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Constitutional Law—Due Process—Power of State to Require Foreign Mail-Order Seller to Collect Use Tax.—National Bellas Hess, Inc. v. Department of Revenue

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CASE NOTES

Constitutional Law—Due Process—Power of State to Require Foreign Mail-Order Seller to Collect Use Tax.—*National Bellas Hess, Inc. v. Department of Revenue.*[1]—National Bellas Hess, a national retail mail-order house specializing in wearing apparel, is licensed to do business only in Missouri, its principal place of business and where all its mail-order activities take place, and in Delaware, where it is incorporated. Mail-order sales are solicited by twice-a-year catalogue mailings addressed to over five million active or recent customers on its mailing list, supplemented by an even larger mailing of advertising flyers or sales books to both past and potential customers. The supplemental advertisements are occasionally mailed in bulk, addressed to "occupant." Customers mail their orders for merchandise to the company in Missouri, from where, if the order is accepted, the merchandise is sent to them by mail or common carrier. Customers who purchase merchandise on credit mail their monthly payments to the company in Missouri. National Bellas Hess regularly makes sales in Illinois in this manner.[2]

The Illinois Use Tax Act[3] imposes a tax "upon the privilege of using in this State tangible personal property purchased at retail . . . from a retailer."[4] The tax is to be collected from the purchaser by "a retailer maintaining a place of business in this State,"[5] and remitted to the Department of Revenue. A "retailer" is defined to include any one "[e]ngaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State."[6]

When National Bellas Hess failed to collect and remit the use taxes assessed on its mail-order sales to Illinois customers, the Illinois Department of Revenue brought action in the Circuit Court of Cook County to recover the assessment, plus a penalty, and was granted a summary judgment. On appeal,[7] the Illinois Supreme Court found that the company was a "retailer maintaining a place of business" in Illinois by virtue of its continuous local solicitation of mail orders and the subsequent delivery of the ordered merchandise to local customers. The supreme court held that to require National Bellas Hess to collect and pay the use taxes on those local mail-order sales "does not deprive defendant of due process of law under the Federal or Illinois constitutions nor does it violate the commerce clause of the Federal constitution."[8] On appeal to the Supreme Court of the United States, HELD: a state may not constitutionally impose the duty of use tax collection and payment

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1 386 U.S. 753 (1967).

2 The company sold over $2,000,000 worth of merchandise to Illinois customers during the fifteen month period for which the taxes in question were assessed. Id. at 761.

3 Ill. Ann. Stat. ch. 120, §§ 439.1-.22 (Smith-Hurd Supp. 1966).

4 Id. § 439.3.

5 Id.

6 Id. § 439.2.

7 Department of Revenue v. National Bellas Hess, Inc., 34 Ill. 2d 164, 214 N.E.2d 755 (1966).

8 Id. at 172-73, 214 N.E.2d at 760.

upon a seller whose only connection with customers there is by mail or common carrier.[9]

The question of the power of a state to impose use tax obligations upon an out-of-state seller has been raised in the Supreme Court six times in the past twenty-eight years.[10] It is submitted that an examination of those decisions reveals an unmistakable tendency to uphold the imposition wherever the out-of-state seller's regular activities in the taxing state consist of direct and continuous local solicitation of sales. It is further submitted, therefore, that the instant decision adopts an erroneous approach to the question of a state's use tax jurisdiction by emphasizing the fact that the out-of-state seller maintained no retail store, sales office or employees in the taxing state to solicit local sales.

In *Felt & Tarrant Mfg. Co. v. Gallagher*,[11] the out-of-state seller was not licensed to do local business and did not have any property in the taxing state. It did, however, maintain two general agents there, for whom it hired offices, to solicit local orders. The Court held California's use tax imposition constitutional on the ground that the seller's elaborate arrangements for soliciting local orders constituted the transaction of local business.

In *Nelson v. Sears, Roebuck & Co.*,[12] and in a companion case, *Nelson v. Montgomery Ward & Co., Inc.*,[13] the Court held that Iowa may constitutionally require out-of-state sellers to collect the use tax imposed on mail orders sent by Iowa residents directly to out-of-state mail-order houses and delivered directly to the customers from there by mail or common carrier. Each seller maintained local retail stores from which it made local sales, and operated a mail-order business from separately administered out-of-state branches. Despite the fact that no local employee solicited the mail orders, the Court found that they were in fact related to the seller's local activities. Justice Douglas, delivering the opinion of the Court in both cases, observed in *Sears*,

> Whatever may be the inspiration for these mail orders, however they may be filled, Iowa may rightly assume that they are not unrelated to respondent's course of business in Iowa. . . . Hence to include them in the global amount of benefits which respondent is receiving from Iowa business is to conform to business facts.[14]

[9] For a state court decision reaching the same result on almost identical facts see State v. Lane Bryant, Inc., 277 Ala. 385, 171 So. 2d 91 (1965), followed in State v. Innkeepers Supply Co., 277 Ala. 476, 172 So. 2d 40 (1965).

[10] The question of the power of a state to impose various other taxes upon a foreign company engaged in interstate commerce has been frequently presented to the Supreme Court during that period. See, e.g., General Motors Corp. v. Washington, 377 U.S. 436 (1964) (gross receipts); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (net income); Braniff Airways, Inc. v. Nebraska State Bd., 347 U.S. 590 (1954) (ad valorem); Spector Motor Serv., Inc. v. O' Connor, 340 U.S. 602 (1951) (franchise); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940) (sales). See generally Developments in the Law—Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953 (1962).

[11] 306 U.S. 62 (1939).

[12] 312 U.S. 359 (1941).

[13] 312 U.S. 373 (1941).

[14] 312 U.S. at 364. Justice Douglas' language referred to the test first enunciated by Justice Frankfurter in Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940), by which a

In *Montgomery Ward*, the parties stipulated that the seller's local retail stores displayed advertisements offering not only retail merchandise but also the availability of a mail-order service using catalogues. The Court rejected substantially the same arguments as were advanced in *Sears* and concluded that the fact that "solicitation [of mail orders] was done through local advertisements rather than directly by local agents as in *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62, is immaterial."[15] By equating the local solicitation of orders by agents with that by retail store advertisements, the Court clearly found the specific means used by the out-of-state seller to stimulate local orders to be constitutionally irrelevant. But the Court's stress upon the totality of the out-of-state seller's course of business in the taxing state indicated that it did not consider the presence of local agents or local retail stores to be without constitutional significance.

Only three years later, however, in *General Trading Co. v. State Tax Comm'n*,[16] the Court unequivocally dismissed the suggestion that the presence of retail stores was necessary to the *Sears* and *Montgomery Ward* decisions.[17] In upholding Iowa's use tax imposition upon an out-of-state seller which continuously sent traveling salesmen into the taxing state to solicit local orders, the Court also noted that a state's requirement that a seller collect the use tax from the local purchaser is "a familiar and sanctioned device."[18] By finding *Felt & Tarrant* indistinguishable,[19] the Court further emphasized the significance of the organized nature, rather than the particular means, of the local solicitation.

The state of Maryland relied heavily on *General Trading* to support its imposition of a use tax upon a Delaware seller in *Miller Bros. Co. v. Maryland*.[20] The company only sold goods to customers at its Delaware store, and did not accept any telephone, mail or C.O.D. orders. But it advertised in Delaware newspapers and on Delaware radio and television stations, within whose circulation and broadcast areas were an unknown number of Maryland residents. It occasionally sent direct mail circulars to all recent customers, including those in Maryland, and occasionally even made deliveries there in its own truck. In denying the power of Maryland to require Miller Brothers to collect the use tax on sales to Maryland residents, the Court held that the com-

state may exert its taxing power: "That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." Id. at 444. Justice Frankfurter later stated in Freeman v. Hewit, 329 U.S. 249 (1946): "State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." Id. at 253.

[15] 312 U.S. at 376.

[16] 322 U.S. 335 (1944).

[17] Id. at 338.

[18] Id. Accord, Monamotor Oil Co. v. Johnson, 292 U.S. 86, 93 (1934) ("a common and entirely lawful arrangement"). For a discussion of the methods available to a state to enforce its sales and use taxes on consumer goods, particularly gasoline, liquor and tobacco, see Note, Enforcing State Consumption Taxes on Out-of-State Purchases, 65 Harv. L. Rev. 301 (1951).

[19] 322 U.S. at 338.

[20] 347 U.S. 340 (1954).

pany's activities in the taxing state did not satisfy the due process requirement of "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[21] It distinguished General Trading's systematic method of local solicitation in Iowa from Miller Brothers' casual and irregular course of business in Maryland:

> [T]here is a wide gulf between this type of active and aggressive operation within a taxing state and the occasional delivery of goods sold at an out-of-state store with no solicitation other than the incidental effects of general advertising. *Here was no invasion or exploitation of the consumer market in Maryland.*[22] (Emphasis added.)

In a more recent case, *Scripto, Inc. v. Carson*,[23] the out-of-state seller maintained no office, warehouse or other place of business in the taxing state, and had no full-time employees there. It did, however, maintain ten brokers there to actively conduct continuous solicitations of orders for its products from local customers by means of catalogues, samples and other advertising materials which it furnished. Although the written contract between Scripto and each broker provided that the parties intended to create the relationship of "independent contractor," the Court found that the distinction between full-time "salesmen" and part-time "independent" brokers was without constitutional significance.[24] The Court found the minimum connection required by due process in the continuous local solicitations of the brokers, and concluded that the case was controlled by *General Trading*.[25] By way of distinction, the Court noted that in *Miller Bros.*, "there was no 'exploitation of the consumer market'; no regular, systematic displaying of its products by catalogs, samples or the like,"[26] and emphasized the fact that "Marylanders went to Delaware to make purchases—Miller did not go to Maryland for sales."[27]

After examining the facts of *National Bellas Hess* against the background of prior cases, the majority rested its opinion almost solely upon the concept that due process criteria limit the power of a state to impose use tax obligations upon an out-of-state seller to those situations in which the seller has some property or personnel physically present within the state.[28] Specifically, the majority declined

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[21] Id. at 344-45.

[22] Id. at 347.

[23] 362 U.S. 207 (1960).

[24] Id. at 211. Cf. General Motors Corp. v. Washington, 377 U.S. at 447.

[25] 362 U.S. at 212.

[26] Id.

[27] Id.

[28] National Bellas Hess also challenged the imposition as creating an unconstitutional burden upon interstate commerce. The majority mentioned that the commerce clause would be violated if a foreign company doing business by mail were required to collect use taxes for every jurisdiction into which it shipped its goods, 386 U.S. at 759-60, but its discussion appears to be unnecessary to the decision. The dissent, apparently disregarding the possibility of the cumulative burden of multiple impositions, dismissed the majority's comments after a brief discussion in which it observed that the issue "should not give us pause." Id. at 766. Thus, the decision does not provide any clear indication of when the

> to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.[29]

In so concluding, the majority stressed the distinction drawn in *Sears* between mail-order houses with local retail outlets and sellers whose only connection with local customers is by mail or common carrier and which, therefore, " 'are not receiving benefits from [the taxing state] for which it has the power to exact a price.' "[30] It described *Scripto* as the "furthest constitutional reach to date,"[31] and then contrasted the fact that Scripto had ten brokers conducting continuous local solicitation with the fact that Miller Brothers had no local retail stores and no local sales solicitors.[32] Observing that "here there was neither local advertising nor local household deliveries,"[33] the majority apparently considered that Miller Brothers had greater contacts with Maryland than National Bellas Hess had with Illinois.

By drawing the line of a state's use tax jurisdiction at a "physical" nexus, the majority apparently overlooked the recurring distinction drawn by the Court in prior decisions between the substance and the method of a seller's local solicitations.[34] That distinction was clearly stated by Justice Rutledge many years ago when he observed that

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administrative costs and mechanics of complying with a vast network of nonuniform taxing statutes unduly burdens interstate commerce.

For a discussion of the relationship of the due process and commerce clauses in cases involving a state's taxing power see Hartman, State Taxation of Interstate Commerce: A Survey and An Appraisal, 46 Va. L. Rev. 1051, 1058-65 (1960).

[29] 386 U.S. at 758.

[30] Id. In *Sears*, the Court rejected the seller's insistence that the imposition violated the commerce clause because its mail-order business was in competition with out-of-state mail-order houses which could not be reached for the tax by pointing out: "[T]hose other concerns are not doing business in the state as foreign corporations. Hence, unlike respondent, they are not receiving benefits from Iowa for which it has the power to exact a price." 312 U.S. at 365.

[31] 386 U.S. at 757.

[32] Id. at 757-58.

[33] Id. at 759.

[34] The Court has drawn a similar distinction in considering the analogous question of the power of a state to subject a foreign corporation to suit. In the landmark case of International Shoe Co. v. Washington, 326 U.S. 310 (1945), Chief Justice Stone observed:

> The test is not merely . . . whether the activity, which the corporation has seen fit to procure through its agents in another state, is a little more or a little less. . . . Whether due process is satisfied must depend rather upon the quality and nature of the activity in relation to the fair and orderly administration of the laws which it was the purpose of the due process clause to insure.

Id. at 319. Compare Hanson v. Denckla, 357 U.S. 235 (1958), with McGee v. International Life Ins. Co., 355 U.S. 220 (1957). See generally Kurland, The Supreme Court, the Due Process Clause and the In Personam Jurisdiction of State Courts, 25 U. Chi. L. Rev. 569 (1958).

The various tests applied by the Court to determine whether a foreign corporation is subject to a state's service of process, taxation, or regulatory jurisdiction all turn, to a greater or lesser extent, on the corporation's nexus or connection or relationship with the state. See Developments in the Law, supra note 10.

> every relevant constitutional consideration affecting taxation of transactions, regular, continuous, persistent solicitation has the same economic, and should have the same legal, consequences as does maintaining an office for soliciting and even contracting purposes or maintaining a place of business, where the goods actually are shipped into the state from without for delivery to the particular buyer.[35]

In every use tax case prior to *National Bellas Hess*, the Court has recognized that distinction, and has adopted an approach which emphasizes the pervasive nature, rather than the specific form, of the out-of-state seller's activities in the taxing state. For example, in *Miller Bros.*, when it distinguished General Trading's activities in Iowa from Miller Brothers' activities in Maryland, the Court characterized the former as "continuous," "active," and "aggressive," and the latter as "occasional" and "incidental." The Court observed that it "could properly approve the State's decision [in *General Trading*] to regard such a rivalry with its local merchants as equivalent to being a local merchant," but then concluded that there was no equivalent "invasion or exploitation" of the Maryland consumer market by Miller Brothers.[36]

It is true that there has been some physical nexus between the out-of-state seller and the taxing state in every case upholding the imposition of use tax obligations. But it is also true that the physical nexus has always involved an intensive and organized effort to develop and exploit the local consumer market by some form of direct and continuous selling activity. In *Montgomery Ward*, the Court found the distinction between the direct solicitation of sales by local agents and that by local advertising to be constitutionally immaterial.[37] In *General Trading*, the Court found the presence of local retail stores in *Sears* and *Montgomery Ward* to be constitutionally irrelevant.[38] In *Miller Bros.*, the only case where the Court found the seller's nexus with the taxing state insufficient to satisfy due process criteria, Miller Brothers' contacts with Maryland involved no regular or continuous selling activity, but rather were the indirect effects of its doing business in Delaware.[39] Thus, it would appear that the nature and extent of National Bellas Hess' activities in Illinois are substantially different from the nature and extent of Miller Brothers' activities in Maryland, but are not significantly different from the nature and extent of Sears' activities in Iowa.

That the scope of the out-of-state seller's selling activities in the taxing state, and not the particular form those selling activities take, should be the primary constitutional consideration in the Court's determination of the power of a state to impose use tax obligations seems most logical. The fact that the seller regularly and continuously solicits orders in the taxing state exclusively by mail, rather than through sales personnel or property physically present

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[35] General Trading Co. v. State Tax Comm'n, 322 U.S. 335, 354 (1944) (concurring opinion; also concurring in International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944), and dissenting in McLeod v. J. E. Dilworth Co., 322 U.S. 327 (1944)).

[36] 347 U.S. at 346-47.

[37] 312 U.S. at 376.

[38] 322 U.S. at 338.

[39] 347 U.S. at 347.

there, should be immaterial.[40] A seller will attempt to utilize the most effective and economical method of inducing sales, and exploitation of a consumer market by actively soliciting sales through a systematic and continuous direct mail campaign may be just as, if not more, effective and economical as would soliciting sales directly through sales personnel or property there. The majority apparently overlooked that obvious fact of business life.

Furthermore, the majority failed to recognize the fact that any seller which regularly exploits a consumer market is participating in the benefits and opportunities afforded by the taxing state. By providing a consumer market for the seller to develop, the state "has given [something] for which it can ask return":[41] the opportunity and privilege of exploiting a consumer market which has been organized and regulated by the state for the benefit of sellers. In the words of Justice Frankfurter:

> A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.[42]

The question of when an out-of-state seller's activities in a taxing state provide a sufficient nexus to allow the state to impose collection duties upon the seller is important not only to states[43] but also to retailers who regularly conduct a substantial part of their business by mail or common carrier from a single place of business. The practical answer of *National Bellas Hess* is that a seller which actively and deliberately exploits the consumer market of a taxing state by regularly soliciting local sales is liable for the collection of the tax where it has a retail store, sales office or employees in the state, but is immune from the collection liability when its only connection with the state is the dissemination of advertising and the subsequent shipment of ordered goods into the state by mail or common carrier. That answer, however, is not entirely satisfactory because of an apparent conflict between the majority's reasoning and the rationale of prior use tax decisions.

A possible resolution of the uncertainty raised by the instant decision may be provided in future cases wherein state taxing authorities will rely upon

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[40] Cf. Eli Lilly & Co. v. Sav-On-Drugs, Inc., 366 U.S. 276 (1961), wherein the Court discussed the significance of the foreign corporation's maintaining a local office and employing 18 "detailmen" who traveled in the state providing free advertising materials to local retailers but who did not regularly solicit sales: "The fact that the business of 'inducing' intrastate sales . . . is primarily a promotional and service business which does not include a systematic solicitaton of orders goes only to the nature of the intrastate business . . . , not to the question of whether [Lilly] is carrying on an intrastate business." Id. at 282.

[41] Wisconsin v. J. C. Penney Co., 311 U.S. at 444.

[42] Id.

[43] The use tax is important to the states because: (1) it protects local revenues by discouraging local taxpayers from attempting to avoid the incidence of the local sales tax by making out-of-state purchases; and (2) it protects local retailers from the competition of out-of-state merchants which are subject to little or no tax burdens. See Miller Bros. Co. v. Maryland, 347 U.S. at 343; Henneford v. Silas Mason Co., 300 U.S. 577, 581 (1937) (Cardozo, J.).

the dissent's reference to National Bellas Hess' presumably necessary utilization of banking, credit and collection institutions in Illinois to determine the financial circumstances of its Illinois customers who order goods on credit plans.[44] When considered in addition to the fact of regular solicitation by mail of sales in the consumer market, the seller's use of local banking and credit institutions may provide the required nexus to sustain the state's imposition of use tax obligations. Such a practical approach to the facts of mail-order business would offer the Court reasonable grounds for distinguishing *National Bellas Hess* and for reestablishing the reasoning and emphasis of prior use tax cases.

DAVID J. LEVENSON

Insurance—Insolvency—General Agent's Right to Set Off Unearned Premiums.—*Korlann v. E-Z Pay Plan, Inc.*[1]—Manhattan Agencies, Inc. was a general agent which wrote automobile policies on young or "rated" drivers for Superior Mutual Insurance Company and other insurance companies. After a time of consistent dealing with each other, Superior encountered financial difficulties and was declared insolvent. As a result, all policies written for Superior were cancelled. Subsequent to a notice of Superior's insolvency, Manhattan, instead of remitting to the receiver in bankruptcy the full amount of the premiums collected on behalf of Superior, returned that portion of the premiums which became unearned because of the cancellation to E-Z Pay Plan, Inc., as assignee of the policies. E-Z Pay was a finance company which discounted the time payment contracts of Manhattan's customers. On the theory that Manhattan was a trustee for both earned and unearned premiums received from policyholders and, therefore, bound to pay all receipts to Superior's receiver upon notice of Superior's insolvency, an order was directed to Manhattan and E-Z Pay to show cause why Manhattan should not be adjudged to be indebted to Superior for the amount of the unearned premiums and why both Manhattan and E-Z Pay should not be held in contempt for a violation of the liquidation order.

The trial court found that Manhattan was a trustee of both the earned and unearned premiums and that Manhattan was, therefore, a converter of the money returned to E-Z Pay, and E-Z Pay a constructive trustee of the refund for the benefit of Superior's receiver. On appeal by Manhattan and E-Z Pay, the Supreme Court of Oregon HELD: The business conduct of Manhattan and Superior over the years clearly indicates that they were at all times dealing with each other as mutual debtor and creditor, and not as

[44] Bellas Hess could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities. . . . [I]t would . . . be unreasonable to assume that the company does not either sell or assign its accounts or otherwise take measures to collect its delinquent accounts, or that collection does not include local activities by the company or its assignees or representatives.

386 U.S. at 762.

[1] 428 P.2d 172 (Ore. 1967).