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State Taxation of Online Tobacco Sales: Circumventing the Archaic Bright Line Penned By Quill

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STATE TAXATION OF ONLINE TOBACCO SALES: CIRCUMVENTING THE ARCHAIC BRIGHT LINE PENNED BY *QUILL*[1]

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I. INTRODUCTION

Over the past decade, the Internet has become an increasingly popular shopping destination for cigarette buyers. A 1997 survey identified thirteen online cigarette vendors,[2] and today that number has multiplied to over 700.[3] The online market for cigarettes thrives on the anonymity and extraterritoriality that characterize so many transactions in cyberspace—allowing parties on both sides to benefit from a mutual

2. *See* Christopher Banthin, *Cheap Smokes: State and Federal Responses to Tobacco Tax Evasion Over the Internet*, 14 HEALTH MATRIX 325, 325 (2004) (citing CTR. FOR MEDIA EDUC., ALCOHOL AND TOBACCO ON THE WEB: NEW THREATS TO YOUTH (1997), http://www.vwjf.org/reports/grr/032436s.htm int_grantinfo (last visited Jan. 7, 2006) (funded by the Robert Wood Johnson Foundation)).

3. *See* K. M. RIBISL ET AL., SALES AND MARKETING OF CIGARETTES ON THE INTERNET: EMERGING THREATS TO TOBACCO CONTROL AND PROMISING POLICY SOLUTIONS IN REDUCING TOBACCO USE: STRATEGIES, BARRIERS, AND CONSEQUENCES (National Academy Press forthcoming).

disregard of applicable laws.[4]

State governments across the nation are particularly troubled by the pervasive practice of tax evasion in the online cigarette marketplace. The state excise tax comprises a significant portion of the retail price of a pack of cigarettes.[5] The Internet gives sellers the opportunity to turn a healthy profit by selling "tax free" cigarettes directly to consumers. In turn, it gives smokers a chance to save money by avoiding payment of cigarette excise taxes. Many state governments stand to lose millions of dollars each year from unpaid cigarette taxes.[6] Unpaid cigarette taxes rob not only state treasuries but also the public's health. Tobacco taxes have proven to be one of the most effective means of reducing tobacco use.[7] Therefore, state governments are concerned that untaxed online sales will impair longstanding campaigns to drive down smoking rates. This is an urgent problem in light of the fact that smoking is the leading cause of preventable death in the nation.[8]

In response to this emerging tax evasion crisis, several states have begun enacting laws designed to capture taxes from online cigarette sales. The new wave of statutes reflects a range of strategies, from an out-and-out ban on the remote sale of cigarettes to state residents to a mere requirement that online sellers notify purchasers of state taxes owed.[9] One

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4. *See* Press Release, Office of the Attorney Gen., State of Cal., Dep't of Justice, Attorney General Lockyer Announces Joint Effort by State and Federal Law Enforcement, Credit Card Firms To Stop Illegal Online Sales of Cigarettes (Mar. 17, 2005), http://caag.state.ca.us/newsalerts/2005/05-019.htm (cautioning that "[v]irtually all online sales of cigarettes are illegal because the sellers violate one or more state and federal laws" including state statutes designed to prevent tobacco sales to minors and to promote the collection of state taxes and federal statutes relating to mail and wire fraud, racketeering, smuggling, contraband, money laundering, cigarette labeling, and tax collection).

5. *See* R.J. Reynolds Tobacco Co., Tobacco Taxes & Payments, Quick Facts, http://www.rjrt.com/legal/taxQuickFacts.aspx (last visited Jan. 7, 2006) [hereinafter R.J. Reynolds Tobacco Co., Quick Facts] (estimating that the weighted average state cigarette excise tax is seventy-nine cents per pack as of November 2005); *see also* R.J. Reynolds Tobacco Co., Tobacco Taxes & Payments, Who Pays Cigarette Taxes?, http://www.rjrt.com/legal/taxWhoPays.aspx (last visited Jan 7, 2006) [hereinafter R.J. Reynolds Tobacco Co., Who Pays] (reporting that since January 1998, the average cigarette pack price increased from $2.04 to $3.82 in 2004).

6. *See* RIBISL, *supra* note 3 (noting that the loss of revenue to the states could run in the hundreds of millions, if not billions, per year).

7. *See* NAT'L CANCER POLICY BD., INST. OF MED. & NAT'L RESEARCH COUNCIL, STATE PROGRAMS CAN REDUCE TOBACCO USE 6 (2000), *available at* http://www.nap.edu/catalog/9762.html.

8. J.L. Fellows, et al., *Annual Smoking-Attributable Mortality, Years of Potential Life Lost, and Economic Costs—United States, 1995–1999*, 51 MORBIDITY & MORTALITY WKLY. REP. 297, 300 (2002).

9. Four states have effectively banned the delivery sale of cigarettes to individual consumers. *See* ARK. CODE ANN. §§ 26-57-203(12), 26-57-215(4) (2005); Ark. Tobacco Control Bd. v. Santa Fe Natural Tobacco Co., No. 04-272, 2004 WL 2823339 (Ark. Dec. 9, 2004)

strategy adopted by a few states, including Arizona, requires online and other remote sellers to collect state tobacco taxes.[10] This Article uses Arizona's approach as a case study to explore the dormant Commerce Clause implications of a statute that requires out-of-state vendors to collect and remit applicable state tobacco taxes on cigarettes sold into the state.

The Arizona statute applies to vendors who accept purchase orders for the delivery sale of tobacco products.[11] The Arizona statute defines "delivery sale" as any sale of tobacco products to a consumer in Arizona in which the consumer submits the order remotely (e.g., via the telephone, the mail, or the Internet) or in which the tobacco products are delivered by use of the mail or a delivery service.[12] The statute mandates that every vendor engaging in the delivery sale of tobacco products shall collect and remit all applicable state tobacco taxes or show proof that such taxes have already been paid.[13] The Arizona tobacco delivery sales statute warrants special attention for policy and legal reasons.

Arizona's statute offers a promising policy solution that could be replicated in other states. Although a total ban on delivery sales of tobacco products to state residents is a more comprehensive tactic, it is likely to be politically unfeasible in many jurisdictions. And statutes that require remote tobacco sellers to alert their customers about taxes owed to the state have hardly produced a wave of voluntary submissions on the part of online shoppers. Yet a statute that compels remote tobacco vendors to shoulder their fair share of the tobacco tax collection and remission burden is a politically palatable solution that is likely to have a significant impact on the problems associated with untaxed cigarette sales.

The Arizona statute provides an ideal lens through which to examine an untested constitutional issue. In the 1992 case of *Quill Corp. v. North Dakota*,[14] the Supreme Court of the United States ruled that under the dormant Commerce Clause, mail-order vendors who did not have a physical presence in a state could not be held responsible for collecting

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(interpeting this Arkansas law to require cigarette retailers to sell face-to-face); CONN. GEN. STAT. § 12-285(c) (2005); MD. CODE ANN., BUS. REG. § 16-223 (LexisNexis 2005); N.Y. PUB. HEALTH LAW § 1399-*ll* (McKinney 2005). Other states, such as California, give remote vendors a choice between collecting and remitting applicable state taxes or placing a notice on shipping containers informing recipients of their tax obligations. *See* CAL. REV. & TAX. CODE § 30101.7(d) (Deering 2005).

10. *See* ARIZ. REV. STAT. ANN. § 42-3227 (2005); DEL. CODE ANN. tit. 30, § 5367 (2005); IDAHO CODE ANN. § 39-5714 (2005) (annotations current through Mar. 25, 2004); OR. REV. STAT. §§ 323.700, 323.724 (2003).

11. *See* ARIZ. REV. STAT. ANN. § 42-3222 (2005).

12. *Id.* § 42-3221.

13. *Id.* § 42-3227. The second option to show proof that taxes already have been paid applies only to the sale of cigarettes.

14. 504 U.S. 298 (1992).

and remitting sales and use taxes on orders shipped into the state.[15] This Article will address the novel legal question of whether the physical presence requirement is pertinent to tobacco excise taxes. It will debunk the prevailing belief that *Quill* should stand in the way of an Arizona-like statute[16] and will explain that such a statute actually should withstand constitutional scrutiny.

This Article begins with a summary of the legal and policy challenges relating to untaxed online sales of cigarettes.[17] Next, it reviews the history and current state of the dormant Commerce Clause doctrine.[18] The Supreme Court has enunciated two different standards for assessing state regulations and state tax schemes under the dormant Commerce Clause. This Article explains both standards and sheds light on the relationship between them. Finally, this Article analyzes the constitutionality of the Arizona tobacco delivery sales statute.[19]

II. THE PROBLEM OF INTERNET SALES AND TOBACCO TAXES

A. *Background on Tobacco Taxes*

A tobacco tax is a retail excise tax. Like retail sales and use taxes, a retail excise tax is a levy on the sale or use of a product.[20] However, sales and use taxes apply to products in general, while an excise tax imposes an extra charge on a particular product. Tobacco taxes fall into a subcategory of excise taxes commonly dubbed "sin taxes."[21] Sin taxes have a regulatory flair. They deter buyers from indulging in harmful products by making those products more expensive to obtain.[22] Moreover, they serve to reimburse society for the costs it incurs due to consumption of the

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15. *See id.* at 317.

16. *See, e.g.*, Banthin, *supra* note 2, at 351.

17. *See infra* Part II.

18. *See infra* Part III.

19. *See infra* Part IV.

20. *See* BLACK'S LAW DICTIONARY 605 (8th ed. 2004) (defining an "excise" as "[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax), or on an occupation or activity (such as a license tax or an attorney occupation fee)"). *See also* Ayda Yurekli, *Design and Administer Tobacco Taxes*, *in* 4 DESIGN AND ADMINISTRATION, WORLD BANK ECONOMICS OF TOBACCO TOOLKIT 1, 24 (Ayda Yureki & Joy de Beyer eds., 2006) (draft), http://www1.worldbank.org/tobacco/pdf/Taxes.pdf (noting that a retail excise tax is "imposed at the point of sale to the ultimate purchaser").

21. *See* BLACK'S LAW DICTIONARY 1499 (8th ed. 2004) (defining "sin tax" as "[a]n excise tax imposed on goods or activities that are considered harmful or immoral (such as cigarettes, liquor, or gambling)").

22. *See, e.g.*, ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, RAISING CIGARETTE TAXES REDUCES SMOKING, ESPECIALLY AMONG KIDS (2005), http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf.

damaging product among the population.[23]

Cigarette excise taxes date back to the early days of the Union.[24] Through the mid-1800s, the amount of the taxes rose and fell based on the short-term revenue needs of the government.[25] The federal government imposed a permanent tax on cigarettes during the Civil War.[26] Iowa became the first state to tax cigarettes in 1921, and by 1969 all fifty states had followed suit.[27] Currently, every state levies an excise tax on cigarettes and many tax other tobacco products as well.[28] Moreover, approximately 500 local jurisdictions have enacted their own tobacco excise taxes.[29]

Most states have implemented a similar system for the collection and remission of state tobacco excise taxes on products sold within the state. The state department of revenue sells tax stamps or meter register settings for approved machines to licensed distributors.[30] Distributors are responsible for affixing tax stamps or printing meter impressions on packs of cigarettes or units of tobacco.[31] So, when a retailer buys the product from the distributor, the excise tax is already folded into the price.

B. *The Importance of Tobacco Taxes to State Coffers and Public Health*

Tobacco taxes are an important source of revenue for the states. The median tax rate is seventy cents per cigarette pack.[32] Rhode Island has the highest state tax rate at $2.46 per pack while Kentucky imposes the lowest at three cents per pack.[33] From Rhode Island to Kentucky, all states rely on the generous revenue stream generated from tobacco excise taxes.[34] In

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23. *See* Ted O'Donoghue & Matthew Rabin, *Optimal Sin Taxes* (June 22, 2005) (unpublished paper), http://people.cornell.edu/pages/edo1/sin.pdf.

24. U.S. DEP'T OF HEALTH & HUMAN SERVS., REDUCING TOBACCO USE: A REPORT OF THE SURGEON GENERAL 1, 338 (2000), http://www.cdc.gov/tobacco/sgr/sgr_2000/ FullReport.pdf.

25. *Id.*

26. *See id.* Today, the federal tax on cigarettes is thirty-nine cents per pack, and there is a comparable tax on other tobacco products. *See* I.R.C. § 5701 (2000). Manufacturers and importers are responsible for paying federal tobacco taxes. *See* I.R.C. §§ 5701-5704, 5761-5763 (2000).

27. Daniel K. Benjamin & William R. Dougan, *Efficient Excise Taxation: The Evidence from Cigarettes*, 40 J.L. & ECON. 113, 116 (1997).

28. *See* FED'N OF TAX ADM'RS, STATE EXCISE TAX RATES ON CIGARETTES (2005), http://www.taxadmin.org/fta/rate/cigarett.html.

29. *See* R.J. Reynolds Tobacco Co., Quick Facts, *supra* note 5.

30. *See* Banthin, *supra* note 2, at 334.

31. *See id.*

32. FED'N OF TAX ADM'RS, *supra* note 28.

33. *Id.*

34. *See* MATTHEW C. FARRELLY & CHRISTIAN T. NIMSCH, RTI INT'L, IMPACT OF CIGARETTE EXCISE TAX INCREASES IN LOW-TAX SOUTHERN STATES ON CIGARETTE SALES, CIGARETTE EXCISE TAX REVENUE, TAX EVASION, AND ECONOMIC ACTIVITY 2 (2003), *available at* http://www.rti.org/pubs/8742_Southern_Neighbors_FR-9-18-03.pdf. Note that states with

2004, Rhode Island garnered over $115 million, while Kentucky brought in nearly $20 million.[35] California and New York, with high per pack rates and large populations, each collected over $1 billion in the same time period.[36]

With rising awareness of the lethal effects of tobacco use, states have commonly justified tobacco excise taxes as a tactic for boosting not only state coffers but also public health. Tobacco taxes have proven to be one of the most effective means of reducing tobacco consumption.[37] Increasing the cost of cigarettes has a dramatic impact on the number of people who start smoking and the number of smokers who quit.[38] Research shows that every ten percent increase in the price of cigarettes will produce a four percent decline in cigarette purchases.[39] Children and adolescents are particularly price sensitive.[40] For every ten percent increase in the price of cigarettes, there is at least a six-and-a-half percent decline in youth smokers.[41] Nationwide, a ten percent tax hike would result in over one million fewer adult smokers and nearly 1.7 million fewer youth smokers.[42]

A decline in tobacco use can yield significant savings for states and their citizens. Tobacco consumption produces $89 billion per year in direct medical costs and an additional $93.6 billion in lost productivity.[43] This

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traditionally low tobacco taxes can gain substantial revenue by increasing their tobacco excise tax—despite the fact that they may no longer serve as suppliers for smugglers, Internet sellers, and out-of-state customers from higher-tax states. *Id.* at 3, 12.

35. U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS: 2004 (2004), http://ftp2.census.gov/govs/statetax/04staxss.xls.

36. *Id.* Note that in recent years, many states have enacted tax hikes. *See* FED'N OF TAX ADM'RS, CIGARETTE TAX INCREASES 2002-2003 (2003), http://www.taxadmin.org/fta/rate/cig_inc02.html. Generally, after a tobacco tax hike, sales rates will drop sharply in the immediate term and will then rise to settle at a somewhat lower level than before the increase. Despite the reduced sales rate, states still will see an upsurge in revenue. *See, e.g.*, Kenneth E. Warner, *The Economics of Tobacco: Myths and Realities*, 9 TOBACCO CONTROL 78, 82 (2000); FARRELLY & NIMSCH, *supra* note 34, at 2.

37. *See* NAT'L CANCER POLICY BD., *supra* note 7.

38. *See id.*; Andrew Hyland et al., *Access to Low-Taxed Cigarettes Deters Smoking Cessation Attempts*, 95 AM. J. PUB. HEALTH 994 (2005) (finding that smokers who bought low-tax cigarettes were half as likely to attempt to quit and had a trend toward lower cessation rates).

39. *See* KATIE MCMAHON, CAMPAIGN FOR TOBACCO-FREE KIDS, STATE CIGARETTE TAXES & PROJECTED BENEFITS FROM INCREASING THEM 1 (2005), http://www.tobaccofreekids.org/research/factsheets/pdf/0148.pdf.

40. Robert M. Kaplan et al., *Simulated Effect of Tobacco Tax Variation on Population Health in California*, 91 AM. J. PUB. HEALTH 239, 240 (2001); NAT'L CANCER POLICY BD., *supra* note 7, at 6 ("Raising the price of tobacco products through taxation is one of the fastest and most effective ways to discourage children and youths from starting to smoke and to encourage smokers to quit.").

41. *See* MCMAHON, *supra* note 39, at 1.

42. *Id.*

43. *See* ERIC LINDBLOM & KATIE MCMAHON, CAMPAIGN FOR TOBACCO-FREE KIDS, TOLL OF TOBACCO IN THE UNITED STATES OF AMERICA (2005), http://www.tobaccofreekids.org/research/

means that every pack of cigarettes gives rise to $8.61 in medical costs and lost productivity.[44] The health consequences of smoking wreak havoc on state Medicaid programs.[45] In 2002, each pack of cigarettes carried $1.31 in attributable Medicaid costs.[46] Nationwide, a fifty-cent increase in cigarette taxes would save $744 billion solely due to a drop in heart attacks, strokes, and pregnancy complications.[47]

Tobacco taxes affect public health not only because they trigger a corresponding reduction in tobacco consumption but also because many states use tobacco tax revenues to prevent and combat disease. Several states, including Arizona, allocate portions of their tobacco tax revenues to fund tobacco control and other health-related programs.[48]

C. *The Jenkins Act*

Long before the advent of the Internet, the problem of tax evasion went hand-in-hand with the delivery sale of cigarettes.[49] By the end of the 1940s, thirty-nine states had enacted cigarette taxes that were supplementing their collective treasuries by nearly $400 million per year.[50] Meanwhile, mail order cigarette houses were popping up all over in the nominal- and no-tax states.[51] These houses profiteered on the simple business strategy of facilitating tax evasion.[52] They purchased cigarettes in their own states and shipped the merchandise directly to customers in the high-tax states.[53] The high-tax states stood to lose millions of dollars as a result.[54] In an attempt to lend these states a hand in their efforts to capture some of the missing revenue, Congress enacted the Jenkins Act in 1949.[55]

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factsheets/pdf/0072.pdf; *see also* CENTERS FOR DISEASE CONTROL & PREVENTION, SUSTAINING STATE PROGRAMS FOR TOBACCO CONTROL: DATA HIGHLIGHTS 2004 5 (2004), *available at* http://www.cdc.gov/tobacco/datahighlights/datahighlights.pdf [hereinafter CDC DATA HIGHLIGHTS].

44. CDC DATA HIGHLIGHTS, *supra* note 43, at 10-11.

45. *Id.* at 5, 10-11.

46. *Id.* at 10-11.

47. *See* MCMAHON, *supra* note 39, at 2.

48. *See, e.g.*, ARIZ. REV. STAT. ANN. § 36-772 (2005); Cal. Health & Safety Code §§ 104350-104480, 104500-104545 (Deering 2005); CAL. REV. & TAX. CODE §§ 30101-30111, 30121-30130 (Deering 2005); IDAHO CODE ANN. §§ 39-5701, 63-2520 (2005).

49. For an elegant summary of the history of the Jenkins Act, see Banthin, *supra* note 2, at 337-45.

50. *See id.* at 338.

51. *See id.*

52. *See id.* at 338-39.

53. *See id.*

54. *See id.* at 338.

55. Pub. L. No. 363, 63 Stat. 884 (1949) (codified as amended at 15 U.S.C. §§ 375-378 (2000)).

The Jenkins Act contains reporting requirements for cigarette sellers who ship or advertise to out-of-state buyers who are not distributors.[56] Such sellers must make two filings with the state into which they are shipping or advertising. First, they must file their name and address.[57] Second, they must file a monthly report documenting every shipment of cigarettes into the state.[58] The monthly report must include the name and address of each buyer, and the brand and quantity of cigarettes shipped.[59] Violations are a misdemeanor punishable by a $1,000 fine, imprisonment for up to six months, or both.[60] Violators can only be prosecuted in federal court.[61]

Soon after its enactment, the Jenkins Act faded into obscurity because mail order cigarette houses were eclipsed by brick-and-mortar retailers.[62] Cigarette manufacturers began pouring millions of advertising dollars into boosting face-to-face cigarette sales, and the public responded accordingly.[63] However, the recent emergence of the online cigarette marketplace has thrust the Jenkins Act back into relevance.

D. *The Challenge of Collecting Tobacco Taxes on Online Sales*

Several hurdles confront states that are seeking to enforce the Jenkins Act and reel in unpaid tobacco taxes from online sales. Online vendors consistently snub the Jenkins Act filing requirements while suffering few, if any, consequences.[64] It is hard for state governments to track unreported out-of-state sales, since they have no easy way of knowing which websites are selling large quantities of cigarettes to state residents. Also, online vendors can play prolonged games of cat-and-mouse with law enforcement by moving from address to address and name to name. Moreover, the Jenkins Act penalties hardly raise a specter of threat for delivery sellers. A $1,000 fine for failure to make a monthly filing is a small price to pay, and no one has ever been imprisoned for a Jenkins Act violation.[65]

Another obstacle to enforcement of the Jenkins Act is that states might be deterred from suing Internet tobacco vendors because there is some

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56. 15 U.S.C. § 376 (2000).
57. *Id.* § 376(a)(1).
58. *Id.* § 376(a)(2).
59. *Id.*
60. *Id.* § 377.
61. *Id.* § 378.
62. *See* Banthin, *supra* note 2, at 339.
63. *See id.*
64. *See* U.S. GEN. ACCOUNTING OFFICE, INTERNET CIGARETTE SALES 2-4 (2002) (describing the minimal Jenkins Act enforcement occurring at both the federal and state level).
65. *See id.* at 6.

doubt whether states have standing to bring a civil action to enforce the Act's reporting requirements. Tobacco delivery vendors have argued that, since the Jenkins Act provides only for criminal penalties, a state has no standing to bring such an action.[66] Two trial courts have rejected this argument, holding that a civil cause of action is implied in the language of the Jenkins Act.[67] But in other jurisdictions, the uncertainty might be enough of a disincentive to tip states away from seeking injunctions against recalcitrant online sellers.

States run up against legal and practical stumbling blocks when they attempt to compel Native American or offshore tobacco vendors to comply with the Jenkins Act. The Supreme Court ruled that states may require vendors on Native American lands to collect sales and excise taxes on cigarettes sold to non-tribal members.[68] However, there are political and practical problems with obtaining and enforcing judgments against tribal and offshore delivery sellers.[69]

Even when states obtain access to customer lists, they may lack the resources to collect the unpaid taxes. They must find the staff power to calculate individual tax obligations, generate tax bills, and pursue residents who decline to pay. For example, Rhode Island state officials spent several months in early 2005 generating letters from a list of over 70,000 online sales to over 1,200 buyers.[70]

A final set of barriers for states hoping to stem the financial and public health losses associated with online sales are the other players in the supply chain. Some manufacturers and distributors facilitate illegal sales by providing tobacco products directly to online vendors.[71] And some common carriers, including the United States Postal Service, continue to deliver shipments of cigarettes to consumers despite protestations by state law enforcement officials.[72]

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66. *See* Wash. Dep't of Revenue v. www.dirtcheapcigs.com, 260 F. Supp. 2d 1048, 1053 (W.D. Wash. 2003); Angelica Co. v. Goodman, 276 N.Y.S.2d 766, 767-68 (1966).

67. *See www.dirtcheapcigs.com*, 260 F. Supp. 2d at 1054-55; *Angelica Co.*, 276 N.Y.S.2d at 769.

68. *See* Okla. Tax Comm'n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 507 (1991).

69. *See* Aaron J. Burstein, *Stopping Internet-Based Tobacco Sales*, HEALTH MATRIX (forthcoming) (suggesting that one effective remedy might entail seizing the domain names of offending vendors).

70. Timothy C. Barmann, *State Smokes Out Online Tobacco Sales*, PROVIDENCE J., June 7, 2005.

71. *See* Press Release, Office of N.Y. State Attorney Gen. Eliot Spitzer, Attorneys General and Philip Morris USA Reach Landmark Agreement to Reduce Illegal Internet Cigarette Sales (Jan. 26, 2006), http://www.oag.state.ny.us/press/2006/jan/jan26a_06.html.

72. *See* Michael Cooper, *Post Office Sidesteps Fray on Illicit Sales of Cigarettes*, N.Y. TIMES, May 29, 2005, § 1 (Metro Desk), at 33.

E. *Federal and State Efforts to Expand Enforcement*

At the federal level, there has been a recent show of interest in intensifying the regulation of online tobacco sales. But as yet, nothing new has been enacted. Pertinent legislation was introduced and even garnered some congressional action in recent years. During the 2003-04 session, the Senate passed the Prevent All Cigarette Trafficking (PACT) Act,[73] which would have amended the Jenkins Act to require mail-order and Internet vendors to pay the excise tax in advance of the delivery of cigarettes and smokeless tobacco to individual consumers.[74] Each state would have been authorized to maintain separate lists of delivery sellers who were either in compliance or not in compliance with the Act.[75] Only sellers on the compliance list would have been allowed to make delivery sales into the state.[76] In addition, the PACT Act would have made common carriers and the United States Postal Service liable for knowingly delivering any package to a consumer from a seller on the noncompliance list without first verifying that the package did not contain cigarettes or smokeless tobacco.[77] After unanimous passage in the Senate, the PACT Act died in the House of Representatives.[78] Currently, there are efforts to revive the legislation, but political opposition led by the United Parcel Service has thwarted its reintroduction thus far.[79]

In June 2005, legislation was introduced in the House of Representatives that would make cigarettes and other tobacco products illegal to mail.[80] The bill would impose a penalty of up to $100,000 per violation on any person attempting to mail tobacco products through the United States Postal Service.[81] Since its introduction, the legislation has been referred to the House Committee on Government Reform,[82] but no additional action has been taken.

While the federal government has toyed with possible changes to the Jenkins Act, state governments have launched a variety of enforcement efforts—some targeted directly at Jenkins Act requirements and others aimed at filling fundamental gaps in the provisions of the Jenkins Act. A

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73. S. 1177, 108th Cong. (2003).

74. S. 1177 § 2.

75. *Id.*

76. *Id.*

77. *Id.*

78. *See* 149 CONG. REC. S16208 (daily ed. Dec. 9, 2003); 150 CONG. REC. H24 (daily ed. Jan. 20, 2004).

79. *See* H. Amdt. 500, 109th Cong. (2005).

80. *See* H.R. 2813, 109th Cong. § 1 (2005). The bill covers smokeless tobacco, pipe tobacco, and roll-your-own tobacco, along with cigarettes. *Id.*

81. *Id.*

82. *See* 151 CONG. REC. H4295 (daily ed. June 8, 2005).

handful of states, including Massachusetts, California, Washington, and Virginia, have sued online vendors for Jenkins Act violations. In Massachusetts, the attorney general won judgments against two online tobacco vendors in 2004. One was permanently barred from selling cigarettes in Massachusetts,[83] and another was ordered to pay $1.5 million in civil penalties.[84] Massachusetts settled another case in 2005 in which the vendor turned over the names and addresses of Massachusetts residents who purchased more than 131,000 cartons since November 2003.[85] The state estimated that it would recover up to $3 million in taxes, interest, and penalties.[86] The California Attorney General reached a settlement in 2004 that barred the online vendor from selling to Californians and imposed $500,000 in penalties.[87] A Washington case resulted in a stipulated judgment requiring the online vendor to provide the names and addresses of Washington customers.[88] Similarly, in the Virginia litigation, the attorney general obtained the customer lists of two Internet vendors whose failure to report had cost forty-six states $2 million in tax revenue.[89] Virginia investigators shared the lists with officials in other states, prompting them to initiate collection efforts.[90]

In early 2005, several states launched big drives to contact individual customers demanding that they remit unpaid tobacco taxes.[91] For example, Michigan sent 1,500 bills and successfully collected $2 million.[92] And after mailing 1,000 bills, Alaska brought in approximately $100,000.[93]

States also have attempted to tackle the problem of online cigarette

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83. Press Release, Office of Mass. Attorney Gen. Tom Reilly, AG Reilly Obtains $125K Judgment Barring Online Cigarette Retailer From Selling in Massachusetts (Aug. 24, 2004), http://www.ago.state.ma.us/sp.cfm?pageid=986&id=1281.

84. Press Release, Office of Mass. Attorney Gen. Tom Reilly, AG Reilly Obtains Court Order Barring Online Cigarette Retailer From Selling to Massachusetts Teens (Apr. 1, 2004), http://www.ago.state.ma.us/sp.cfm?pageid=986&id=1209.

85. Bruce Mohl, *Online Cigarette Vendor Settles*, BOSTON GLOBE, Oct. 11, 2005, http://www.boston.com/business/taxes/articles/2005/10/11/online_cigarette_vendor_settles/.

86. *Id.*

87. *California Clamps Down on Online Cigarette Sales*, DAILY NEWS (Nat'l Assoc. of Convenience Stores), Sept. 22, 2004, http://www.nacsonline.com/NACS/News/Daily_News_Archives/September2004/nd0922042.htm.

88. Press Release, Wash. State Dep't of Revenue, Internet Tobacco Seller Agrees to Turn Over Lists of Washington Customers to Department of Revenue (Dec. 11, 2003), http://dor.wa.gov/Docs/Pubs/News/2003/NR_dirtcheap_ settlesv2.pdf.

89. Kathleen Hunter, *States Hunt Down Online Cigarette Buyers*, STATELINE.ORG, May 3, 2005, http://www.stateline.org/live/ViewPage.action?siteNodeId=136&languageId=1&contentId=29157.

90. *Id.*

91. *See id.*

92. *Id.*

93. *Id.*

sales by interceding at different points in the supply chain. In March 2005, the attorneys general of several states reached an agreement with the major credit card companies in which the companies promised to adopt policies prohibiting the use of their cards for the purchase of cigarettes over the Internet.[94] The attorneys general also guaranteed that if law enforcement agencies identified online sellers who were accepting those cards as payment, they would take appropriate action.[95] Later in 2005, a group of attorneys general reached agreements with DHL and UPS in which the package delivery companies promised to stop delivering cigarettes to individual consumers throughout the United States.[96] In early 2006, over forty attorneys general signed an agreement with Philip Morris USA pursuant to which Philip Morris will implement protocols to reduce the illegal delivery sale of its products.[97]

While state law enforcement agencies are proceeding with lawsuits, collection efforts, and agreements, state legislatures have started enacting legislation to address head-on the problem of tax evasion and Internet sales (almost always along with the problem of sales to youth). Four states have banned the delivery sale of cigarettes to individual residents.[98] Many other states have passed statutes regulating various aspects of online sales.[99] While the statutes vary from state to state, common provisions include those relating to age verification, licensing, common carrier liability for transporting cigarettes to unlawful recipients, and notice to the recipient of excise tax obligations.[100]

Arizona is one of a handful of states that have passed legislation

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94. *See* Press Release, Office of N.Y. State Attorney Gen. Eliot Spitzer, UPS Joins Effort to Reduce Youth Smoking (Oct. 24, 2005), http://www.oag.state.ny.us/press/2005/oct/oct24a_05.html.

95. *See id.*; Press Release, Office of the Attorney Gen., State of Cal., Dep't of Justice, Attorney General Lockyer Announces Joint Effort by State and Federal Law Enforcement, Credit Card Firms To Stop Illegal Online Sales of Cigarettes (Mar. 17, 2005), http://caag.state.ca.us/newsalerts/2005/05-019.htm.

96. *See* Press Release, Office of N.Y. State Attorney Gen. Eliot Spitzer, Leading Package Delivery Company Agrees to Stop Shipping Cigarettes to Individual Customers (July 5, 2005), http://www.oag.state.ny.us/press/2005/jul/jul05a_05.html.

97. *See* Press Release, Office of the Attorney Gen., State of Cal., Dep't of Justice, Attorney General Lockyer Announces Landmark Agreement with Philip Morris USA to Curb Illegal Internet Sales (Jan. 26, 2006), http://ag.ca.gov/newsalerts/release.php?id=1256.

98. *See* ARK. CODE ANN. §§ 26-57-203(12), 26-57-215(4) (2005); Ark. Tobacco Control Bd. v. Santa Fe Natural Tobacco Co., No. 04-273, 2004 WL 2823339 (Ark. Dec. 9, 2004); CONN. GEN. STAT. § 12-93 285(c) (2005); MD. CODE ANN., BUS. REG. § 16-223 (LexisNexis 2005); N.Y. PUB. HEALTH LAW § 1399-*ll* (McKinney 2005).

99. Approximately half of the states regulate some aspect of the delivery sale of tobacco products. *See* JAMIE CHRIQUI ET AL., A REVIEW OF STATE LAWS GOVERNING DELIVERY SALES OF CIGARETTES IN THE U.S.A.: ANALYSIS OF PROVISIONS TO PREVENT YOUTH ACCESS AND TAX EVASION (forthcoming 2006).

100. *See id.*

requiring online tobacco vendors, including those located outside of the state, to collect and remit excise taxes.[101] As state legislatures continue to search for methods to mitigate the problems of untaxed remote cigarette sales, they should not be afraid to follow in Arizona's footsteps by forcing collection and remission obligations on those who are best positioned to bear responsibility.

III. THE HISTORY AND CURRENT STATE OF THE DORMANT COMMERCE CLAUSE DOCTRINE

The dormant Commerce Clause has a long and convoluted history. At an early phase of its development, the doctrine branched into two separate strands of analysis for state activities that affected interstate commerce—one for state regulations and the other for state taxes. Even though this article focuses on a state tax regime, it is important to begin by reviewing the evolution of the regulation strand of the doctrine because in practice, the two strands intertwine, and in theory, they are driven by the same motivating principles.

A. *Historic Treatment of State Regulations Under the Dormant Commerce Clause*

The Commerce Clause of the United States Constitution explicitly grants Congress the power "to regulate Commerce . . . among the several states."[102] The impetus behind not only the Commerce Clause, but also the entire Constitutional Convention, was the desire to mend a patchwork of "rival, conflicting and angry" economic regulations that had stifled trade among the colonies.[103]

"When victory relieved the Colonies from the pressure for solidarity that war had exerted, a drift toward anarchy and commercial warfare between states began. '. . . each state would legislate according to its estimate of its own interests, the importance of its own products, and the local advantages or disadvantages of its position in a political or commercial view.' This came 'to threaten at once the peace and safety of the Union.'"[104]

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101. *See* sources cited *supra* note 10.

102. U.S. CONST. art. I, § 8, cl. 3.

103. H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534 (1949) (quoting 3 THE RECORDS OF THE FEDERAL CONVENTION OF 1787 547 (Max Farrand ed., rev. ed. 1966)).

104. *Id.* at 533 (quoting JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES §§ 259-60 (Da Capo Press reprint ed. 1970) (1883)).

Given that the Framers clearly intended to wrest control over cross-border trade from the colonies, it is perplexing that the Constitution does not specifically limit state interference with the national economy.[105] Instead, the Commerce Clause is the only reference to interstate commerce in the Constitution. The Supreme Court, however, has long read the Commerce Clause's bestowal of power on Congress to imply a corresponding denial of power to the states.[106] The resulting "dormant Commerce Clause" limits the ability of states to pass and enforce regulations that encumber interstate commerce.[107]

Since first recognizing the dormant Commerce Clause in the 1824 case of *Gibbons v. Ogden*,[108] the Court has struggled to classify which types of state regulatory activities impermissibly impede—and which have an acceptable incidental impact on—the free flow of trade across state borders. The dormant Commerce Clause doctrine has endured several iterations as the Court has tested and rejected various lines that ultimately proved too blurry.

In its first incarnation, the dormant Commerce Clause drew a distinction between the regulation of interstate commerce and regulation pursuant to the traditional police power.[109] The "dual federalism" approach envisioned two mutually exclusive spheres of regulation. Regulation of interstate commerce was assigned exclusively to Congress, while each state retained the power it had possessed as a sovereign government before ratification to "regulate its police, its domestic trade, and to govern its own citizens."[110] The interstate commerce versus police power divide proved elusive, given that traffic and industry paid little regard to state boundaries in the increasingly national economy. The 1829 case of *Willson v. Black Bird Creek*[111] illustrates the challenge inherent in differentiating between

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105. *See* LAURENCE H. TRIBE, 1 AMERICAN CONSTITUTIONAL LAW 1029 (3d ed. 2000) (noting in a discussion of the dormant Commerce Clause that "[o]ccasionally, the Framers' failure to employ explicit words of exclusion has seemed somewhat puzzling"); DANIEL A. FARBER ET AL., CONSTITUTIONAL LAW: THEMES FOR THE CONSTITUTION'S THIRD CENTURY 1001 (1986) (observing that "[t]he origins of the dormant Commerce Clause are something of a mystery").

106. *See* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824) (announcing that the Commerce Clause restricts the ability of states to affect interstate commerce).

107. *See, e.g.*, *Du Mond*, 336 U.S. at 534-35 ("While the Constitution vests in Congress the power to regulate commerce among the states, it does not say what the states may or may not do in the absence of congressional action, nor how to draw the line between what is and what is not commerce among the states. Perhaps even more than by interpretation of its written word, this Court has advanced the solidarity and prosperity of this Nation by the meaning it has given to these great silences of the Constitution.").

108. 22 U.S. (9 Wheat.) 1 (1824).

109. *See* Mayor of New York v. Miln, 36 U.S. (11 Pet.) 102, 142 (1837); Willson v. Black Bird Creek Marsh Co., 27 U.S. (2 Pet.) 245, 252 (1829); *Gibbons*, 22 U.S. (9 Wheat.) at 221.

110. *Gibbons*, 22 U.S. (9 Wheat.) at 208.

111. 27 U.S. (2 Pet.) 245 (1829).

an interstate-commerce and a police-power regulation.[112] The Court considered a state law authorizing the construction of a dam on a marshy creek that fed into an interstate waterway.[113] The dam would drain the creek, thus obstructing federally licensed shipping.[114] It would also enhance the value of the surrounding property and would "probably improv[e]" the health of nearby inhabitants.[115] The Court upheld the law, making the somewhat arbitrary determination that the law was not a regulation of interstate commerce but was instead a health measure within the domain of the state's police power.[116]

The Supreme Court took its next cut at the dormant Commerce Clause in the mid-1880s. *Cooley v. Board of Wardens*[117] addressed a state law requiring all out-of-state ships to engage local pilots when entering or leaving the port of Philadelphia.[118] The Court upheld the law using a revised standard that focused on whether the subject matter of the regulation was intrinsically national or local.[119] Under the "*Cooley* doctrine," some subjects were so national in character as to "imperatively demand[] a single uniform rule, operating equally on the commerce of the United States in every port" while others were so local in character as to "imperatively demand[] that diversity, which alone can meet the local necessities."[120] The Court in *Cooley* pronounced that even though pilotage in port clearly affected interstate commerce, it was essentially a local issue.[121] As foreshadowed by the *Cooley* case itself, the *Cooley* doctrine soon manifested the same capriciousness as the dual federalism approach.[122]

So the Court once again changed its focus—this time, from the subject

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112. *See id.* at 251; *see also Miln*, 36 U.S. (11 Pet.) at 142-43 (upholding as a valid exercise of the police power a state law requiring ship masters arriving from out-of-state locations to report the names and residences of passengers to local authorities).

113. *Wilson*, 27 U.S. (2 Pet.) at 248.

114. *Id.* at 251.

115. *Id.*

116. *Id.*

117. 53 U.S. (12 How.) 299 (1851).

118. *Id.* at 311. The requirement also applied to all ships bearing more than seventy-five tons except those in the Philadelphia coal trade. *Id.*

119. *Id.* at 319.

120. *Id.*

121. *Id.* at 320; *see also* Wabash, St. Louis & Pac. Ry. Co. v. Illinois, 118 U.S. 557, 577 (1886) (striking down a state statute regulating rates that railroads charged state residents for goods coming from or going to other states because "this species of regulation is one which must be, if established at all, of a general and national character, and cannot be safely and wisely remitted to local rules and local regulations").

122. *See* TRIBE, *supra* note 105, at 1049 (noting that "the classification of regulatory subject matter as 'national' or 'local,' like the earlier dichotomy between 'police' and 'commerce' regulations, was more conclusory than explanatory").

to the effect of the given regulation. From the late 1800s through the mid-1900s, the dormant Commerce Clause standard assessed whether the challenged state regulation had a direct or indirect impact on interstate commerce. State regulations that imposed a direct burden on interstate commerce were deemed invalid, while those that had a mere indirect effect were upheld. For example, in *Hall v. DeCuir*,[123] the Court struck down as a direct burden upon interstate commerce a Louisiana law requiring all vessels traveling through the state to accord equal rights to passengers without regard to race or color.[124] But a few years later in *Smith v. Alabama*,[125] the Court upheld an Alabama statute requiring all railroad engineers operating trains passing through the state to take a state examination and obtain a state license.[126] The Court found that the Alabama statute "affect[ed] transactions of commerce among the states . . . only indirectly, incidentally, and remotely . . . ."[127] As reflected in these transportation cases, the direct versus indirect standard produced results that were as conclusory as the outmoded dual federalism and *Cooley* doctrines.

The historic iterations of the dormant Commerce Clause were rigid and mechanical. The Court dropped a given state regulation into one side of the interstate commerce versus police power, national versus local, or direct versus indirect divide, and by definition, the regulation emerged as invalid or valid. In the mid-1900s, a more pliant dormant Commerce Clause doctrine took shape as the Court attempted to formalize the analytic process that had lurked beneath the surface of the prior versions. First, the Court began singling out for harsh treatment those state regulations that blatantly discriminated against interstate commerce.[128] Second, with regard to nondiscriminatory state regulations, the Court stopped trying to maintain sustainable groupings of those that trampled too heavily—and those that treaded with a light enough step—on interstate commerce.[129] Instead, the Court came clean on the exercise it had been conducting all along, namely, attempting on a case-by-case basis to strike a reasonable balance between competing national and local interests.[130]

123. 95 U.S. 485 (1877).
124. *Id.* at 487, 488.
125. 124 U.S. 465 (1888).
126. *See id.* at 468, 482-83.
127. *Id.* at 482.
128. *See infra* Part III.B.1.
129. *See infra* Part III.B.2.
130. *See infra* Part III.B.2.

B. *Contemporary Treatment of State Regulations Under the Dormant Commerce Clause*

By 1970, the Court had settled into the contemporary two-tier method of reviewing state regulations for dormant Commerce Clause violations. The first tier culls out discriminatory state regulations, and the second tier applies a balancing test to nondiscriminatory state regulations.

1. Discrimination (Tier One)

Under the first tier, the Court considers whether a state regulation discriminates against interstate commerce. A regulation can be discriminatory on its face, in its purpose, or in its effect.[131] There are three types of regulations that the Court commonly finds to be discriminatory. First, there are those that impose costs or restrictions on goods or services originating out-of-state in order to protect in-state sellers or consumers. For example, in *Granholm v. Heald*,[132] the Court ruled that it was discriminatory to prohibit out-of-state wineries but not in-state wineries from making direct sales to in-state consumers.[133] Second, there are those that deflect out-of-state burdens or risks in order to safeguard in-state interests. These regulations often involve solid waste disposal. The classic case is *City of Philadelphia v. New Jersey*,[134] where the Court held that a state law discriminated because it banned the importation of most solid or liquid waste from outside state lines.[135] Third, there are those that hoard local resources for the benefit of local businesses that process or handle them. For instance, in *South-Central Timber Development, Inc. v.*

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131. *See, e.g.*, Hughes v. Oklahoma, 441 U.S. 322, 336-37 (1979) (finding a state statute forbidding the transportation for sale of natural minnows out of the state to be facially discriminatory); Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 352-53 (1977) (finding a state statute prohibiting the display of other states' apple grades on closed containers shipped into the state to be discriminatory in purpose and effect); Wyoming v. Oklahoma, 502 U.S. 437, 455 (1992) (finding a state statute requiring that coal-fired power plants located in and serving the state burn a minimum percentage of state-mined coal to be discriminatory on its face and in effect).

132. 125 S. Ct. 1885 (2005).

133. *Id.* at 1907; *see also* Healy v. Beer Inst., 491 U.S. 324 (1989) (invalidating a discriminatory state law designed to keep beer prices low for state residents by requiring out-of-state beer shippers to certify that the prices they charged in-state wholesalers were no higher than the prices they charged wholesalers in three neighboring states); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951) (invalidating a discriminatory city ordinance prohibiting the sale of milk unless bottled within five miles of the center of the city).

134. 437 U.S. 617 (1978).

135. *Id.* at 626-27; *see also* Fort Gratiot Sanitary Landfill, Inc. v. Mich. Dep't of Natural Res., 504 U.S. 353 (1992) (invalidating a discriminatory state statute limiting the ability of private landfill operators to accept solid waste that originated outside the county in which their facilities were located).

Wunnicke,[136] the Court found discrimination in a state requirement that timber taken from state lands be processed within the state prior to export.[137] Discriminatory state regulations are subject to strict scrutiny in the guise of "a virtually per se rule of invalidity."[138] It is nearly impossible for a regulation to survive this exacting degree of scrutiny.[139]

2. *Pike* Balancing (Tier Two)

Under the second tier, when a state law does not discriminate against—but does have an incidental impact on—interstate commerce, the Court will use the balancing test enunciated in *Pike v. Bruce Church, Inc.*:[140] "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[141] When applying the *Pike* balancing test to a state regulation, the Court will begin by assessing whether the state has asserted a legitimate local interest.[142] The Court generally defers to the judgment of state legislatures regarding "subjects relating to the health, life, and safety of their citizens."[143] Next, the Court will weigh the proffered local interest against the financial, bureaucratic, and temporal burdens shouldered by interstate

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136. 467 U.S. 82 (1984).

137. *Id.* at 100; *see also* C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383 (1994) (invalidating a discriminatory ordinance requiring that solid waste be processed at the local transfer station before leaving the municipality).

138. *City of Philadelphia*, 437 U.S. at 624; *see also C & A Carbone*, 511 U.S. at 392 ("Discrimination against interstate commerce in favor of local business or investment is *per se* invalid, save in a narrow class of cases in which the [state or] municipality can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest."); Catherine Gage O'Grady, *Targeting State Protectionism Instead of Interstate Discrimination Under the Dormant Commerce Clause*, 34 SAN DIEGO L. REV. 571, 574 n.12 (1997) (discussing confusion over the meaning of "the oxymoronic phrase 'virtual per se' invalidity" and noting that in some cases, for example, South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82 (1984), the Court struck down discriminatory laws as "per se" invalid without further analysis, while in others, for example, Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93 102 (1994), the Court gave the state a "last-ditch" but "illusory" "opportunity to save the statute by showing that no reasonable, nondiscriminatory alternatives exist").

139. Among many cases applying strict scrutiny to "discriminatory" laws, the Court has upheld only one such law. *See* Maine v. Taylor, 477 U.S. 131, 151-52 (1986) (finding that a state statute prohibiting the importation of live baitfish discriminated on its face against interstate commerce, but upholding the statute because there was no available nondiscriminatory alternative to protect the state's unique fisheries from parasites and non-native species).

140. 397 U.S. 137 (1970).

141. *Id.* at 142.

142. *See id.*

143. Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 443 (1960).

commerce.[144] In so doing, the Court will consider "the nature of the local interest involved, and . . . whether it could be promoted as well with a lesser impact on interstate activitites."[145] The *Pike* balancing test is more forgiving than the "virtually *per se* rule of invalidity."[146] It embodies a recognition that "incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people."[147] However, as revealed in *Pike* itself—where the Court invalidated a state official's order prohibiting the transportation of cantaloupes out-of-state for crating, processing, and labeling—the Court will not hesitate to strike down an "even-handed[]" state regulation that burdens interstate commerce in a manner incommensurate with its local benefits.[148]

3. Ambiguities in the Two-Tier Standard

Each tier of this apparently clear-cut dormant Commerce Clause methodology is plagued by some ambiguity. As to the first tier, it is hard to predict which state regulations will be deemed discriminatory and thus subject to the "virtually *per se* rule of invalidity."[149] The discriminatory versus nondiscriminatory dichotomy can be as nebulous as the dichotomies that preceded it.[150] Starting with the seminal *Pike* case, the Court has treated as nondiscriminatory many regulations that arguably discriminated against out-of-state interests on their face,[151] in their

144. *See, e.g.*, Kassel v. Consol. Freightways Corp., 450 U.S. 662, 670-78 (1981) (applying the *Pike* balancing test to an Iowa law barring the use of trucks longer than sixty feet on Iowa's interstate highways); Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 440-47 (1978) (applying the *Pike* balancing test to Wisconsin regulations barring the use of trucks longer than fifty-five feet on Wisconsin's interstate highways).

145. *Pike*, 397 U.S. at 142.

146. City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978).

147. *Id.*

148. *Pike*, 397 U.S. at 142, 146.

149. *City of Philadelphia*, 437 U.S. at 624.

150. *Cf.* Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 579 (1986) ("We have . . . recognized that there is no clear line separating the category of state regulation that is virtually *per se* invalid under the Commerce Clause, and the category subject to the *Pike v. Bruce Church* balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity.").

151. At stake in the seminal *Pike* case was an Arizona official's order prohibiting an Arizona grower from transporting uncrated cantaloupes to a nearby California city for crating, processing, and labeling. Ironically, the Court did not treat this order as discriminatory on its face, but instead struck it down under its freshly articulated balancing test for "even-handed[]" regulations. *See Pike*, 397 U.S. at 146; *see also* Bendix Autolite Corp. v. Midwesco Enters., Inc., 486 U.S. 888, 898 (1988) (applying the *Pike* balancing test to an Ohio statute of limitations that tolled for claims against entities that were not within the state and did not designate an agent for service of process, explaining: "The Ohio statute before us might have been held to be a discrimination that invalidates

purpose, or in their effect.[152] A discrimination determination requires the Court to compare similarly situated in- and out-of-state actors, so the result often turns on the Court's arbitrary definition of the relevant market and its participants.[153] For example, in *Exxon Corp. v. Governor of Maryland*,[154] the Court considered a Maryland statute that barred petroleum producers and refiners of petroleum—all of whom resided out-of-state—from operating service stations in Maryland.[155] The alleged purpose of the statute was to correct inequities in the distribution and pricing of gasoline during times of shortage.[156] In the Court's view, the statute did not discriminate because it treated in- and out-of-state independent gasoline dealers equally.[157] The dissent construed the pertinent market more broadly to include all potential gasoline dealers, arguing that the statute had the discriminatory effect of "exclud[ing] a class of predominantly out-of-state gasoline retailers while providing protection from competition to a class of nonintegrated retailers that is overwhelmingly composed of local businessmen."[158]

When the Court advances to the second tier, it is not always easy to foresee how the *Pike* balancing test will play out. The test calls for an impromptu, case-by-case weighing of national against local interests, and there is a fundamental lack of parity between the interests poised on each side of the scale. So the Court makes decisions based on its ad hoc

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without extended inquiry. We choose, however, to assess the interests of the State, to demonstrate that its legitimate sphere of regulation is not much advanced by the statute while interstate commerce is subject to substantial restraints.").

152. For example, in *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981), the Court considered a Minnesota statute banning the sale of milk in plastic, nonreturnable, and nonrefillable containers, but allowing the sale of milk in nonreturnable, nonrefillable containers made of pulpwood. *Id.* at 458. The alleged purposes of the statute were to promote conservation and ease solid waste disposal problems, but lurking in the background was the fact that the raw materials for plastic jugs were produced entirely by non-Minnesota firms while pulpwood was a major Minnesota product. *Id.* at 461-62, 473. The Court dismissed the notion that the statute had a discriminatory purpose or effect and proceeded to uphold the statute under the *Pike* balancing test. *Id.* at 472. *See also* Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978) (upholding under the *Pike* balancing test a state statute prohibiting producers or refiners of petroleum—none of whom resided in state—from operating service stations in Maryland); Julian Cyril Zebot, *Awakening a Sleeping Dog: An Examination of the Confusion in Ascertaining Purposeful Discrimination Against Interstate Commerce*, 86 MINN. L. REV. 1063, 1077-84 (2002) (discussing the confusion among the lower courts about how to distinguish state regulations that have a discriminatory purpose from those that do not).

153. *See* O'Grady, *supra* note 138, at 589 (critiquing the discrimination tier of review for its misguided focus on comparing resident and nonresident competitors).

154. 437 U.S. 117 (1978).

155. *Id.* at 119.

156. *Id.* at 121.

157. *See id.* at 125-26.

158. *Id.* at 137 (Blackmun, J., concurring in part and dissenting in part).

appraisal of the interests in each given scenario.[159]

4. The Running Themes of Political and Economic Union

From the murkiness of the dormant Commerce Clause doctrine, however, scholars have been able to isolate two constitutional principles that have consistently informed the Court's decision-making over the years: political union and economic union.[160] When the Court finds that a state regulation threatens one of these principles, it is likely to strike down the regulation no matter which tier of review it applies.[161]

The political union principle turns on the notion that the residents of the states are first and foremost citizens of the nation.[162] The Court has recognized that "[t]he Constitution was framed . . . upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division."[163] Given the importance of national solidarity, the Court has looked askance at state regulations that benefit political insiders at the expense of outsiders who lack a voice in the state's democratic process.[164] When the Court has identified the presence of an in-state surrogate for out-of-state interests, however, the Court has been willing to uphold state regulations that impose considerable burdens on interstate commerce.[165]

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159. *See* Daniel A. Farber, *State Regulation and the Dormant Commerce Clause*, 3 CONST. COMMENT. 395, 398, 399 (1986) (noting that results in dormant Commerce Clause cases are notoriously unpredictable and arguing that the fundamental flaw in the current approach is that the Court assumes a legislative role by evaluating economic policy); Earl M. Maltz, *How Much Regulation is Too Much—An Examination of Commerce Clause Jurisprudence*, 50 GEO. WASH. L. REV. 47, 58-64 (1981) (criticizing contemporary commerce clause jurisprudence for its heavy reliance on ad hoc balancing).

160. *See, e.g.*, DANIEL A. FARBER ET AL., CASES AND MATERIALS ON CONSTITUTIONAL LAW 1007-10 (1986) (summarizing these principles along with a third principle that arguably overlies the first two—namely, the "dislocations and reprisals" problem that, without a judicial check, states will cheat on the federal arrangement thus undermining the economic and political stability of the Union).

161. *See infra* notes 164, 168-69.

162. Professor Laurence H. Tribe is a major proponent of the theory that the dormant Commerce Clause derives primarily from the principle of political union. *See* TRIBE, *supra* note 105, at 1057.

163. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 523 (1935).

164. *See, e.g.*, S.C. State Highway Dep't v. Barnwell Bros., 303 U.S. 177, 185 (1938) (noting that underlying the dormant Commerce Clause "has been the thought, often expressed in judicial opinion, that when the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state"). *See also* Mark Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125 (articulating a cost-exporting rationale for the dormant Commerce Clause based on the tendency of insiders to use the political process to extract rents from underrepresented outsiders).

165. *See, e.g.*, Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 n.17 (1981)

The economic union principle rests on the primacy of an integrated national economy.[166] The Court characterized the dormant Commerce Clause as fostering a system in which "every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation . . . [and in which] every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any."[167] Under the economic union principle, protectionist state regulations are "evil" because they by nature interfere with the efficient allocation of resources throughout the country,[168] and because they have the potential to cause further disruption by "excit[ing] those jealousies and retaliatory measures the Constitution was designed to prevent."[169]

C. *Historic Treatment of State Taxation Under the Dormant Commerce Clause*

The Supreme Court has long recognized that the dormant Commerce Clause imposes a limitation not only on state regulations but also on state taxation: "A burden on interstate commerce is none the lighter and no less objectionable because it is imposed by a State under the taxing power rather than under manifestations of police power in the conventional sense."[170] Despite the fact that states often use taxation for regulatory purposes, the dormant Commerce Clause at least nominally treats state tax

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(upholding a Minnesota statute allowing the sale of milk in paperboard—but not plastic—nonreturnable, nonrefillable containers and noting that "the existence of major in-state interests [i.e., a Minnesota dairy with equipment for manufacturing plastic jugs] adversely affected by the Act is a powerful safeguard against legislative abuse"). *See also* Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 444 n.18 (1978) (observing that "[t]he Court's special deference to state highway regulations derives in part from the assumption that . . . their burden usually falls on local economic interests as well as other States' economic interests, thus insuring that a State's own political processes will serve as a check against unduly burdensome regulations").

166. Professor Donald Regan is the chief advocate of the theory that the dormant Commerce Clause derives primarily from the principle of economic union. *See* Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1092 (1986) (arguing that behind the Court's purported balancing in movement-of-goods cases, "the Court has been concerned exclusively with preventing states from engaging in purposeful economic protectionism"); *see also* O'Grady, *supra* note 138, at 575, 587-603 (arguing that the primary dormant Commerce Clause concern ought to be the "long-recognized prohibition against resident economic protectionism" and describing how discrimination has often served as an awkward proxy for protectionism).

167. H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 539 (1949).

168. City of Philadelphia v. New Jersey, 437 U.S. 617, 623-24 (1978) ("The opinions of the Court through the years have reflected an alertness to the evils of 'economic isolation' and protectionism . . . ." (quoting *Du Mond*, 336 U.S. at 537-38)); *see also* Erwin Chemerinsky, *The Values of Federalism*, 47 FLA. L. REV. 499, 501 (1995) (stating that dormant Commerce Clause cases focus on "the importance of a national market economy unrestricted by protectionist state laws").

169. C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 390 (1994).

170. Freeman v. Hewit, 329 U.S. 249, 252-53 (1946).

laws apart from state regulations. Over the years, the Supreme Court has applied a series of special standards to state tax laws that affect interstate commerce. The history of the tax-related standards mirrors that of the regulation-related standards, evolving from rigidity and formalism to a malleability designed to accommodate for the principles of political and economic union.

Only three years after first recognizing the dormant Commerce Clause as a constraint on state regulatory activity,[171] the Court pronounced that the dormant Commerce Clause limits the ability of states to levy taxes that "derange" Congress's power over interstate commerce.[172] The first state taxation cases banned states from imposing any taxes on interstate commerce.[173] This prohibition plainly begged the question of what constitutes a tax on interstate commerce. In the late 1800s, the Court made a bid for clarity by importing the reigning standard for state regulations into the realm of state taxation. The Court began asking whether the challenged state taxation regime had a direct or indirect impact on interstate commerce.[174] State taxes that imposed a direct tax on interstate commerce were invalidated, while those that had an indirect effect were sustained.[175] The indirect versus direct duality proved to be just as amorphous in the taxation as in the regulatory context.

Nonetheless, the early incantations of the taxation standard endured well into the 1900s. The 1946 case of *Freeman v. Hewit*[176] involved the application of an Indiana tax on income generated for a local trust from the sale of securities on the New York Stock Exchange.[177] The Court struck down the tax, proclaiming a blanket prohibition against any state taxation imposed directly on an interstate transaction—regardless of whether or not the tax was discriminatory or unduly burdensome on commerce.[178] Five years later, in *Spector Motor Service, Inc. v. O'Connor*,[179] the Court reaffirmed this approach, enunciating what came to be known as the "*Spector* rule": A state may not tax the privilege of conducting exclusively interstate business.[180] As the Court later acknowledged, the *Spector* rule was "a triumph of formalism over substance," reducing outcomes to

171. *See* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 200-01 (1824).

172. Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 449 (1827).

173. *See* Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888) (announcing that "no State has the right to lay a tax on interstate commerce in any form").

174. *See, e.g.*, Sanford v. Poe, 165 U.S. 194, 219-20 (1897).

175. *See id.* (upholding a property tax on telegraph, telephone, and express companies because taxation on property "does not affect interstate commerce otherwise than incidentally").

176. 329 U.S. 249 (1946).

177. *Id.* at 250-51.

178. *See id.* at 257-58.

179. 340 U.S. 602 (1951).

180. *Id.* at 609-10.

questions of "draftsmanship and phraseology."[181] For example, in the wake of *Spector*, the Court invalidated a Virginia "annual license tax" levied on the gross receipts of an interstate railroad for "the privilege of doing business in [the] State."[182] When Virginia revised the statutory language to impose a "franchise tax" on intangible property as measured by gross receipts, the Court found that Virginia was no longer in breach of the *Spector* rule.[183] In upholding the newly worded tax, the Court acknowledged that the *Spector* rule had created a situation in which "the use of magic words or labels" could "disable an otherwise constitutional levy."[184]

Over the course of the 1900s, the Court did decide a handful of cases with an eye toward whether a given tax actually offended principles of political and economic union.[185] But it was not until 1977 that the Court explicitly renounced the black-and-white *Spector* rule.

D. *Contemporary Treatment of State Taxation Under the Dormant Commerce Clause*

A few years after the Court enunciated the modern two-tier method for evaluating state regulations, the Court introduced a similarly flexible and contextual standard for reviewing state tax laws. The seminal case of *Complete Auto Transit, Inc. v. Brady*[186] involved a five percent gross income tax on interstate motor carriers for the privilege of engaging in business in Mississippi.[187] The Court declined to apply the *Spector* rule, finding that "[the] reason for attaching constitutional significance to a semantic difference is difficult to discern."[188] Instead, the Court upheld the Mississippi tax,[189] applying a new "sensitive, case-by-case analysis" that prevails to this day.[190]

The *Complete Auto* standard has four prongs. First, the taxed entity and

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181. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 281 (1977).

182. *See* Ry. Express Agency, Inc. v. Va. Ry. Express I, 359 U.S. 362 (1954).

183. *See* Ry. Express Agency, Inc. v. Va. Ry. Express II, 358 U.S. 434, 440-41 (1959).

184. *Va. Ry. Express II*, 358 U.S. at 441.

185. *See, e.g.*, Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753 (1967) (requiring out-of-state sellers to have a physical presence within a state in order to be subject to the state's sales and use taxes); Nippert v. City of Richmond, 327 U.S. 416 (1946) (invalidating a municipal license tax imposed on all soliciting because of its discriminatory and exclusionary effects); W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 256-58 (1938) (examining the impact of multiple and concurrent state taxation on businesses engaged in interstate commerce due to concerns over fair apportionment).

186. 430 U.S. 274 (1977).

187. *Id.* at 275.

188. *Id.* at 285.

189. *Id.* at 289.

190. W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 201 (1994).

activity must have a substantial nexus with the taxing state.[191] Second, the tax must be fairly apportioned.[192] Third, the tax must not discriminate against interstate commerce.[193] Fourth, the tax must be fairly related to the services provided by the state to the taxed entity.[194] Since introducing the *Complete Auto* standard, the Court has elaborated on the requirements of each prong.

1. Discrimination (Prong Three)

Although it is ranked toward the bottom of the *Complete Auto* standard, the third prong sets an initial threshold; it imposes a blanket prohibition on state tax regimes that discriminate against interstate commerce by treating interstate enterprises more harshly than their intrastate counterparts.[195] In fact, the third prong is the chief basis on which the Court has invalidated state tax statutes since *Complete Auto*.[196]

Just like a state regulation, a state tax statute can discriminate on its face,[197] in its purpose, or in its effect.[198] The Court typically finds three types of tax statutes to be discriminatory. First, there are those that exempt local businesses from obligations imposed on comparable out-of-state businesses. For example, in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*,[199] the Court found a state property tax to be discriminatory because it exempted charitable institutions serving a primarily intrastate clientele but not those serving an interstate clientele.[200] Second, there are those that impose facially neutral taxes on interstate companies that in practice do not apply to local competitors. For instance, in *West Point Wholesale Grocery Co. v. City of Opelika*,[201] the Court ruled that the city discriminated against interstate commerce by imposing a tax on the delivery of wholesale groceries into the city when the tax applied in practice to outside—but not resident—wholesale grocers.[202] Third, there

191. *Complete Auto*, 430 U.S. at 279.
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*
196. *See* TRIBE, *supra* note 105, at 1107.
197. *See, e.g.*, Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 253 (1987) (finding facial discrimination in a business and occupation tax that applied to local manufacturers who sold to out-of-state customers but exempted local manufacturers who sold to local customers).
198. *See, e.g.*, Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270 (1984) (finding discriminatory purpose and effect in a Hawaii sales tax that exempted certain locally produced wines).
199. 520 U.S. 564 (1997).
200. *Id.* at 567, 593-94; *see also Bacchus Imports*, 468 U.S. at 271.
201. 354 U.S. 390 (1957).
202. *Id.* at 391; *see also* Robbins v. Taxing Dist. of Shelby County, 120 U.S. 489 (1887)

are those that function to give tax credits to in-state producers of particular products. A prototypical case is *New Energy Co. of Indiana v. Limbach*,[203] in which the Court held that an Ohio tax was discriminatory because it provided special tax credits for ethanol produced in the state.[204]

2. Substantial Nexus (Prong One)

The first prong of the *Complete Auto* standard calls for the taxing state to have a substantial nexus with the entity and activity it is taxing. The substantial nexus prong is about jurisdiction to levy a tax.[205] A state has no right to impose a tax unless it has a sufficient relationship with the entity and activity being taxed. A state's jurisdiction to tax is limited not only by the dormant Commerce Clause, but also by the Due Process Clause. Historically, the dormant Commerce Clause and Due Process Clause nexus tests were inextricably intertwined.[206] As discussed below, it was only in the 1990s that the Court divorced the two from one another.

Substantial nexus challenges have arisen in two kinds of cases.[207] The first involves local sellers who are forced to collect and remit a tax to their own state on sales made to out-of-state customers. In this type of situation, the Court has ruled that a local seller may only be required to collect the tax if the sale has a substantial nexus to the taxing state. Delivery within the taxing state is adequate to establish nexus. For example in *International Harvester Co. v. Department of Treasury of Indiana*,[208] the

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(finding a city license fee for the privilege of soliciting sales in the city to be discriminatory when it did not apply in practice to local businesses).

203. 486 U.S. 269 (1988).

204. *Id.* at 280; *see also* W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199-200 (1994) (finding that a tax scheme, which imposed a nondiscriminatory tax on milk and then distributed its proceeds to in-state milk producers, to be discriminatory despite the fact that each part of the statute would have been constitutional on its own).

205. *See* Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 3 (2003). Professor Hellerstein distinguishes substantive jurisdiction to tax from enforcement jurisdiction to tax. The former refers to the power of a state to impose a tax in the first place. The latter relates to the power of the state to compel collection of a tax once a state has imposed the tax pursuant to its substantive jurisdiction to tax. This Article does not explore the problems of enforcement jurisdiction to tax. For one compelling treatment of enforcement jurisdiction to tax in the Internet tobacco sales context, see Aaron J. Burnstein, *Stopping Internet-Based Tobacco Sales*, HEALTH MATRIX (forthcoming).

206. *See, e.g.*, Standard Pressed Steel Co. v. Wash. Dep't of Revenue, 419 U.S. 560, 562-63 (1975) (melding the Due Process Clause and Commerce Clause requirements for nexus in upholding a Washington business and occupation tax as applied to an out-of-state supplier of the Boeing Company); Scripto, Inc. v. Carson, 362 U.S. 207, 210-12 (1960) (conflating the Due Process Clause and Commerce Clause requirements for nexus in upholding a Florida use tax).

207. *See* TRIBE, *supra* note 105, at 1119.

208. 322 U.S. 340 (1944).

Court determined that Indiana could require an Indiana manufacturer to pay an Indiana tax on sales of Indiana goods to an out-of-state buyer who took delivery in Indiana.[209]

The second kind of case addressing substantial nexus is apposite to the issue of remote sales of tobacco products. It involves out-of-state sellers who are obliged to collect and remit sales or use taxes to a state on sales made to customers within the state. The 1967 case of *National Bellas Hess, Inc. v. Department of Revenue of Illinois*[210] established that both the dormant Commerce Clause and Due Process Clause require out-of-state sellers to have a physical presence within a state in order to be subject to the state's sales and use tax regimes.[211] *Bellas Hess* involved an Illinois use tax on an out-of-state mail order firm.[212] The Court held that Illinois had no power to impose the tax on a firm whose only contacts with the state were via the U.S. mail or common carrier.[213]

Given the shift in dormant Commerce Clause jurisprudence away from bright-line rules during the 1970s and the blossoming of the mail-order industry into a multi-billion dollar business during the 1980s,[214] at least thirty-four states took the risk of enacting use tax statutes that rebuffed the *Bellas Hess* physical presence requirement.[215] Inevitably, one such statute landed before the Supreme Court.

The 1992 case of *Quill Corp. v. North Dakota*[216] involved a challenge to a North Dakota use tax on every entity that "engage[d] in regular or systematic solicitation of a consumer market in th[e] state."[217] State regulations defined such solicitation to include "three or more advertisements within a 12-month period."[218] Quill was a mail-order office equipment and supplies house that solicited business through catalogs, flyers, magazine advertisements, and phone calls.[219] Its corporate headquarters and warehouses were located outside North Dakota, but it

209. *Id.* at 349.
210. 386 U.S. 753 (1967).
211. *Id.* at 756-58.
212. *Id.* at 753-54.
213. *Id.* at 759-60.
214. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 303 (1992).
215. *See* Christina R. Edson, Quill*'s Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce*, 49 TAX LAW. 893, 917-18, 918 n.145 (1996) (citing Charles Rothfeld, *Mail-Order Sales and State Jurisdiction to Tax*, 53 TAX NOTES 1405, 1405-06 (1991)). The most common such use tax imposed a collection obligation on mail-order firms that regularly and systematically solicited sales in the taxing state by mail or electronically. *Id.*
216. 504 U.S. 298 (1992).
217. *Id.* at 302-03.
218. *Id.* at 303.
219. *Id.* at 302.

had annual sales to approximately 3,000 customers in North Dakota.[220] Quill refused to abide by the North Dakota use tax, so the state filed a court action to compel payment.[221] The state trial court struck down the tax scheme as a patent violation of the *Bellas Hess* physical presence requirement.[222] The state supreme court reversed on the theory that "wholesale changes in the social, economic, commercial, and legal arenas" had rendered the *Bellas Hess* rule obsolete.[223]

A nearly unanimous United States Supreme Court made three major holdings in *Quill*. First, the Court drove a wedge between the formerly united Due Process and dormant Commerce Clause tests for substantial nexus. According to the *Quill* Court, "[d]espite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical."[224] This is because the "two standards are animated by different constitutional concerns and policies."[225] Due process focuses on the fairness of a tax in relation to the targeted individual, while the dormant Commerce Clause focuses on the structural impact of a tax on the national economy.[226] The Court thus "launch[ed] into an uncharted . . . foray into differentiating between the [two] 'nexus' requirements."[227]

Second, the Court ruled that a business need not have a physical presence in a taxing state in order to have a substantial nexus for due process purposes.[228] The Court equated the due process nexus requirement for state court jurisdiction over an entity with that for state legislative taxation of an entity.[229] Drawing from a long line of cases regarding in personam jurisdiction, the Court held that due process requires an individual to have minimum contacts with the taxing jurisdiction so as not to offend "'traditional notions of fair play and substantial justice,'"[230] including "'notice' or 'fair warning.'"[231] In the Court's view, traditional notions of fair play and substantial justice would abide a state's taxation of any enterprise that directs its commercial efforts toward residents of the state so as to "purposefully avail" itself of the benefits of the economic market in that state—regardless of whether the enterprise maintains a

220. *Id.*
221. *Id.* at 303.
222. *Id.*
223. State v. Quill Corp., 470 N.W.2d 203, 213 (N.D. 1991), *rev'd*, *Quill*, 504 U.S. at 319.
224. *Quill*, 504 U.S. at 312.
225. *Id.*
226. *Id.*
227. *Id.* at 325 (White, J., concurring in part and dissenting in part).
228. *Id.* at 307 (majority opinion).
229. *Id.*
230. *Id.* (citing Int'l Shoe Co. v. Washington, 326 U.S. 310, 316 (1945)).
231. *Id.* at 312.

physical presence in the taxing state.[232] The Court acknowledged that "[i]t is an inescapable fact of modern life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted."[233] Since Quill engaged in constant and widespread solicitation in North Dakota and thus had fair warning that it might be subject to jurisdiction in that state, the Court ruled that the Due Process Clause did not bar the North Dakota use tax even though Quill had no physical presence in the state.[234]

The third major holding in *Quill* was a blow to the majority of states who had presumed the extinction of the *Bellas Hess* physical presence requirement. The Court resoundingly upheld *Bellas Hess*, invalidating the imposition of sales and use taxes on companies that maintain no physical presence in the taxing state.[235] The Court asserted several reasons for declining to repudiate *Bellas Hess*.

The Court began by addressing how *Bellas Hess* fit into the "latest rally between formalism and pragmatism."[236] The Court recognized that *Complete Auto* rejected the *Freeman* and *Spector* direct versus indirect dichotomy on the theory that the validity of statutes should not hinge on "'legal terminology,' 'draftsmanship and phraseology.'"[237] However, the Court distinguished *Bellas Hess* because it "did not rely on any such labeling."[238] While conceding that modern dormant "Commerce Clause jurisprudence now favors more flexible balancing analyses," the Court stressed that it had "never intimated a desire to reject all established 'bright-line' tests."[239]

The Court proceeded to play out the implications of the distinction between substantial nexus tests of the Due Process Clause and the dormant Commerce Clause. The Court reiterated that in contrast to the Due Process Clause, "the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy."[240] The Court furthered that "[u]nder the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these

232. *Id.* at 308 (citing Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985)).
233. *Id.*
234. *Id.*
235. *Id.* at 318-19.
236. *Id.* at 310.
237. *Id.* (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 281 (1977)).
238. *See id.* at 310-11.
239. *Id.* at 314.
240. *Id.* at 312.

structural ills."[241] In the eyes of the Court, the *Complete Auto* standard enables this cure by prohibiting discriminatory taxes on interstate commerce and barring taxes that impose an undue burden upon interstate commerce.[242] The Court found the North Dakota tax to be unduly burdensome because "a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State" would not only be subject to the North Dakota tax but could also be entangled "in a 'virtual welter of complicated obligations'" imposed by over 6,000 taxing jurisdictions in the nation.[243]

Next, the Court expounded on the advantages of maintaining a discrete safe harbor from interstate sales and use taxes for mail order houses. The Court admitted that "the *Bellas Hess* rule appears artificial at its edges . . . [because it can] turn on the presence in the taxing State of a small sales force, plant, or office."[244] However, the Court determined that the artificiality is well worth the benefits of a bright-line rule, especially when the "law in this area is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'"[245] The Court cited several benefits in particular, including reducing litigation, encouraging settled expectations, and fostering investment.[246]

The Court invoked the doctrine of stare decisis as another reason for affirming *Bellas Hess*. The Court unabashedly stated that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today."[247] However, the Court listed three rationales for adhering to stare decisis.[248] First, as discussed above, *Bellas Hess* did not fall into the disavowed *Freeman* and *Spector* line of cases

241. *Id.* (citing THE FEDERALIST NOS. 7, 11 (Alexander Hamilton)).

242. *Id.* at 313 (noting that the second and third prongs of the *Complete Auto* standard ensure that a state does not impose an unfair share of a given tax burden on interstate commerce and the first and fourth prongs ensure that a state does not overreach its right to burden interstate commerce).

243. *Id.* at 313 n.6 (citing Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 759-60 (1967)).

244. *Id.* at 315.

245. *Id.* (citing Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457-58 (1959)).

246. *Id.*

247. *Id.* at 311.

248. *See id.* at 316-17 (comparing the case at bar with Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n, 461 U.S. 375 (1983), in which the Court rejected the indirect versus direct dichotomy in the regulatory context).

because it turned on a different logic.[249] Second, Supreme Court decisions relied on *Bellas Hess* for twenty-five years without ever hinting at dissatisfaction with the physical presence requirement.[250] Third, the *Bellas Hess* rule engendered substantial reliance in the mail order community—indeed becoming "part of the basic framework of a sizeable industry."[251]

Finally, the Court saw fit to reaffirm *Bellas Hess* because "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve."[252] The role of the Court is to ensure that states do not exercise unwarranted authority over interstate commerce.[253] Because Congress retains ultimate supremacy over interstate commerce, however, Congress is always free to enter the field and "decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[254]

It is worth underscoring the point that *Bellas Hess* and *Quill* explicitly limit the application of the physical presence requirement to sales and use taxes. The *Quill* Court referred to *Bellas Hess* as creating "a bright-line rule in the area of sales and use taxes"[255] and noted 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."[256] Both decisions are silent regarding the substantial nexus requirement for other types of taxes, including excise taxes.

3. Fair Apportionment (Prong Two)

Under the second prong of the *Complete Auto* standard, a state tax must be fairly apportioned.[257] This prong ensures that each state taxes only its fair share of an interstate transaction.[258] In order to determine whether a tax is fairly apportioned, the Court examines whether it is both "internally

249. *Id.* at 317.
250. *Id.*
251. *Id.*
252. *Id.* at 318 (footnote omitted).
253. *See id.*
254. *Id.*
255. *Id.* at 316.
256. *Id.* at 314.
257. *Id.* at 313.
258. *See* Goldberg v. Sweet, 488 U.S. 252, 261 (1989); *see also* Bradley W. Joondeph, *The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation*, 71 FORDHAM L. REV. 149, 151 (2002) (giving a clear description of the fair apportionment prong and arguing that it embodies a lower-order constitutional value meant to advance the higher constitutional goals of preventing discrimination and ensuring nexus).

consistent" and "externally consistent."[259]

Internal consistency prevents multiple and concurrent taxation problems. Take, for example, a business that operates in three states. One state will be internally consistent if it levies an income tax on the business so that, if the other two states levied the identical income tax, the business would end up paying out no more than 100% of the value of its income tax.[260] Internal consistency depends not on the actual taxing practices of other jurisdictions but instead on the theoretical effect if every jurisdiction were to impose the same tax.[261] In the Court's view, "[a] failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax."[262]

External consistency confines the taxing authority of each state to its own jurisdiction, precluding states from "reach[ing] beyond that portion of value that is fairly attributable to economic activity within the taxing State."[263] A state will be externally consistent if it has a legitimate justification for taxing an entity or activity located outside its borders.[264]

Although "the term 'apportionment' tends to conjure up allocation by percentages," the Court has "consistently approved taxation of sales without any division of the tax base among different States."[265] Generally, an unapportioned sales, use, or excise tax will not offend the principle of internal consistency because it involves a discrete transaction that is clearly subject to only one taxing jurisdiction and thus does not raise the specter of multiple taxation.[266] Such a tax is likely to pass external consistency muster because the state should be able to show that it has a valid reason for asserting a claim upon the taxed value.[267]

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259. *Goldberg*, 488 U.S. at 261.

260. *Cf.* Okla. Tax Comm'n. v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995) ("Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear."); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) (describing an internally consistent formula for income taxes and stating that "the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed").

261. *See* TRIBE, *supra* note 105, at 1133 (calling this a Kantian test).

262. *Jefferson Lines*, 514 U.S. at 185.

263. *Id.*

264. *Id.*

265. *Id.* at 186.

266. *See id.* at 187; *cf.* Goldberg v. Sweet, 488 U.S. 252, 263-64 (1989) (upholding an Illinois excise tax on telephone calls in part because it allowed customers to obtain a credit if they could show that they had been forced to pay the same tax in another state).

267. *Goldberg*, 488 U.S. at 262.

4. Fair Relationship to State Services (Prong Four)

The final prong of the *Complete Auto* standard will not allow a state to impose a tax unless the tax is fairly related to the services the state offers the taxpayer.[268] This prong sets a very low bar.[269] A state need not proffer a "detailed accounting of the services provided to the taxpayer on account of the activity being taxed, nor, indeed, is a State limited to offsetting the public costs created by the taxed activity."[270] Instead, a state may satisfy prong four by a mere showing that the state provides to the taxpayer "the benefits of a trained work force and the advantages of a civilized society."[271] Prong four has "little independent significance" because a tax that violates prong four "is likely to flunk" one of the other three prongs, and a tax that satisfies prongs one through three is destined to meet prong four.[272]

5. Crossover Between the Regulation and Taxation Standards

Although *Complete Auto* is characterized as a four-prong standard for state taxes independent of the two-tier standard for state regulations, the standards have significant overlap. In practice, the Court first evaluates whether a challenged state tax is discriminatory. If the Court finds a tax to be discriminatory, it often declines to invoke *Complete Auto* at all, instead striking down the tax with reference to cases involving discriminatory state regulations.[273] For nondiscriminatory state tax schemes, the Court will apply the first, second, or fourth prongs—or all three prongs—of the *Complete Auto* standard. These three prongs have much in common with the *Pike* balancing test in that each attempts to resolve a different facet of the question of how to weigh the burden that a tax places on interstate commerce against a state's interest in collecting its fair share of taxes from businesses that operate within its borders and benefit from its services.

Like the two-tier standard for state regulations, the *Complete Auto* standard embodies a fundamental concern for the concepts of political and economic union. The Court will not tolerate a state tax that benefits insiders at the expense of outsiders who have no connection to the state or

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268. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992).

269. *See generally* TRIBE, *supra* note 105, at 1125-26 (citing several cases that demonstrate how the Court "transformed this prong . . . into [a] fairly trivial requirement").

270. *Jefferson Lines*, 514 U.S. at 199.

271. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 445 (1979).

272. *See* Walter Hellerstein, *State Taxation and the Supreme Court*, 1989 SUP. CT. REV. 223, 244-45 (1989).

273. *See, e.g.*, Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270-71 (1984) (citing dormant Commerce Clause cases involving state regulations in applying the discrimination test to a Hawaii sales tax that exempted certain locally produced wines).

whose interests are not represented in the state's political process.[274] Moreover, the Court will not abide state taxes that are blatantly protectionist or that stall the free flow of goods and services by subjecting them to multiple, disproportionate, or overly complicated tax schemes.[275]

IV. THE ARIZONA TOBACCO DELIVERY SALES LAW

In 2004, Arizona became one of the first states in the nation to place a tax collection duty on remote tobacco vendors. Section 42-3227 of the Arizona Code (hereinafter, the "Arizona statute") mandates that anyone who engages in the delivery sale of tobacco products to Arizona residents must collect and remit applicable state tobacco taxes. The statute provides an exemption for remote cigarette sellers who obtain proof that applicable state taxes have already been paid.[276]

As of yet, no one has challenged the Arizona statute in court. However, online sellers have not hesitated to raise legal objections to statutes in

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274. *See, e.g.*, W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 200 (1994) (invalidating a Massachusetts scheme that imposed a tax on all milk and distributed the proceeds of the tax to in-state milk producers, stating that "political processes can no longer be relied upon to prevent legislative abuse, because one of the instate interests which would otherwise lobby against the tax has been mollified by the subsidy").

275. *See, e.g.*, Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992) (invalidating the imposition of a use tax on a mail order company with no physical presence in the taxing state in part because of the overwhelming administrative burden such a tax would impose on interstate commerce); New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278-80 (1988) (invalidating as simple economic protectionism a state tax credit for ethanol produced in the state).

276. ARIZ. REV. STAT. ANN. § 42-3227 (2005). The applicable section of the statute reads:

> Each person accepting a purchase order for a delivery sale shall collect and remit to the department all taxes imposed on tobacco products by this state with respect to the delivery sale. With respect to cigarettes, the collection and remission shall not be required if the person has obtained proof in the form of the presence of applicable tax stamps or tax exempt stamps or other proof that the taxes have already been paid to this state.

Id. The Arizona statute is similar to the model statute proposed by the Campaign for Tobacco-Free Kids, which reads:

> No tobacco products shall be sold or delivered to any consumer in the State unless all State tobacco product excise taxes on the tobacco products have already been remitted to the State and the tobacco products are marked with all required State tax stamps or other markings or indicia that establish that the State excise taxes have already been paid.

ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, MODEL STATE LEGISLATION TO RESTRICT INTERNET & MAIL ORDER TOBACCO PRODUCT SALES (2005), http://www.tobaccofreekids.org/research/factsheets/pdf/0230.pdf.

other states that regulate or prohibit online tobacco sales.[277] The Arizona statute (along with other similar statutes) is likely to receive judicial attention—especially since it raises novel questions of law; no published case thus far addresses the ability of a state to hold online vendors responsible for collection and remission of excise taxes.

This section of the article will begin by explaining Arizona's tobacco tax laws. It will proceed to analyze the Arizona statute under the four-prong *Complete Auto* standard. It will highlight critical distinctions between the Arizona statute and tax schemes that have failed one or more prongs, and will focus in particular on the substantial nexus prong as articulated in *Quill*.

A. *Arizona Tobacco Tax Law*

Arizona has long imposed an eighteen-cents-per-pack excise tax on cigarettes, as well as a comparable tax (as measured by weight) on other tobacco products.[278] In 1994 and again in 2002, Arizona voters approved propositions raising tobacco taxes and earmarking the increases for tobacco control and other health-related programs.[279] The current Arizona tax on a pack of cigarettes is $1.18 (with a comparable tax on other tobacco products),[280] eighteen cents of which goes to the general fund[281] and $1.00 of which goes to the "tobacco tax and healthcare fund."[282] Arizona preempts local jurisdictions from passing additional tobacco taxes.[283]

There are three separate systems for tobacco tax administration and collection in Arizona. The first and oldest pertains to distributors who acquire or possess yet-untaxed tobacco products for the purpose of making the first sale in Arizona.[284] These distributors must pay $25 to obtain a license from the Arizona Department of Revenue and must bear responsibility for purchasing tax stamps from the Department and affixing the stamps to the tobacco products they are distributing.[285] The second

277. *See, e.g.*, Brown & Williamson Tobacco Corp. v. Pataki, 320 F.3d 200, 203 (2d Cir. 2003) (addressing the constitutionality of New York's tobacco delivery sales ban).

278. *See* ARIZ. REV. STAT. ANN. § 42-3052 (2005).

279. *See id.* §§ 42-3251, 42-3251.01.

280. *See id.* §§ 42-3052, 42-3251, 42-3251.01. Note that there is an analogous tax that applies to sales on Indian reservations to non-tribal members who are residents of Arizona. The Indian Reservation Tobacco Tax is "presumed to be" a tax on the consumer rather than the distributor, but it places collection responsibility on the distributor. *Id.* §§ 42-3302, 42-3303.

281. *See id.* §§ 42-3051, 42-3052.

282. *See id.* § 36-771.

283. *See id.* § 42-3002.

284. *See id.* § 41-3001 (defining "distributor").

285. *Id.* §§ 42-3201, 42-3203.

system applies to distributors on Indian reservations and functions similarly to the first with concessions made to principles of sovereignty and fair apportionment.[286]

Finally, there is the newly enacted system for delivery sales, defined as any sale of tobacco products to a consumer in Arizona in which the consumer submits the order remotely (e.g., via the telephone, the mail, or the Internet) or in which the tobacco products are delivered by use of the mail or a delivery service.[287] Delivery sellers must comply with the licensing and tax stamp provisions set forth in the first system for tax administration and collection described above.[288] In addition, they must abide by a special set of requirements relating to age verification, disclosure, shipping, registration and reporting, and tax collection.[289] As for tax collection, delivery sellers must collect and remit applicable state tobacco taxes.[290] The statute provides an exemption for remote cigarette sellers who obtain proof that applicable state taxes have already been paid.[291] This third system for tax administration and collection has its own penalty and enforcement scheme. Violators who fail to pay applicable taxes are subject to a penalty of five times the retail value of the tobacco products sold.[292] The Attorney General has authority to enforce the delivery sales statute by preventing or restraining violations in state court.[293]

The Arizona statute is by no means a panacea for the problem of tax evasion in the online cigarette marketplace. It still leaves the state to play hide-and-seek with ephemeral Internet storefronts at all stages of the enforcement process, from tracking unreported sales to enforcing disregarded court judgments. However, the statute offers a significant improvement from the status quo as demarcated by the federal Jenkins Act. It places the tax collection and remission obligation on the parties who clearly ought to bear responsibility. In so doing, it streamlines the system, obviating the need for the state to engage in the onerous process of tracking down customer lists from remote vendors and sending bills to each individual purchaser for every online sale. The statute imposes harsh penalties on offenders, thus serving as a deterrent for potential violators

286. *Id.* §§ 3301-3307.

287. *Id.* § 42-3221.

288. *Id.* § 42-3222(D)(6), (D)(7). Note that a delivery seller might raise a dormant Commerce Clause challenge not only to the tax collection portion of the Arizona statute but also to the licensing requirement. It is beyond the scope of this Article to address how a court might treat such a challenge.

289. *Id.* § 42-3222.

290. *Id.* § 42-3229.

291. *Id.*

292. *Id.* § 42-3228(c).

293. *Id.* § 42-3229.

and an incentive for state law enforcement officials. Moreover, it removes any lingering doubts about whether a state has standing by explicitly giving enforcement authority to the state Attorney General. A final advantage is that it opens up state court as a forum for judicial review.

B. *Application of the* Complete Auto *Standard to the Arizona Statute*

Should the Arizona delivery sales statute be subject to a dormant Commerce Clause challenge in court, the *Complete Auto* standard for state taxation schemes would apply. There is a technical argument to be made that the Arizona statute is not a pure tax law because the exemption gives remote cigarette vendors the "regulatory" option to obtain proof that taxes have already been paid. But in practice, the statute places the tax burden on all remote tobacco sellers one way or the other, since they must incorporate the Arizona tobacco tax into the price of their merchandise. The remainder of this section explores how the Arizona statute should withstand review under the four *Complete Auto* prongs.

1. Discrimination (Prong Three)

Since the non-discrimination prong sets an initial threshold, the opening inquiry should be whether the Arizona statute is discriminatory and thus subject to the virtually per se rule of invalidity. A statute is discriminatory if it treats interstate enterprises more harshly than their intrastate counterparts on its face, in its purpose, or in its effect.[294] In order to conduct a discrimination analysis, a court must first determine which in- and out-of-state market participants should be compared.

In contrast to the *Exxon* case,[295] this case is easy because no matter how the court defines the market, the outcome would be the same.[296] The court could compare out-of-state delivery sellers with in-state delivery sellers or with all in-state sellers (i.e., including brick-and-mortar sellers). In either scenario, as discussed below, the statute places all of the players on a field that, if not level, is tilted slightly in favor of out-of-state participants.

Clearly, the Arizona statute is not discriminatory on its face because it does not purport to treat interstate remote tobacco vendors more harshly than their intrastate counterparts. If anything, the statute places extra obligations on the latter because it requires them to abide by two tax regimes—one for in-state distributors and the other for in-state and out-of-

294. *See supra* note 131 and accompanying text.

295. *See supra* notes 154-58 and accompanying text.

296. *Cf.* Brown & Williamson Tobacco Corp. v. Pataki, 320 F.3d 200, 215-16 (2d Cir. 2003) (upholding New York's cigarette delivery sales ban and defining the relevant market participants as in- and out-of-state shippers rather than all businesses engaged in cigarette sales).

state remote sellers.[297]

Neither is the Arizona statute discriminatory in its purpose or effect because it does not operate in practice to treat interstate remote tobacco vendors more harshly than their intrastate counterparts. As discussed above, the Court typically finds three types of tax statutes to be discriminatory.[298] Here, unlike in the *Camps Newfound/Owatonna* case,[299] Arizona is not exempting local businesses from duties imposed on interstate businesses. Unlike in the *West Point Wholesale Grocery* case,[300] Arizona is not levying a tax on out-of-state businesses that in practice does not apply to comparable in-state businesses. And unlike in the *New Energy* case,[301] Arizona is not giving tax credits to in-state producers of particular products.

Granted, the Arizona statute may place an incidental administrative burden on out-of-state delivery sellers by forcing them to handle transactions with Arizona consumers differently from transactions with residents in other states. But this is not a discrimination problem. Instead, it triggers an undue burden inquiry that goes to the other three prongs of the *Complete Auto* standard.[302]

2. Substantial Nexus (Prong One)

A major barrier to the passage of Arizona-like statutes in other states is the concern that the *Bellas Hess* physical presence requirement affirmed in *Quill* precludes states from implicating Internet vendors in the collection and remittance of state tobacco taxes.[303] However, this concern is misguided for several reasons.

a. Reasons for Declining to Apply the *Bellas Hess* Rule

Plain Language of *Quill*: The *Quill* Court explicitly limited the bright-line physical presence requirement to the area of sales and use taxes,[304] noting 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."[305] Both *Bellas Hess* and *Quill* are silent about the substantial nexus requirement for other types of taxes, including excise

297. *See* ARIZ. REV. STAT. ANN. § 42-3222 (2005).

298. *See supra* text accompanying notes 199-204.

299. *See supra* notes 199-200 and accompanying text.

300. *See supra* notes 201-02 and accompanying text.

301. *See supra* notes 203-04 and accompanying text.

302. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 313, 313 n.6 (1992).

303. *See, e.g.*, Banthin, *supra* note 2, at 351 (suggesting that *Quill* may preclude the adoption of tobacco delivery sales statutes like Arizona's).

304. *See Quill*, 504 U.S. at 315-16.

305. *Id.* at 314.

taxes. Were a court to adjudicate the constitutionality of the Arizona statute, it would have to consider not whether *Quill* per se applies, but rather whether *Quill* should be extended to the arena of tobacco excise taxes.

Quill as a Stare Decisis Holding: The *Quill* Court's retention of the *Bellas Hess* rule was grounded in significant part on the principle of stare decisis. The Court was loathe to change course since it indicated in a twenty-five-year span of decisions that *Bellas Hess* was good law.[306] Moreover, the Court was troubled that a substantial reliance on the physical presence test had "become part of the basic framework of [the] sizable [mail-order] industry."[307] Stare decisis is no reason to extend *Quill*, however, when the Court has never applied *Bellas Hess* to excise taxes. It would be disingenuous for tobacco delivery vendors to argue that they have built a sizable industry in reliance on a physical presence requirement that has never been held to apply to tobacco excise taxes.

Tone of *Quill*: *Quill* practically issues an invitation to the lower courts to reserve the physical presence requirement only for sales and use taxes. The Court's affirmation of *Bellas Hess* as applied to sales and use taxes was tepid at best. The Court acknowledged that in the "latest rally between formalism and pragmatism" in dormant Commerce Clause jurisprudence, the latter was winning hands-down.[308] In general, the Court pronounced that it "now favors more flexible balancing analyses."[309] The Court even went so far as to say that in light of its rulings signaling a "retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach,"[310] it might not have arrived at the same result "were the issue to arise for the first time today."[311] Even though the Court saw fit to uphold the formalistic *Bellas Hess* rule for the specific arena of sales and use taxes, it hinted very strongly that it prefers to use pragmatic and flexible balancing tests in dormant Commerce Clause cases.[312]

Seven state courts have considered whether to extend the physical presence requirement to other types of taxes, six of which took up the Court's invitation to limit *Bellas Hess* to sales and use taxes.[313] As the

306. *See id.* at 316-17.
307. *Id.* at 317.
308. *Id.* at 310, 314.
309. *Id.* at 314.
310. *Id.*
311. *Id.* at 311.
312. *See id.* at 317-18.
313. *See* Borden Chems. & Plastics, L.P. v. Zehnder, 726 N.E.2d 73, 75, 80 (Ill. App. Ct. 2000) (considering a state replacement tax); Truck Renting and Leasing Ass'n v. Comm'r of Revenue, 746 N.E.2d 143, 145, 149 n.13 (Mass. 2001) (considering a corporate excise tax); A & F Trademark, Inc. v. Tolson, 605 S.E.2d 187, 189, 193-94 (N.C. Ct. App. 2004) (considering a state

North Carolina Court of Appeals aptly explained, "the tone in the *Quill* opinion hardly indicates a sweeping endorsement of the bright-line test it preserved, and the Supreme Court's hesitancy to embrace the test certainly counsels against expansion of it."[314] The only court to go against the grain recognized that "the *Quill* Court expressed some reservations about the vitality of the *Bellas Hess* decision."[315] However, it extended the physical presence requirement to a business franchise and excise tax because the state had not proffered any basis for distinguishing between that tax and a sales or use tax.[316]

Distinctiveness of Tobacco Excise Taxes: Sales and use taxes together comprise one breed of taxes, while tobacco excise taxes represent an entirely different species. A sales tax is a general tax on the sale of goods.[317] There has never been a federal sales tax, but states began adopting sales taxes in the 1930s.[318] Today, forty-six states exact a sales tax, and approximately two-thirds of the states allow cities and counties to impose additional sales taxes.[319] Sales tax rates and exemption schedules vary widely from state to state and locality to locality. Although the ultimate sales tax obligation normally falls on consumers, vendors are almost always held responsible for collection and remission.[320] They add the tax amount to the purchase price, collect it at the point of sale, and submit it to the government on a regular basis as a percentage of gross receipts.[321]

Soon after sales taxes became a popular source of revenue among the states, the Court made clear that the dormant Commerce Clause prohibits a state from imposing a sales tax on goods acquired outside—but enjoyed within—its borders.[322] Consumers thus trotted across state lines to acquire goods in non-sales-tax states, leaving sales-tax states to face the wrath of

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corporate franchise and income tax); Couchot v. State Lottery Comm'n, 659 N.E.2d 1225, 1227, 1230 (Ohio 1996) (considering a state tax on lottery winnings); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13, 15, 18 n.4 (S.C. 1993) (considering a state royalty income tax); Gen. Motors Corp. v. Seattle, 25 P.3d 1022, 1024, 1028-29 (Wash. Ct. App. 2001) (considering a state business and occupation tax). *But see* J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831, 839 (Tenn. Ct. App. 1999).

314. *A & F Trademark*, 605 S.E.2d at 194.

315. *J.C. Penney Nat'l Bank*, 19 S.W.3d at 839.

316. *See id.*

317. *See* BLACK'S LAW DICTIONARY 1498-99 (8th ed. 2004) (defining "sales tax" as "[a] tax imposed on the sale of goods and services, [usually] measured as a percentage of their price").

318. *See* Hellerstein, *supra* note 205, at 19-20.

319. *See* FED'N OF TAX ADM'RS, COMPARISON OF STATE AND LOCAL RETAIL SALES TAXES (2004), http://taxadmin.org/fta/rate/sl_sales.html.

320. *See* BLACK'S LAW DICTIONARY 1339 (8th ed. 2004).

321. *See* M. DAVID GELFAND ET AL., STATE AND LOCAL TAXATION AND FINANCE IN A NUTSHELL 58 (2d ed. 2000).

322. *See* McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944).

local merchants and the depletion of state coffers.[323] To solve this problem without offending the Constitution, sales-tax states began enacting compensatory use taxes on the local usage, storage, or consumption of goods purchased outside the state.[324] A use tax is a tax imposed on personal property bought out-of-state that is equal to the sales tax that would have been imposed had the property been bought in-state.[325] Just as with sales taxes, the typical use tax is nominally pegged on the consumer but is supposed to be collected and remitted by the vendor.[326]

While sales and use taxes are imposed on the sale or use of goods in general, excise taxes are imposed on the sale or use of a particular product or on involvement in a particular activity.[327] Excise taxes are levied at every level of government.[328] Like sales and use taxes, excise taxes usually are collected and remitted by vendors on behalf of the consumers who shoulder ultimate responsibility for their payment.[329] Although tobacco excise taxes are administered similarly to sales and use taxes, they are distinguishable on at least three grounds that counsel against their subjection to the *Bellas Hess* rule.

First, tobacco taxes fall into the special "sin tax" subcategory of excise taxes. Sin taxes fulfill a regulatory function. By increasing the price of a product deemed "sinful" by the government, such as tobacco or alcohol, sin taxes deter users from indulging in damaging habits.[330] They not only promote the health and well-being of the targeted consumer, but also protect the general population from the harmful secondary effects of the product's prevalence in society. Moreover, sin taxes serve to reimburse society for the costs associated with the given product. Sometimes, they go into the general fund of the taxing jurisdiction, and sometimes they are earmarked specifically for mitigation efforts relating to the product.[331] If out-of-state sellers are exempt from collecting and remitting excise taxes on the product, they can thwart the state's regulatory goals by triggering a rise in consumption and a fall in compensation. Since sin taxes have a

323. *See* Hellerstein, *supra* note 205, at 20.

324. *See id.*

325. *See* BLACK'S LAW DICTIONARY 1499 (8th ed. 2004) (defining "use tax" as "[a] tax imposed on the use of certain goods that are bought outside the taxing authority's jurisdiction").

326. *See* GELFAND ET AL., *supra* note 321, at 67.

327. *See* BLACK'S LAW DICTIONARY 1499 (8th ed. 2004) (defining an "excise" as "[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax), or on an occupation or activity (such as a license tax or an attorney occupation fee)").

328. For instance, there are federal, state, and local taxes on tobacco products. *See, e.g.*, I.R.C. § 5701 (2000) (federal cigarette tax); ARIZ. REV. STAT. ANN. § 42-3251 (2005) (Arizona state cigarette tax); N.Y. COMP. CODES R. & REGS. tit. 11, § 11-1302.

329. *See* GELFAND ET AL., *supra* note 321, at 71.

330. *See, e.g.*, LINDBLOM, *supra* note 22.

331. *See* CCH U.S. MASTER EXCISE TAX GUIDE, 40 (3d ed. 2002).

strong regulatory component and since the dormant Commerce Clause standard for state regulations considers not only burdens on interstate commerce but also benefits for local commerce, the one-dimensional physical presence requirement is ill-suited at least for the sin tax subset of excise taxes.[332]

The second ground for distinguishing between tobacco excise taxes and sales and use taxes relates only to cigarette vendors. The federal Jenkins Act already has established a nexus between remote cigarette sellers and the states in which they are advertising or shipping their products. Under the Jenkins Act, an out-of-state cigarette vendor must file monthly reports with each state into which it ships or advertises to buyers who are not distributors.[333] Every report must contain the name and address of each buyer and the brand and quantity of cigarettes shipped.[334] For over half of a century, federal law has obliged remote cigarette sellers to submit detailed data about their sales on a regular basis to states in which they have no physical presence.[335] Therefore, it would be rather late in the game for them to challenge the Arizona statute on the theory that they have no nexus with the state.

Third, compelling remote vendors to collect tobacco excise taxes would impose a de minimis burden on interstate commerce. The *Quill* Court retained the physical presence requirement for sales and use taxes in large part because it was concerned about the burden interstate commerce would shoulder if remote vendors became entangled in a "virtual welter of complicated obligations" imposed by over 6,000 taxing jurisdictions in the

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332. In the recent case of *Granholm v. Heald*, 125 S. Ct. 1885 (2005), the Court suggested in dicta that a state would not violate the dormant Commerce Clause if it placed tax collection and remission obligations on out-of-state wineries who engage in direct shipping to in-state consumers. *See id.* at 1906. This case related to the intersection of the Twenty-first Amendment and the dormant Commerce Clause. *Id.* at 1895. The Court struck down two state liquor licensing schemes that allowed in-state, but not out-of-state, wineries to make direct sales to consumers. *Id.* at 1892. The Court held that the Twenty-first Amendment did not save the schemes from the "'virtually *per se* rule of invalidity'" that applies to laws that discriminate against interstate commerce. *See id.* at 1897 (quoting Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)). In applying the "'virtually *per se* rule of invalidity,'" the Court gave the states a last-ditch chance to save the schemes by showing that no reasonable nondiscriminatory alternatives existed for meeting the asserted state interests in protecting minors and collecting taxes owed. *See id.* at 1897, 1905. As for the latter interest, the Court noted that the states could achieve their tax collection objective by requiring out-of-state wineries to collect and remit taxes. *Id.* at 1906. The Court did not elaborate as to why such a requirement would pass muster under the dormant Commerce Clause test for state tax laws, but the Court certainly implied that the physical presence requirement does not apply to state wine taxes.

333. 15 U.S.C. § 376 (2000).

334. *Id.*

335. *See* Pub. L. No. 363, 63 Stat. 884 (1949) (codified as amended at 15 U.S.C. §§ 375-78 (2000)).

nation.[336] Far fewer jurisdictions levy tobacco excise taxes than sales and use taxes: Fifty states and fewer than 500 localities in all.[337] Moreover, unlike sales and use taxes, tobacco excise taxes are not plagued with a complicated and confusing array of rates, bases, exemptions, and practices.[338] As evidenced by the R.J. Reynolds Tobacco Company website—which contains a treasure trove of charts, graphs, fact sheets, and payment tables relating to federal, state, and local tobacco taxes—an interstate vendor could easily keep track of its tobacco excise tax obligations with the mere push of a few computer keys.[339]

Increasing Irrelevance of Physical Presence: Finally, an obvious point bears acknowledgment: If the burgeoning mail order business intimated the extinction of the *Bellas Hess* rule in the period leading up to *Quill*, the booming realm of e-commerce now makes the rule look hopelessly antiquated. In his partial dissent in *Quill*, Justice White lambasted the *Bellas Hess* rule, observing that "in today's economy, physical presence frequently has very little to do with a transaction a State might seek to tax."[340] Justice White made this observation in the early 1990s, when the Internet was a primitive communications tool for a small cadre of academic, government, and tech industry wonks. But it has become increasingly apt as the Internet has morphed into the world's busiest marketplace.[341]

The Internet has upended all notions of place and geographic boundary. Online vendors can be everywhere at once—advertising, providing interactive services, closing deals, and distributing their wares—without ever stepping foot in the jurisdictions where their target customers reside.

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336. Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992) (quoting Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 759-60 (1967)).

337. *See* R.J. Reynolds Tobacco Co., Quick Facts, *supra* note 5.

338. *See* Hal R. Varian, *Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 639, 650 (2000) (describing the complexity inherent in the diverse assortment of sales and use tax regimes across the nation).

339. *See* R.J. Reynolds Tobacco Co., Quick Facts, *supra* note 5; R.J. Reynolds Tobacco Co., Tobacco Taxes & Payments, Taxes & Payments by State, http://rjrt.com/legal/taxPaymentsBy State.aspx (last visited Jan. 7, 2006).

340. *Quill*, 504 U.S. at 328 (White, J., concurring in part and dissenting in part).

341. For more on the problems with *Quill* in the era of e-commerce, see, for example, P. Greg Gulick & Paul M. Jones, Jr., *The Internet's Impact on State Tax Systems: A Proposal to Impose a Use Tax Collection Duty on Remote Vendors*, 33 URB. LAW. 479, 490 (2001) (asserting that *Quill* factors that would create "substantial nexus" are not analogous to e-commerce); Walter Hellerstein, *Deconstructing the Debate Over State Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH 549, 553-56 (2000); W. Ray Williams, *The Role of Caesar in the Next Millennium? Taxation of E-Commerce: An Overview and Analysis*, 27 WM. MITCHELL L. REV. 1703, 1704-05, 1718-22, 1731 (2001); Jenine Elco Graves, Comment, *Physical Presence in Cyberspace: As Electronic Commerce Takes Off, Does* Quill *Leave Local Merchants in the Dust?*, 37 DUQ. L. REV. 261, 261-62, 281-86 (1999).

As such, there is wide consensus among tax scholars that the physical presence requirement should be extinguished in favor of a destination-based taxation system that treats remote and local sales alike.[342] This is not to say that a lower court should echo the North Dakota Supreme Court in *Quill* by holding that "wholesale changes" in the national economy have now really and truly rendered *Bellas Hess* obsolete.[343] Instead, it is only to suggest that if *Quill* was a weak decision in its day, it has since become sorely wounded precedent that is in no shape to stretch beyond its current reach.

b. An Alternative to the *Bellas Hess* Rule

Since the *Bellas Hess* rule should not apply to tobacco excise taxes, what should the substantial nexus inquiry look like? Most of the Court's dormant Commerce Clause taxation cases do not shed light on the answer, since they conflated the Due Process Clause and dormant Commerce Clause tests until the *Quill* decision in 1992. The six state court cases that declined to extend *Quill* do not offer much illumination either. Not one of the courts in these cases took the opportunity to enunciate a generally applicable substantial nexus test. Instead, they all made ad-hoc determinations based upon the facts at hand.[344]

The substantial nexus test for non-sales and non-use taxes actually is embedded in *Quill*. The *Quill* Court not only asserted that modern dormant

342. *See* Hellerstein, *supra* note 341, at 550 (noting that more than 170 academic tax economists and law professors have formally endorsed these principles in an "Appeal for Fair and Equal Taxation of Electronic Commerce").

343. State v. Quill Corp., 470 N.W.2d 203, 213 (N.D. 1991), *rev'd*, *Quill*, 504 U.S. at 319.

344. *See, e.g.*, Borden Chems. & Plastics, L.P. v. Zehnder, 726 N.E.2d 72, 81 (Ill. App. Ct. 2000) (concluding that the physical presence in the taxing state of the partnership that generated the income sufficed to hold the nonresident partner accountable for replacement tax liability); Truck Renting & Leasing Ass'n v. Comm'r of Revenue, 746 N.E.2d 143, 149-50 (Mass. 2001) (concluding that a truck-leasing business established a substantial nexus with Massachusetts because its vehicles were physically present and generated income in the state, it provided administrative services for customers related to the operation of its vehicles in the state, and because the corporate excise tax did not inhibit interstate commerce); A & F Trademark, Inc. v. Tolson, 605 S.E.2d 187, 195 (N.C. Ct. App. 2004) (concluding that "under facts such as these where a wholly-owned subsidiary licenses trademarks to a related retail company operating stores located within North Carolina, there exists a substantial nexus with the State" for the purposes of income and franchise taxes); Couchot v. State Lottery Comm'n, 659 N.E.2d 1225, 1230-31 (Ohio 1996) (declining to apply *Quill* to an Ohio income tax assessment against non-resident Ohio lottery winners, but upholding the assessment because the income received by the lottery winner was directly related to his physical presence in Ohio when he bought the ticket); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13, 23 (concluding that the presence of intangible property in a state is sufficient to establish nexus for income tax purposes); Gen. Motors Corp. v. Seattle, 25 P.3d 1022, 1029 (Wash. Ct. App. 2001) (concluding that because out-of-state automakers exploited the Seattle market, they could be liable for a business and occupation tax).

Commerce Clause jurisprudence favors "more flexible balancing analyses,"[345] but it marked a direct correlation between the *Pike* balancing test and the *Complete Auto* substantial-nexus test. In the portion of its opinion differentiating between the nexus requirements of the Due Process Clause and dormant Commerce Clause, the Court stressed that the former focuses on fairness to the individual while the latter focuses on the structure of the national economy.[346] It proceeded to note that the dormant Commerce Clause standards for regulations and taxes reflect identical concerns about the flow of interstate commerce—namely an intolerance for discriminatory or unduly burdensome state action.[347] The Court pointed to similarities between the two-tier standard for regulations and the four-prong standard for taxes.[348] The Court drew a parallel between the second tier of the regulation standard (i.e., the *Pike* balancing test) and the first and fourth prongs of the taxation standard: "The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce."[349] In other words, the *Quill* Court suggested that the first and fourth prongs of the *Complete Auto* standard are commensurate with the *Pike* balancing test, which assesses whether a regulation inflicts an undue burden upon interstate commerce by balancing the interstate and local interests involved.[350] Since the fourth prong of the *Complete Auto* standard tends to collapse into the other three prongs, it is reasonable to read the *Quill* decision as endorsing the use of the *Pike* balancing test as a stand-in for the substantial nexus prong. Under this reading of *Quill*, the *Bellas-Hess* rule represents a permanent resolution of the *Pike* balancing test in favor of physical presence in a discrete subset of cases relating to sales and use taxes.[351]

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345. Quill Corp. v. North Dakota, 504 U.S. 298, 314 (1992).

346. *See id.* at 312.

347. *Id.*

348. *See id.* at 313.

349. *Id.* The Court also drew a parallel between the first tier of the regulation standard (i.e., the discrimination tier) and the second and third prongs of the taxation standard. *Id.* Herein lies another conundrum in the Court's dormant Commerce Clause jurisprudence. If the fair apportionment and nondiscrimination prongs of the taxation standard are co-extensive with the discrimination tier of the standard for regulations, is the fair apportionment prong really a subset of the discrimination prong?

350. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

351. As the Court explained:

> Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. *Bellas Hess* followed the latter

A court considering the constitutionality of the Arizona statute should rule that it meets the Due Process Clause and dormant Commerce Clause substantial nexus requirements. The due process analysis should be elementary. Just like the mail order company in *Quill*, a remote tobacco vendor advertising to residents in Arizona and shipping its products into Arizona is "purposefully avail[ing]" itself of the benefits of the Arizona market.[352] The vendor has reporting obligations to the state under the Jenkins Act, is "engaged in continuous and widespread solicitation of business" within the state, and thus has "fair warning that [its] activity may subject [it] to the jurisdiction" of the state.[353]

The Arizona statute also should satisfy the *Pike* balancing test, and thus the substantial nexus prong of the *Complete Auto* standard. Under the *Pike* balancing test, "[w]here the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[354]

The Arizona statute undoubtedly advances a legitimate state interest, since a core function of the states is to protect and promote the health and safety of their citizens.[355] The statute's effects on interstate commerce are only incidental because the statute is non-discriminatory. On one side of the scale, the burden imposed by the Arizona statute on interstate commerce is marginal. It is a minor administrative inconvenience for out-of-state vendors to calculate the excise tax owed on Arizona-bound tobacco products, add that amount to the purchase price, and submit the money to the Arizona tax authorities along with the federally mandated monthly reports. It is equally trivial for such vendors to choose the option of acquiring Arizona tax stamps or pre-stamped cigarettes and sending proof of payment to the Arizona tax authorities along with the Jenkins Act reports. On the other side of the scale, the putative local benefits of the Arizona statute are weighty. The statute facilitates a proven strategy for reducing consumption of the nation's leading cause of disease and death.[356] In addition, it generates well over $200 million per year that are allocated specifically for tobacco control and other health-related programs.[357] A rise

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approach . . . .

Quill, 504 U.S. at 314-15.

352. *Id.* at 308 (citing Burger King Corp. v. Rudzewicz, 471 U.S. 462, 475 (1985)).

353. *Quill*, 504 U.S. at 308 (quoting Shaffer v. Heitner, 433 U.S. 186, 218 (1977) (Stevens, J., concurring in the judgment)).

354. *Pike*, 397 U.S. at 142 (citing Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 443 (1960)).

355. *Cf. Huron Portland Cement Co.*, 362 U.S. at 443.

356. *See* NAT'L CANCER POLICY BD., *supra* note 7.

357. *See* R.J. Reynolds Tobacco Co., Taxes & Payments, Cigarette Tax & Payment

in tobacco use and a fall in funding due to untaxed online sales could be disastrous for public health in Arizona. Pack-for-pack, remote vendors contribute to tobacco-related morbidity and mortality in Arizona at the same rate as their brick-and-mortar counterparts, so those that reside out of state should not be exempt from collecting and remitting tobacco taxes merely because they might otherwise have to perform a set of inconsequential administrative tasks. Common sense and over fifty years of experience with the Jenkins Act regime dictate that the only viable way for a state to capture its due in tobacco excise taxes is to put the collection and remission obligation on everyone selling tobacco to residents of the state.

3. Fair Apportionment (Prong Two)

There should be little controversy over the question of whether the Arizona statute satisfies the fair apportionment prong. Presumably, the Arizona statute entails an unapportioned excise tax, since there is no conceivable scenario in which another state would lay claim to an excise tax on the remote sale of a tobacco product to an Arizona buyer. The Court consistently allows for unapportioned sales, use, and excise taxes even when a taxed transaction triggers "the intangible movement of electronic impulses through computerized networks" located in different states or when the transaction results in the immediate movement of goods across state lines.[358] An unapportioned tobacco excise tax does not offend the principle of internal consistency because it involves a discrete transaction that is clearly subject to taxation in only one state. The Arizona statute is externally consistent because Arizona has several legitimate justifications for levying an excise tax on out-of-state tobacco vendors who advertise and ship their noxious products into its domain.

4. Fair Relationship to State Services (Prong Four)

Since the Arizona statute easily should pass the first three prongs of the *Complete Auto* standard, it should breeze through the token fourth prong. Clearly, Arizona offers remote tobacco vendors "the benefits of a trained

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Table, Tobacco Taxes and Payments for Arizona, http://www.rjrt.com/legal/taxStateView.asp?State=az (last visited Jan. 7, 2006) (noting that Arizona's excise tax collection for the fiscal year ending in June 2004 amounted to $280,174,000); *see also* ARIZ. REV. STAT. ANN. § 36-771 (2005).

358. Goldberg v. Sweet, 488 U.S. 252, 264-65 (1989) (upholding an Illinois excise tax on phone calls that originated in Illinois or were billed to an Illinois address); *see also* Okla. Tax Comm'n. v. Jefferson Lines, Inc., 514 U.S. at 175, 186-88 (1995) (upholding Oklahoma's imposition of a sales tax on the full price of interstate bus travel and explaining the rationale and precedent supporting unapportioned taxes on sales).

work force and the advantages of a civilized society."[359] The state has a role in maintaining the technological and physical infrastructure that allows its residents to shop online and receive deliveries at their doorsteps. For that alone, the Arizona statute satisfies the fair relationship prong.

C. *Reckoning with the Principles of Political and Economic Union*

Although it is important to walk step-by-step through the *Complete Auto* standard in order to show that the Arizona statute is constitutionally valid, it also is worth stepping back to address the fundamental question of whether the statute violates the essential principles of political and economic union. A simple smell test reveals that the Arizona statute does not offend the principles underlying the dormant Commerce Clause. Arizona is not seeking to benefit political insiders at the expense of outsiders who lack a voice in the democratic process. Neither is it erecting protectionist barriers that imperil the integration of the national economy. Instead, Arizona is merely creating a legitimate and equitable system in which all tobacco vendors—regardless of their location—are subject to the excise tax that the state has levied in the name of the health of its citizens.

V. CONCLUSION

Given its sizeable benefits, the Arizona statute is an attractive model for states looking for ways to mitigate the serious financial and public health costs associated with online cigarette sales. These states can rest assured that an Arizona-like statute should withstand scrutiny under the four-prong *Complete Auto* standard. The first prong presents the only real hurdle, given the prevailing assumption that the *Bellas Hess* physical presence requirement affirmed in *Quill* bars states from requiring remote vendors to collect and remit tobacco excise taxes. However, the physical presence requirement is inapposite to the Arizona statute. The plain language of *Quill* explicitly limits the *Bellas Hess* rule to sales and use taxes, which are entirely distinguishable from tobacco excise taxes.[360] Moreover, *Quill* is a tepid decision grounded in large part on the principle of stare decisis, and its precedential value has been further weakened by the explosion of the Internet economy. *Quill* practically entreats lower courts not to extend the *Bellas Hess* rule beyond the arena of sales and use taxes. Instead, *Quill* indicates that for other types of taxes, the *Pike* balancing test should stand in for the substantial nexus prong. The Arizona statute should pass the *Pike* balancing test with flying colors. It imposes

359. Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979).

360. See Quill Corp. v. North Dakota, 504 U.S. 298, 317 (1992).

a de minimis burden on interstate commerce while serving as an essential tactic in a comprehensive campaign against the ills wrought by the influx of cheap smokes into the population of the state.