's fiscal health.

Considering the rapid changes affecting commerce since the *Quill* decision, a contemporary Commerce Clause analysis must go beyond the limiting physical presence requirement. A merchant's economic presence must be a factor when judicial modernization of the Commerce Clause nexus requirement is contemplated, as the economic realities of today's emerging cyberspace commerce make a physical presence requirement obsolete.

VI. CONCLUSION

The realities of modern commerce command further examination of the current Commerce Clause nexus requirement. Modernizing the antiquated physical presence requirement would allow state governments

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170. *See* Edson, *supra* note 30, at 942. The author noted that the United States Supreme Court to date has held that a nexus is achieved through physical presence defined to include property such as local stores; *see, e.g.*, Nelson v. Sears, Roebuck & Co. 312 U.S. 359 (1941), and employees, including the presence of local agents, *see, e.g.*, Felt & Tarrant Co. v. Gallagher, 306 U.S. 62 (1939). *Id.* at 947 n.265. However, modern case law suggests a more tenuous relationship with a taxing state may establish a sufficient nexus. *See, e.g.*, Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993) (holding that failure to prohibit the use of a trademark in a state constituted a substantial nexus). The standards advanced by *Quill* and *Geoffrey* represent the extremes along the "substantial nexus" continuum plausible in modern society. Edson, *supra* note 30, at 942.

171. *See generally Quill Corp.*, 504 U.S. at 298 (bifurcating the Due Process Clause and Commerce Clause analysis resulting in the establishment of separate nexus requirements under each Clause). *See also* Tyler Pipe Industries Inc. v. Washington Dep't of Revenue, 483 U.S. 232, 250-51 (1987) (holding that a sufficient nexus was established based upon the presence of a representative in Washington); Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954, 960-61 (N.Y. 1995) (finding that while the physical presence of an out-of-state vendor in a taxing state is required in order to impose a duty on the vendor to collect compensating use tax, physical presence need not be substantial but, rather, needs to be demonstrably more than the slightest presence); *Geoffrey, Inc.*, 437 S.E.2d at 18 (holding that the foreign merchant need not be physically present within the state for the state to impose its income tax on the foreign merchant's royalty income); B.L. Key, Inc. v Utah State Tax Comm'n, 934 P.2d 1164, 1168 (Utah Ct. App. 1997) (arguing that a permanent physical presence in a state may not be required to impose sales and use tax collection duties on out-of-state merchants; that repeated trips into the state, along with significant business activities in the state, constitute regularly engaging in delivery or servicing sufficient to create a nexus for taxing purposes) . The Court stated that the "crucial factor governing nexus is whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales." *Tyler Pipe*, 483 U.S. at 250.

to collect their fair share of sales and use tax revenues in cyberspace and abrogate any disparate treatment among local and foreign merchants. Undeniably, interstate commerce should not enjoy a more favorable status than intrastate commerce. Yet, by continuing to impose the physical presence requirement, the *Quill* Court made an economic decision to do just that. Retaining the physical presence requirement created an interstate tax shelter for the voluminous mail-order industry and was out of touch with economic reality. Thus, modernization of the physical presence requirement is necessary to avoid creating another sheltered and privileged class of merchants—foreign cyberspace merchants.

Ultimately, congressional action or judicial modernization of the Commerce Clause nexus requirement would ensure the continuing emergence of cyberspace commerce and an equity for all merchants and state governments. Tax policy involves principles of equity and justice compelling every foreign merchant to support the economic and environmental stability of the local markets in which it chooses to conduct business.[172] Accordingly, a Commerce Clause nexus requirement based on an economic presence supports these principles. A foreign merchant who avails itself of modern technologies to engage in continuous and intentional solicitation of a state's consumer market while receiving benefits, services, and opportunities from the state should be held responsible for paying its share of the burden required to maintain the economic and environmental stability of its chosen markets. Arguably, the "first sale" standard meets the twin aims of equity and justice because it creates a true bright-line, removes the competitive tax disadvantage faced by local merchants, and enables state governments to access their fair share of a growing revenue source, while still upholding the constitutional protections of the Commerce Clause of the United States. Similarly, the "substantial economic presence" standard satisfies the twin aims by creating less of a bright-line, but still removing the competitive local disadvantage and enabling states to tap the rapidly growing revenue source in cyberspace.

As state governments look to access their fair share of cyberspace revenues, they must be cognizant of balancing these prominent aims with continued progress. State governments must exercise social responsibility and focus on fair administration in taxing cyberspace. Unrealistic and creative interpretation of existing statutory law is not the answer. The benefits will be very real if states can develop and utilize a thoughtful tax regime that provides equitable treatment for cyberspace merchants and consumers without hindering the explosive commercial

172. Edson, *supra* note 30, at 947.

growth being experienced in cyberspace. By suggesting that the North Dakota Supreme Court had the "right idea"[173] at the wrong time, *Quill* created a slippery standard which state governments onerously struggle with in maintaining the state's crucial tax base. By pronouncing that the North Dakota Supreme Court's right idea has now found a "right time," Congress, or alternatively, the United States Supreme Court can prevent the mail-order muddle from being "virtualized" in cyberspace.

Julie M. Buechler

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173. The North Dakota Supreme Court pronounced that an economic relationship rather than a physical relationship should establish the nexus necessary for use tax collection purposes.