

NOTE: Common Sense and the Commerce Clause: Why Elimination of the Physical Presence Test for Taxation Defies Both

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Introduction

A recurring nightmare of every attorney is learning about personal jurisdiction in law school. Picking apart *Pennoyer* ² from *International Shoe* ³ and *Burger King* ⁴ from *Asahi* ⁵ is enough to challenge even the brightest legal scholars. As a reward for trudging through the morass of jurisdictional issues (Federal Rules of Civil Procedure grasped firmly in hand), second- and third-year law students earn the right to take Taxation, complete with its maze of codes and regulations.

Despite the endless complications and (seemingly incomprehensible) proposition that a hybrid of Civil Procedure and Taxation presents, the Supreme Court of the United States deftly navigated the waters and produced a bright-line rule of simplification and common sense: a state cannot impose a tax on an out-of-state business entity unless that entity has some physical presence within the state. ⁶ This rule has remained valid law for decades; however, due to Justice Stevens's ambiguous language in *Quill Corp. v. North Dakota*, ⁷ courts and state legislatures have ignored [*708] the physical presence requirement, interpreting the requirement as only applying to sales and use taxes. ⁸ This interpretation, however, violates the Commerce Clause and allows states to regulate interstate

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² *Pennoyer v. Neff*, 95 U.S. 714 (1877).

³ *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945).

⁴ *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

⁵ *Asahi Metal Indus. Co. v. Superior Court of Cal.*, 480 U.S. 102 (1987).

⁶ *Quill Corp. v. North Dakota*, 504 U.S. 298, 306, 311 (1992); *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 756-57 (1967).

⁷ *Quill*, 504 U.S. at 312-21. For example, Justice Stevens noted the lack of a formal adoption of the physical presence standard in non-sales tax contexts, stating that "although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established 'bright-line' tests. Although 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, that silence does not imply repudiation of the *Bellas Hess* rule." *Id.* at 314. Justice Stevens echoed this sentiment later in the opinion, noting that "although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes" *Id.* at 317.

⁸ See, e.g., *Comptroller of the Treasury v. SYL, Inc.*, 825 A.2d 399, 415-16 (Md. 2003); *Kmart Props., Inc. v. Taxation & Revenue Dep't of N.M.*, 131 P.3d 27, 35 (N.M. Ct. App. 2001); *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1230 (Ohio

commerce, a right that was clearly reserved to the federal government.⁹ The most recent of these violations occurred in *Revenue Cabinet v. Asworth Corp.*, where the Kentucky Court of Appeals upheld a circuit court decision and subjected a non-Kentucky business, with no physical presence in Kentucky, to Kentucky state income taxes.¹⁰

This Note presents the argument that the physical presence standard has always applied, and still does apply, to all state taxes, and not just sales and use taxes, and that the Supreme Court of the United States should grant certiorari on the issue and clarify the confusion evidenced by conflicting state courts and statutes. Part I contains a brief summary of the two cases developing the physical presence standard, *Bellas Hess* and *Quill*, and explains why even though those cases involved sales and use taxes, their shared principle extends to all levels of state taxation.¹¹ It contends that Justices Stevens's ambiguous language in *Quill* has led several state courts and legislatures throughout the United States to adopt laws that violate the Commerce Clause, a trend that will continue to gain momentum as technology expands the possibility of out-of-state sales. Part II examines the Commerce Clause of the United States Constitution,¹² discussing the development of the dormant Commerce Clause doctrine and explaining why the doctrine mandates a physical presence requirement. Part III reviews legislative and judicial interpretations of the physical presence requirement, focusing on the confusion displayed by the Kentucky Court of Appeals in its recent *Asworth* decision.¹³ Finally, Part IV discusses the advancement of technology and its relationship to the Internet, explaining, [*709] through the use of a modern example, why a bright-line test is exceedingly important as technology capabilities expand.

I. The Development of the Physical Presence Requirement: *Bellas Hess* and *Quill*

The physical presence test was originally developed to offer bright-line guidance to states regarding what qualified as acceptable taxation of out-of-state businesses. The Supreme Court first established the test in *Bellas Hess*,¹⁴ and later reaffirmed its application in *Quill*.¹⁵

A. *Bella Hess's* Bright-Line Physical Presence Requirement

The physical presence requirement for out-of-state taxation originated in *National Bellas Hess v. Department of Revenue*, when a mail order house operating out of Missouri challenged an Illinois use tax imposed because it solicited Illinois customers with biannual mail catalogues.¹⁶ The taxpayer had no physical presence in Illinois- as the Supreme Court stated:

[It] does not maintain in Illinois any office, distribution house, sales house, warehouse or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois.¹⁷

1996); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13, 18 (S.C. 1993).

⁹ See *Gibbons v. Ogden*, 22 U.S. 1, 3, 200-01 (1824).

¹⁰ *Revenue Cabinet v. Asworth Corp.*, No. 2007-CA-002549-MR, 2009 Ky. App. LEXIS 229, at *1, *10-12 (Ky. Ct. App. Nov. 20, 2009), cert. denied, 131 S. Ct. 1046 (2011).

¹¹ *Bellas Hess*, 386 U.S. 753; *Quill*, 504 U.S. 298.

¹² U.S. Const. art. I, § 8, cl. 3.

¹³ *Asworth Corp.*, 2009 Ky. App. LEXIS 229.

¹⁴ *Bellas Hess*, 386 U.S. at 758.

¹⁵ *Quill*, 504 U.S. at 306-07.

¹⁶ *Bellas Hess*, 386 U.S. at 753-55.

¹⁷ *Id.* at 754.

The only contact that the taxpayer had with the state of Illinois was that "[t]wice a year catalogues [were] mailed to the company's active or recent customers throughout the [United States], including Illinois . . . supplemented by advertising 'flyers.'" ¹⁸ Despite this lack of contact, Illinois classified the taxpayer as "a 'retailer maintaining a place of business in [Illinois],'" causing it to be subject to the Illinois use tax. ¹⁹

The Illinois Supreme Court allowed the tax, splitting its analysis between the Commerce Clause and the Due Process Clause of the Fourteenth Amendment (focusing on whether "the exercise of in personam jurisdiction by the circuit court deprived [the taxpayer] of due process of [*710] law" since the taxpayer had minimal connections to the taxing state). ²⁰ In an opinion authored by Justice Stewart, however, the Supreme Court reversed, finding that the tax was unconstitutional because it violated both the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. ²¹ The Court determined that permitting a state to tax entities with no physical presence in that state presented an unconstitutional burden on interstate commerce, noting that "the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail." ²² It explained that "[t]he many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [the taxpayer's] interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a 'fair share of the cost of local government.'" ²³ Upon reflection, these justifications make logical sense: because it is nearly impossible for a business to keep track of every jurisdiction it sells products in, a physical presence test is, if nothing else, a product of simplification.

The Court never explicitly stated that it was creating a "physical presence test." Its holding that the outer limit of taxation would be a situation in which the taxpayer had "10 wholesalers, jobbers, or 'salesmen' conducting continuous local solicitation in [the taxing state]," combined with its emphasis on the taxpayer's lack of physical presence in Illinois, clearly indicated that the Court intended to establish a physical presence standard. ²⁴ The purpose of this test was consistent with the purpose of the Commerce Clause: "to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control." ²⁵ Permitting the states to impinge on this exclusive province undermines the Constitution and grants states greater taxing authority than the drafters of the Constitution ever intended.

B. Justice Stevens's Ambiguous Language in Quill

For twenty-five years, courts embraced the ruling in *Bellas Hess* that required a taxpayer to have physical presence in a state before it could be subject to taxation by that state. ²⁶ In 1992, the Supreme Court granted [*711]

¹⁸ *Id.*

¹⁹ *Id.* at 755.

²⁰ *Dep't of Revenue v. Nat'l Bellas Hess, Inc.*, 214 N.E.2d 755, 760-62 (Ill. 1966); U.S. Const. amend. XIV, § 1.

²¹ *Bellas Hess*, 386 U.S. at 760.

²² *Id.* at 758.

²³ *Id.* at 759-60 (citations omitted).

²⁴ *Id.* at 757-58.

²⁵ *Id.* at 760.

²⁶ See, e.g., *Ind.-Ky. Elec. Corp. v. Ind. Dep't of State Revenue*, 598 N.E.2d 647 (Ind. 1992) (analogizing connections made through electric wires to mail-order subscriptions in an income tax case); *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991) (ruling that a use tax was unconstitutional as applied due to lack of physical presence); *Evanston Ins. Co. v. Merin*, 598 F. Supp. 1290 (D. N.J. 1984) (holding that the physical presence test was satisfied by the taxpayers connections to the state in an income tax dispute); *Nat'l Liberty Life Ins. Co. v. State*, 215 N.W.2d 26 (Wis. 1974) (finding that there was sufficient physical presence to justify the imposition of a general revenue tax).

certiorari to a similar case, *Quill Corp. v. North Dakota*.²⁷ The facts in *Quill* were not entirely unlike those in *Bellas Hess*: The taxpayer was "an out-of- state mail-order house . . . [with] neither outlets nor sales representatives in the State."²⁸ The Rehnquist Court reversed the North Dakota Supreme Court. In an opinion authored by Justice Stevens, the Court upheld the physical presence requirement established in *Bellas Hess*.²⁹ The opinion, however, cast some doubt as to whether the physical presence requirement applied to all taxes or just sales and uses taxes. This confusion resulted from Justice Stevens's comment that:

[A]lthough in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes."³⁰

Because both *Bellas Hess* and *Quill* involved sales and use taxes, Justice Stevens's statement suggested the possibility that the physical presence requirement only existed for sales and use taxes.

Proponents of the elimination of the physical presence test argue that *Quill* overruled *Bellas Hess*, limiting the physical presence test to sales and use taxes.³¹ But Justice Stevens's opaque statement was dicta at best, since the Court ruled that the tax in question in *Quill* was unconstitutional due to the taxpayer's lack of physical presence.³² The Court's decision in *Quill* should not have represented a substantial departure in the law, as it merely reapplied the preexisting *Bellas Hess* standard. Because of the court's unclear language, however, various state courts since 1992 have interpreted *Quill* to overturn *Bellas Hess*, limiting the physical nexus standard to sales and use taxes.³³ The confusion among state courts as to what *Quill* means was recently displayed in *Revenue Cabinet v. Asworth Corp.*, where the Kentucky Court of Appeals stated that "the applicability of *Quill*'s physical presence [712] requirement to income tax cases, such as the matter before us, is unclear," then subsequently chose to invalidate the physical presence test.³⁴ The court's actions represent the chaos that courts face when interpreting *Quill*, which, while never actually changing the law, has cast doubt on the viability of the physical presence requirement in non-sales and use tax situations.

II. Examining the Commerce Clause

A. Development of the Dormant Commerce Clause

The Commerce Clause states that Congress shall have power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."³⁵ While the Due Process Clause of the Fourteenth Amendment is implicated when considering issues involving discrimination in interstate commerce, the Supreme Court in *Quill* focused primarily on the Commerce Clause, which is the focus of this Note.³⁶

²⁷ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

²⁸ *Id.* at 301.

²⁹ *Id.* at 317-19.

³⁰ *Id.* at 317.

³¹ See, e.g., *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13, 18 (S.C. 1993) ("It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus.").

³² See *Quill*, 504 U.S. at 317-19.

³³ *Supra* note 8.

³⁴ *Revenue Cabinet v. Asworth Corp.*, No. 2007-CA-002549-MR, 2009 Ky. App. LEXIS 229, at *11 (Ky. Ct. App. Nov. 20, 2009), cert. denied, 131 S. Ct. 1046 (2011).

³⁵ U.S. Const. art. 1, § 8, cl. 3.

³⁶ See *Quill*, 504 U.S. at 305.

On its face, the Commerce Clause does not involve state taxation at all. The provision itself is a federal constitutional phrase enumerating a power of the federal government. Records of the Constitutional Convention, however, indicate that the drafters of the Constitution intended for the Commerce Clause to limit state regulation of commerce.³⁷ The Supreme Court recognized the drafters' intentions in the landmark decision, *Gibbons v. Ogden*, where the Court held that:

In each of those proceedings [of the Constitutional Convention], it was clearly contemplated, that the individual States should at least retain the power of absolutely prohibiting the importation of any article they thought fit, within their own respective limits. How far was this intention subsequently departed from?

. . . [W]hen a State proceeds to regulate commerce with foreign nations, or among the several States, it is exercising the very power that is granted to Congress, and is doing the very thing which Congress is authorized to do.

. . . [T]hat a State might impose duties on exports and imports, if not expressly forbidden, will be conceded; but that it follows as a consequence, from this concession, that a State may regulate [*713] commerce with foreign nations and among the States, cannot be admitted.³⁸

Since its decision in *Gibbons*, the Supreme Court has emphasized the importance of preventing states from regulating interstate commerce. As it recently explained in *Department of Revenue v. Davis* (a case that, like *Asworth*, arose from the Kentucky Court of Appeals):

The Commerce Clause empowers Congress "to regulate Commerce . . . among the several States," and although its terms do not expressly restrain "the several States" in any way, we have sensed a negative implication in the provision since the early days. The modern law of what has come to be called the dormant Commerce Clause is driven by concern about "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." The point is to "effectuat[e] the Framers' purpose to 'prevent a State from retreating into . . . economic isolation.'"³⁹

As this opinion displays, the dormant Commerce Clause remains a valid doctrine, necessitating a bright-line test to protect its viability in the taxation context.

B. Eliminating the Physical Presence Test Endangers the Dormant Commerce Clause

Allowing a state to tax a corporation with no physical presence within the state allows that state to regulate interstate commerce. Judges that have declined to impose a physical presence requirement have typically supported their rejection of the test by arguing that a corporation receiving income from a state takes advantage of that state's laws, meaning that the corporation should be required to pay taxes on that benefit.⁴⁰ While this

³⁷ Martin, Statement at the Federal Constitutional Convention (June 19, 1787), in 2 *The Founders' Constitution* 483 (Philip B. Kurland & Ralph Lerner eds., 1987).

³⁸ *Gibbons v. Ogden*, 22 U.S. 1, 133-34, 199-201 (1824).

³⁹ *Dep't of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008) (alteration in original) (citations omitted).

⁴⁰ See, e.g., *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13, 16 (S.C. 1993) ("By electing to license its trademarks and trade names for use by Toys R Us in many states, Geoffrey contemplated and purposefully sought the benefit of economic contact with those states. Geoffrey has been aware of, consented to, and benefitted from Toys R Us's use of Geoffrey's intangibles in South Carolina. Moreover, Geoffrey had the ability to control its contact with South Carolina by prohibiting the use of its intangibles here as it did with other states.").

argument may be tempting, it ignores a critical underlying fact: Corporations are already required to pay income taxes in their home state. ⁴¹

The question might be raised: Why is physical presence the only test that satisfies the Commerce Clause? Admittedly, other tests could potentially [*714] satisfy constitutional standards. The pragmatism of physical presence, however, makes it a logical choice. It avoids the pitfalls of a minimum contacts test because courts are not forced to answer, and parties are not forced to guess, what constitutes "minimum contacts." And proponents of the elimination of the physical presence test are curiously silent when given the possibility to provide a practical and logical test that would satisfy the Commerce Clause—the absence of logical alternatives makes physical presence the only reasonable option.

Stating the obvious, if a corporation is not physically located in one specific state, it will be located in a different state. This simple logical inference opens the door to yet another problem with eliminating physical presence: to tax a corporation on the same income in one state (its state of location) as well as a state in which it has no physical presence opens the door for double taxation. As tax scholars have noted, "the principle that the Commerce Clause requires states to avoid double taxation by apportioning the tax obligations of actors in interstate commerce has, as a theoretical matter, proved relatively uncontroversial. . . . On a visceral level, double taxation is a bad thing." ⁴² The purpose of the Commerce Clause is to leave interstate commercial regulation in the hands of the United States Congress; the physical presence rule strengthens this principle by restricting states' taxing authority to entities that are present within the state. The Supreme Court itself admits that the dormant Commerce Clause doctrine has weakened from the drafters' intentions. ⁴³ It is time that the Court draws a clear line to strengthen a principle that was essential to the drafters of the Constitution: the ability of the federal government, and not state governments, to regulate interstate commerce. ⁴⁴ And it is obvious [*715] after reviewing the Constitution and case law interpreting it that this line must be physical presence.

C. Getting (a Little Bit) Physical

Once it is established that some measure of physical presence is required to subject an out-of-state corporation to state taxes, the logical follow-up question is how much physical presence is required. Unsurprisingly, given the state of ambiguity in the law, the Supreme Court has not established a bright-line test that states exactly how much physical presence is required to satisfy the dormant Commerce Clause; however, piecing together the Court's language in *Bellas Hess* and *Quill* along with various lower court decisions gives some indication as to what the test might be.

The first place to look to determine what degree of physical presence the Commerce Clause mandates is the Supreme Court's original *Bellas Hess* opinion. In *Bellas Hess*, the Court found that interactions with a state through

⁴¹ See, e.g., Ky. Rev. Stat. Ann. § 141.040 (West 2010), which provides that (1) Every corporation doing business in this state, except those corporations listed in [KRS 141.040(1)(a) through (i)], shall pay for each taxable year a tax . . . on taxable net income (6) For taxable years beginning on or after January 1, 2007, the following rates shall apply: (a) Four percent (4%) of the first fifty thousand dollars (\$ 50,000) of taxable net income; (b) Five percent (5%) of taxable net income over fifty thousand dollars (\$ 50,000) up to one hundred thousand dollars (\$ 100,000); and (c) Six percent (6%) of taxable net income over one hundred thousand dollars (\$ 100,000). Clearly, a corporation would be "doing business" in Kentucky if it operated or distributed out of Kentucky.

⁴² Edward A. Zelinsky, *Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause*, 28 Va. Tax Rev. 1, 31 (2008) (emphasis added).

⁴³ See Gregory R. Evans, Comment, *Separate But Taxed: A Rejection of the Streamlined Sales Tax Project Through a Commerce Clause and Federalist Analysis*, 56 Am. U. L. Rev. 421, 441 ("The Court itself has admitted that the strength of the dormant Commerce Clause, however, has vacillated during the Court's history." (citing *Okla. Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 180 (1995))).

⁴⁴ Martin, *supra* note 37.

"the United States mail or a common carrier" did not qualify as physical presence.⁴⁵ The Court indicated that some examples of physical presence would be the operation of a physical plant,⁴⁶ presence of company of employees in the state,⁴⁷ the ownership of tangible property in the state,⁴⁸ or the presence of distinct intangibles, such as a state phone number listing or directed advertising through state media outlets.⁴⁹

Examining all of the various examples of what does satisfy physical presence indicates that it is a lenient standard. For example, state courts have acknowledged that "[w]hile a physical presence is required . . . it need not be substantial."⁵⁰ The presence of an employee within a state is almost assuredly enough to satisfy the physical presence test,⁵¹ potentially even if [*716] that employee is merely a "part-time independent contractor-salesman."⁵² Likewise, the physical transportation of goods by a company generally constitutes physical presence within the state to which the company delivers.⁵³ Physical presence, on the other hand, does not exist in situations where a corporation maintains only an intangible presence within a state, such as mailing solicitations to customers within the state.⁵⁴ These decisions indicate that if a corporation maintains any physical presence within a state, however miniscule that presence is, it will be subject to that state's taxes. While this is a rather lenient standard, however, the "bright-line regime that [physical presence] establishes is unqualifiedly in its favor" because it is the only standard that can satisfy the Commerce Clause.⁵⁵

III. Neither Courts nor Legislatures Agree What Quill Actually Means

Courts have interpreted Quill in one of two ways: Quill either (1) reaffirms *Bellas Hess*⁵⁶ or (2) obliterates it.⁵⁷ Several courts have interpreted Quill to uphold *Bellas Hess*, imposing a physical nexus requirement on all types of out-of-state taxation. For example, the Tennessee Court of Appeals' opinion in *J.C. Penney National Bank v. Johnson* clearly and explicitly rejected the argument that the physical presence requirement is limited to sales and

⁴⁵ *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 754 (1967).

⁴⁶ *Id.* ("[National] does not maintain in Illinois any office, distribution house, sales house, warehouse, or any other place of business." (alteration in original)).

⁴⁷ *Id.* ("[National] does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells.").

⁴⁸ *Id.* ("[National] does not own any tangible property, real or personal, in Illinois.").

⁴⁹ *Id.* ("[National] has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois.").

⁵⁰ See *Magnetek Controls, Inc. v. Revenue Div., Dep't of Treasury*, 562 N.W.2d 219, 223 (Mich. Ct. App. 1997) (alteration in original) (quoting *In re Orvis Co. v. Tax Appeals Tribunal*, 654 N.E.2d 954, 960-61 (N.Y. 1995)).

⁵¹ See, e.g., *Gillette Co. v. Dep't of Treasury*, 497 N.W.2d 595, 600 (Mich. Ct. App. 1993) (finding that employing a workforce in the state establishes sufficient physical presence to impose a "single business" tax); *Telebright Corp. v. Dir., Div. of Taxation*, 25 N.J. Tax 333, 350-51 (N.J. Tax Ct. 2010) (holding that a single employee doing business within the state satisfies the Commerce Clause); *Galland Henning Nopak, Inc. v. Combs*, 317 S.W.3d 841, 844-46 (Tex. App. 2010) (finding that a single employee's activities were sufficient physical presence to satisfy Quill).

⁵² *J.W. Hobbs Corp. v. Revenue Div., Dep't of Treasury*, 706 N.W.2d 460, 468 (Mich. Ct. App. 2005) (remanding to the trial court to determine if such an employee would cause a corporation to have physical presence).

⁵³ See *Saudi Ref., Inc. v. Dir. of Revenue*, 715 A.2d 89, 96-97 (Del. Super. Ct. 1998).

⁵⁴ See *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 839-42 (Tenn. Ct. App. 1999).

⁵⁵ *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concurring) (citation omitted) (internal quotation marks omitted).

⁵⁶ *Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349, 376 (Mich. Ct. App. 1993); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 298-300 (Tex. App. 2000).

⁵⁷ *Supra* note 8.

use taxes.⁵⁸ In *J.C. Penney*, the state of Tennessee imposed a franchise tax on a bank that had no physical presence within Tennessee. Tennessee taxed the bank because it had performed marketing services aimed at causing Tennessee customers to sign up for the bank's credit card. Explaining the delineation between the Due Process Clause and the Commerce Clause, the court explained that, while the Due Process Clause does not necessarily require physical presence, the Commerce Clause does.⁵⁹ Interpreting *Quill*,⁶⁰ the court explained that:

[T]o satisfy the Commerce Clause, [presence must] be more than merely "doing business" in the State of Tennessee. . . . Both [*717] *Bellas Hess* and *Quill* are clear in their holding that in the context of a use tax, physical presence is required in order to satisfy the substantial nexus requirement. . . . While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case. In fact, the Commissioner is unable to provide any authority as to why the analysis should be different for franchise and excise taxes.⁶¹

Several states, including Texas and Michigan, have agreed with Tennessee and have limited state taxes to entities with a physical presence within the state.⁶² A majority of courts, however, have chosen to ignore the Court's language in *Bellas Hess*, interpreting *Quill* as opening the door for taxation of all non-sales and use taxes, regardless of an entity's physical presence in the state.⁶³

A. The Kentucky Court of Appeals' Misguided Attempt at Interpretation

The Kentucky Court of Appeals most recently addressed the physical presence standard *Revenue Cabinet v. Asworth, Corp.*, where the court concluded that *Quill* overruled *Bellas Hess* and eliminated the physical presence requirement.⁶⁴ In *Asworth*, the plaintiff had filed Kentucky corporate income tax returns despite the fact that it lacked a physical presence in Kentucky.⁶⁵ *Asworth* did however own a ninety-nine percent share of the tobacco company *Conwood Company, LP*, which operated in Kentucky.⁶⁶ *Asworth* argued that the taxes it paid should be refunded [*718] because *Asworth's* only presence within Kentucky was an investment in a partnership that it did not control or manage.⁶⁷

⁵⁸ *J.C. Penney Nat'l Bank*, 19 S.W.3d at 839.

⁵⁹ *Id.* at 836-37.

⁶⁰ In *Quill*, the court emphasized that the lack of a physical presence requirement for Due Process analysis does not affect the physical presence requirement for Commerce Clause analysis. See *Quill Corp.*, 504 U.S. at 305-06. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes 'undue.' But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones. *Id.* (quoting *Int'l Harvester Co. v. Dep't of Treasury of Ind.*, 322 U.S. 340, 353 (1944)).

⁶¹ *J.C. Penney Nat'l Bank*, 19 S.W.3d at 839.

⁶² See *Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349, 377-79 (Mich. Ct. App. 1993); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 300 (Tex. App. 2000).

⁶³ See *supra* note 8.

⁶⁴ *Revenue Cabinet v. Asworth Corp.*, No. 2007-CA-002549-MR, 2009 Ky. App. LEXIS 229 (Ky. Ct. App. Nov. 20, 2009), cert. denied, 131 S. Ct. 1046 (2011).

⁶⁵ *Id.* at *2, *4-5.

⁶⁶ *Id.* at *2-3.

⁶⁷ *Id.* at *7.

In evaluating whether Asworth had a sufficient nexus to be taxed under Kentucky law, the court noted the vagueness of the Quill opinion, stating that:

In addressing the sales and use taxes at issue in Quill, the Supreme Court reaffirmed its previous bright-line rule that "a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause." However, the Supreme Court recognized that it had not articulated the same physical-presence requirement in reviewing other types of taxes. Thus, the applicability of Quill's physical presence requirement to income tax cases, such as the matter before us, is unclear.⁶⁸

Despite recognizing the lack of clarity in the law, the court concluded that Asworth's presence in Kentucky was one satisfying the Commerce Clause, stating that "even if a substantial nexus requires a physical presence in Kentucky, for the reasons stated hereafter, we hold that [Asworth] in fact [has] such a nexus."⁶⁹ The court, however, was unable to find any physical presence, ultimately establishing Asworth's nexus with Kentucky as being based on the fact that:

[W]hile the Corporations do no business in Kentucky, at various times they have owned up to a 99% limited and/or general partnership interest in, and have received distributive shares of partnership income from the profits of, a partnership which does business in Kentucky. Such a partnership unquestionably has received protection and benefits from Kentucky, thereby enabling the distribution of income to the Corporations. We hold that this connection gives rise to a substantial nexus with, and/or a physical presence within, Kentucky.⁷⁰

The problem with this application is that ownership of a partnership interest does not constitute physical presence in any way—as the Supreme Court said in *Bellas Hess*, an example of "the furthest constitutional reach" of a state's power to tax out-of-state entities is one where at least some representatives of the taxpayer physically enter the state.⁷¹ Merely owning a share of a partnership within a state clearly falls short of this physical presence standard.⁷²

It is one thing for a lower court to establish law when the Supreme Court has left an issue unstated; it is quite another for a lower court to [*719] be left guessing as to what the Supreme Court meant when it issued an opinion. Yet, the Kentucky Court of Appeals admitted to guessing the intent of Congress, stating that "the applicability of Quill's physical presence requirement . . . is unclear."⁷³ It is not enough for courts to play guessing games to determine what the Supreme Court intended, but this is exactly what the court did in *Asworth*. And the court's lone foundation for upholding the tax on *Asworth*—that *Asworth* had taken advantage of Kentucky's laws and protections—fails when extrapolated to other situations arising as technology increases and furthers corporations' out-of-state reach.⁷⁴

⁶⁸ *Id.* at *11 (emphasis added) (citations omitted).

⁶⁹ *Id.* at *11-12.

⁷⁰ *Id.* at *12.

⁷¹ *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 757- 58 (1967).

⁷² *Id.* While it is true that a ninety-nine percent share in a corporation is clearly greater than a single share, this does not change the fact that the court has established a physical presence requirement. The justification of the physical presence requirement - to prevent states from over-reaching by establishing a bright- line standard - exists, regardless of the degree of ownership (whether one share or ninety-nine percent) maintained in a corporation.

⁷³ *Asworth Corp.*, 2009 Ky. App. LEXIS 229, at *11 (emphasis added).

⁷⁴ See *infra* Part IV.A (explaining why the mere fact that a corporation has a connection to a state is entirely insufficient to conclude that the corporation is protected by the state's laws).

Removing the physical presence requirement from taxation leaves taxpayers with a test that is analogous to the "minimum contacts" test for personal jurisdiction. ⁷⁵ This test is problematic because scholars have long criticized application of the minimum contacts test in the personal jurisdiction context for its "ambiguity and incoherence." ⁷⁶ This problem magnifies when applied to Internet corporations; as technology evolves and more corporations adopt an Internet presence, scholars increasingly emphasize the importance of physical presence in the personal jurisdiction context. ⁷⁷ In other words, as legal scholars embrace physical presence in other contexts due to the clarity it provides, courts are moving farther away from physical presence in taxation settings. It is simply inexcusable for courts to be left in such a state of confusion, but it is an even bigger problem that these confused courts are creating unconstitutional precedents that will cause conflicts for decades in the absence of Supreme Court guidance.

B. Case Closed . . . Or Not

At least one commentator has remarked that the Supreme Court's denial of certiorari thus far regarding the physical presence test signifies that the Court will likely review the physical presence requirement in the future. ⁷⁸ [*720] One could argue that the Court's denial to resolve the issue indicates that the state of the law is becoming clearer and that certiorari is not required. When recent judicial opinions are examined, however, it is impossible to avoid the fact that courts have consistently demonstrated confusion as to the appropriate standard. A comparison of two recent opinions filed within days of each other exemplifies this point.

On December 22, 2010, the Virginia Deputy Tax Commissioner issued a ruling suggesting that physical presence was a key (and perhaps mandatory) element in determining whether an out-of-state corporation could be subjected to Virginia state income tax. ⁷⁹ The taxpayer in question was a parent corporation of four subsidiaries - it had "no property or payroll in Virginia," and its only connection to the state was that it "own[ed] and manage[d] certain intangible assets (trademarks, patents, manufacturing know-how, and other intellectual property)" used in the state. ⁸⁰

The Tax Commissioner ruled that there was insufficient nexus for the state to tax the corporation. It first cited *Geoffrey, Inc. v. South Carolina Tax Commission*, ⁸¹ noting that in South Carolina, an intangible holding corporation can have sufficient nexus taxation "through the licensing of intangible property within the state." ⁸² The ruling, however, contrasted this decision with Virginia law, stating that "[e]ven if the Taxpayer's intangible assets were to establish nexus with Virginia, the facts provided raise the question as to whether the Taxpayer would have any Virginia source income. The Taxpayer has no property or payroll in Virginia." ⁸³ While the ruling stopped short

⁷⁵ See supra note 42.

⁷⁶ See Kevin C. McMunigal, *Desert, Utility, and Minimum Contacts: Toward a Mixed Theory of Personal Jurisdiction*, 108 Yale L.J. 189, 189 (1998) (noting that "[a]mbiguity and incoherence have plagued the minimum contacts test for the more than five decades during which it has served as a cornerstone of the Supreme Court's personal jurisdiction doctrine").

⁷⁷ See Tricia Leigh Gray, *Minimum Contacts in Cyberspace: The Classic Jurisdiction Analysis in a New Setting*, 1 J. High Tech. L. 85, 88-89 (2002).

⁷⁸ See Robert Willens, *Iowa Supreme Court Disputes Need for 'Physical Presence,' Bureau Nat'l Aff., Tax & Acct. Ctr.* (Nov. 7, 2011), http://taxandaccounting.bna.com/btac/display/batch_print_display.adp (search "Robert Willens"; then follow "Iowa Supreme Court Disputes Need for 'Physical Presence'" hyperlink) (discussing the Iowa Supreme Court's controversial decision to eliminate the physical presence test in *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308 (Iowa 2010), and the Supreme Court's denial of certiorari).

⁷⁹ Tax Comm'r Rul. 10-279, at *2 (Va. Dec. 22, 2010).

⁸⁰ *Id.* at *1.

⁸¹ *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993).

⁸² Tax Comm'r Rul. 10-279, at *3-4 (Va. Dec. 22, 2010).

⁸³ *Id.* at *4.

of explicitly requiring physical presence, the fact that the court cited Geoffrey as a contradictory case and ruled in favor of the taxpayer suggests that the ruling intended a physical presence requirement.

While the Virginia Tax Commission Ruling implied that physical presence may be required, but stopped short of actually saying so, the Washington Supreme Court's ruling in *Lamtec Corp. v. Dep't of Revenue*, two weeks later, did the exact opposite: It implied that physical presence is probably not required, yet went on to apply a physical presence analysis.⁸⁴ In *Lamtec*, the taxpayer was a New Jersey corporation appealing the enforcement of a Washington business and occupation tax.⁸⁵ The taxpayer [*721] had no offices, addresses, phone numbers, or employees in Washington, but it sent representatives to Washington "[a]bout two or three times a year."⁸⁶

The court suggested that it believed *Quill* did not require physical presence, stating that "[the Supreme Court] has not held that an established sales force (or a physical presence) is a requirement to establish the requisite nexus [for taxation]."⁸⁷ It noted that "the United States Supreme Court itself has cast some doubt on the reach of the physical presence test it established in the sales and use context"⁸⁸ and that "[t]here is also extensive language in *Quill* that suggests the physical presence requirement should be restricted to sales and use taxes."⁸⁹ Despite its clear belief that physical presence was not required, the court nevertheless felt the necessity to conduct a physical presence analysis, ultimately concluding the taxpayer's "practice of sending sales representatives to meet with its customers within Washington" was sufficient to expose them to state taxation.⁹⁰

Two differing opinions were issued within one month of each other involving physical presence. In one, a Tax Commissioner acknowledged that physical presence was a major element, without explicitly establishing it as the mandatory test,⁹¹ and in the other, a state Supreme Court noted that physical presence probably was not required, but felt it necessary to conduct a physical presence analysis anyway.⁹² To put it simply: courts are confused. Courts feel unable to issue definite rulings and are applying tests that may or may not be required by the Constitution. Guidance by the Supreme Court is more than needed - it is necessary.

C. Send in the Legislators

Of course, without legislation enabling unconstitutional taxation, there would not be an issue of judicial interpretation. The Supreme Court has stated that the goal of its judicial decisions is consistency, noting that "[i]n reviewing Commerce Clause challenges to state taxes, our goal has . . . been to 'establish a consistent and rational method of inquiry' focusing on the 'practical effect of a challenged tax.'"⁹³ The Court has partially met its goal: since *Quill*, state legislatures have been consistently confused.

Since *Quill*, an interesting trend has emerged that further emphasizes this point. At the time of the Supreme Court's ruling on *Quill*, thirty-six states (seventy-two percent) had tax laws that allowed states to tax out- [*722] of-state entities with no physical presence.⁹⁴ After *Quill* one of two things should have happened: (1) *Quill*'s reaffirmation

⁸⁴ See *Lamtec v. Dep't of Revenue*, 246 P.3d 788, 792-95 (Wash. 2011).

⁸⁵ *Id.* at 790.

⁸⁶ *Id.*

⁸⁷ *Id.* at 792.

⁸⁸ *Id.* at 793.

⁸⁹ *Id.* at 794.

⁹⁰ *Id.* at 795.

⁹¹ See Tax Comm'r Rul. 10-279, at *2-3 (Va. Dec. 22, 2010).

⁹² See *Lamtec*, 246 P.3d at 792-95.

⁹³ *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981).

⁹⁴ Laura A. Kulwicki, *State Taxation of Mail Order Sellers: An End to the Nexus Wars?*, 1 St. Tax Notes 332, 332 (1991).

of the physical presence test should have superseded these statutes, making them unenforceable; or (2) the remaining fourteen states should have expanded their own legislation to allow for taxation. Surprisingly (or perhaps unsurprisingly, given the ambiguous nature of Quill), neither of these occurred.

Instead, state legislation in the wake of Quill remains largely the same. In 2010, according to a survey conducted by the Bureau of National Affairs,⁹⁵ twenty-five states did not base their state nexus policy on physical presence,⁹⁶ fourteen states (plus the District of Columbia) based their state nexus policy on physical presence,⁹⁷ one state answered "depends,"⁹⁸ and ten states did not respond or did not participate in the survey.⁹⁹ This shows that, since 1992 (when the Supreme Court decided Quill), between fifty percent¹⁰⁰ and seventy percent¹⁰¹ of the states still do not require physical presence and at least thirty percent of the states still do. This raises the question: why?

Why would a state not tax an entity to the fullest extent allowed by law? The answer is obvious: no one can say with any definiteness what the full extent of the law actually is.

IV. The Evolution of Technology and the Increasing Need for a Bright-Line Test

The problem with eliminating the physical presence requirement for taxation becomes clearer when considering the increasing capabilities of modern technology. Parties on both sides of the nexus argument will agree that some nexus requirement exists, whether it is physical presence or some lower standard. But if physical nexus is no longer required and there [723] is no bright-line test, the ambiguity opens the door for state taxation of companies for the purchase of self-soliciting items, a threat that is alarming.

A. The Amazon Kindle: A Paradigmatic Example of the Need for Legal Clarity¹⁰²

It is no secret that Internet sales are dominating the economic landscape. The convenience provided by Internet transactions combined with the technological capabilities that companies are developing suggests that Internet-ready devices will be around for the foreseeable future. Take, for example, Amazon's popular Kindle e-reader device. A consumer using a Kindle is free to order as many or as few books as they desire; there is no quota and, essentially, no restrictions as to what a consumer may purchase. When powered on, a Kindle displays a screen with a list of books and applications owned by the user; there are no advertisements, and a separate "store" must be entered before a consumer can purchase a book. In the store, there is a small area where "recommended books" are listed, but there are no pop-up advertisements, and the only books listed are ones that are consistent

⁹⁵ Tax Mgmt., Bureau Nat'l Affairs, 2010 Survey of State Tax Departments (George R. Farrah et al. eds., 2010).

⁹⁶ Those states were Arizona, Arkansas, Colorado, Connecticut, Idaho, Illinois, Iowa, Kentucky, Maine, Maryland, Minnesota, Missouri, Montana, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Rhode Island, South Carolina, Utah, Vermont, Virginia, and West Virginia. *Id.* at S-20 to S-21.

⁹⁷ Those states were Delaware, District of Columbia, Florida, Hawaii, Indiana, Louisiana, Massachusetts, Michigan, Nebraska, New Mexico, Oklahoma, Pennsylvania, Tennessee, Texas, and Wisconsin. *Id.*

⁹⁸ That state was New York; although, notably, New York City (which answered separately) answered that it did require physical presence. *Id.* at S-21.

⁹⁹ Those states were Alabama, Alaska, California, Georgia, Kansas, Mississippi, Nevada, South Dakota, Washington, and Wyoming. *Id.* at S-20 to -21.

¹⁰⁰ This assumes that none of the non-responsive states required physical presence.

¹⁰¹ This assumes that all of the non-responsive states required physical presence.

¹⁰² The author relies predominantly his own personal experience with the Amazon Kindle throughout this section. The details of how a Kindle works can be found in the Kindle's user manual. Amazon, Kindle User's Guide, [http://s3.amazonaws.com/kindle/Kindle User Guide.pdf](http://s3.amazonaws.com/kindle/Kindle%20User%20Guide.pdf) (last visited Mar. 4, 2012). Additionally, this analysis assumes for the sake of argument that Amazon has no physical presence in at least some states; the author acknowledges, however, that due to the nature of Amazon's sales model, which involves extensive shipping and distribution centers, such a state may not exist.

with the buyer's purchasing history. In a world full of advertising, Amazon seems uniquely eager to let the consumer order only that in which he is actively interested, avoiding constant solicitation and advertisements. Yet, if the physical presence requirement is eliminated, Amazon could (and would) be subject to out-of-state income tax (in addition to Washington state income tax, where it resides) on every purchase made in the Kindle store. Is this fair?

Proponents of the elimination of the physical presence requirement would argue that it is fair because Amazon is availing itself of the law in which a purchaser lives - that it is, essentially, contracting within a state. This argument's errors become glaring when examined. Kindle could function without any advertisements, leaving the Internet connection that consumers use to purchase the books as the only connection between Amazon and the consumers.¹⁰³ If Amazon does not advertise within a state and does not have a physical presence within a state, it would be unfair to subject Amazon to the state's income taxes because it opens the door for double- (or even triple-) taxation. Even the argument that the purchasers [*724] avail themselves of a state's laws by making a purchase within the state fails: Kindle users who purchase their Kindles from Amazon's website agree to be bound by Washington state law.¹⁰⁴ Disregarding the physical presence test, however, a state would be able to collect income taxes from Amazon for every book purchased in the Kindle store as long as the purchase originated from the taxing state. Kindle is one of countless examples of popular devices that allow for the online purchase of separate items without the business's solicitation or advertisements, while offering no protection to the consumer under the consumer's resident state law (other devices and services such as Apple's popular iTunes store¹⁰⁵ and Motorola's Android application store¹⁰⁶ use forum limitation clauses similar to Amazon's).

Proponents of eliminating the physical presence requirement may argue that even the limited amount of advertising provided by devices such as the Kindle should expose corporations to state taxation. If limited advertising within a state alone can establish essential nexus, where should courts draw the line? Is a single advertisement within a state enough to open the door to taxation? What about a single flyer? If the physical presence test is abandoned and replaced with an obscure balancing test that no person-and certainly not state courts, who are already in conflict over the presence of a bright-line rule-can resolve with any consistency, the potential for corporate tax liability will be endless. The need for a bright- line, irrefutable test is clear: whether the Supreme Court chooses to adopt a physical presence test or a different test, the current ambiguity of the law is [*725] inexcusable and will continue to cause confusion as technological abilities advance even further.

B. The Main Street Fairness Act

¹⁰³ Even this connection is tenuous because, with the expansion of networking capacity, a consumer living at a state's border could theoretically connect to the Internet using an out-of-state connection.

¹⁰⁴ Amazon.com Help: Conditions of Use, Amazon.com, http://www.amazon.com/gp/help/customer/display.html/ref=footer_cou?ie=UTF8&nodeId=508088 (last updated Aug. 19, 2011) ("By visiting Amazon.com, you agree that the Federal Arbitration Act, applicable federal law, and the laws of the state of Washington, without regard to principles of conflict of laws, will govern these Conditions of Use and any dispute of any sort that might arise between you and Amazon.").

¹⁰⁵ iTunes Store Terms and Conditions, Apple, <http://www.apple.com/legal/itunes/us/terms.html#SALE> (last visited Jan. 3, 2012) ("The iTunes Service is operated by Apple from its offices in the United States. You agree to comply with all local, state, federal, and national laws, statutes, ordinances, and regulations that apply to your use of the iTunes Service. All transactions on the iTunes Service are governed by California law, without giving effect to its conflict of law provisions. Your use of the iTunes Service may also be subject to other laws. You expressly agree that exclusive jurisdiction for any claim or dispute with Apple or relating in any way to your use of the iTunes Service resides in the courts in the State of California. Risk of loss and title for all electronically delivered transactions pass to the purchaser in California upon electronic transmission to the recipient. No Apple employee or agent has the authority to vary this Agreement.").

¹⁰⁶ Site Terms of Service, Android, <http://www.android.com/terms.html> (last updated Apr. 16, 2007) (on file with author) ("The Terms, and your relationship with Google under the Terms, shall be governed by the laws of the State of California without regard to its conflict of laws provisions. You and Google agree to submit to the exclusive jurisdiction of the courts located within the county of Santa Clara, California to resolve any legal matter arising from the Terms. Notwithstanding this, you agree that Google shall still be allowed to apply for injunctive remedies (or an equivalent type of urgent legal relief) in any jurisdiction.").

The constitutionality of out-of-state taxation is more relevant today than ever before due to the massive Internet retail market. In 2010, there was an estimated \$ 165.4 billion of retail sales generated from the Internet alone.¹⁰⁷ While Internet sales transactions have historically not been subject to taxation, the trend may be changing. In *Amazon.com LLC v. New York State Department of Taxation and Finance*, plaintiff Amazon, a nationwide retail distributor, sued the state of New York after being taxed on its sales within the state.¹⁰⁸ Citing *Quill*, Amazon argued that it could not be subject to a New York state tax because it lacked a substantial nexus with the state of New York.¹⁰⁹ The court skirted the issue of whether physical presence is required; instead, it held that Amazon had physical presence within New York, noting that:

Amazon contracts with thousands of associates that provided it with a New York address.

...

Amazon chooses to benefit from New York associates that are free to target New Yorkers and encourage Amazon sales, all the while earning money for Amazon in return for which Amazon pays them commissions. Amazon does not discourage its associates from reaching out to customers or contributors and pressing Amazon sales.¹¹⁰

While failing to directly address the issue of essential nexus, Amazon raises an interesting, and constitutionally troubling question: can a state impose a tax requirement on an out-of-state business merely because the business sells to customers within the state? As discussed above, if *Quill* is read to negate the physical presence requirement of out-of-state taxation, the answer is almost certainly yes.

Indeed, legislators are already attempting to banish the physical presence requirement, even for sales and use taxes. Twenty-four states have already enacted statutes that "require tax payments for online transactions."¹¹¹ A recently proposed House Bill known as "The Main Street Fairness Act" [*726] seeks to extend such legislation to all states, allowing states "to require all sellers not qualifying for the small seller exception to collect and remit sales and use taxes with respect to remote sales sourced to that Member State under the Agreement."¹¹² Application of the bill would allow states to charge sales and use taxes on out-of-state businesses for sales made to in-state customers, even if the business has no physical presence within the states.

While the Commerce Clause would potentially allow legislation such as The Main Street Fairness Act to be enacted by Congress, it would specifically prevent states from implementing such legislation in the absence of a federal enabling statute. State legislatures have no authority to invoke taxes (sales, use, or otherwise) on an out-of-state entity with no physical presence - such a tax would be unconstitutional under both *Bellas Hess* and *Quill*.¹¹³ Additionally, as Congressman Paul W. Hodges (discussing The Main Street Fairness Act) recently stated, state taxation of Internet sales would be "burdensome," negating the effects the Internet has had to "further job creation and innovation."¹¹⁴

¹⁰⁷ U.S. Census Bureau, U.S. Dep't Commerce, Quarterly Retail E-Commerce Sales 4th Quarter 2010 (2011), available at http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf.

¹⁰⁸ *Amazon.com LLC v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842, 846 (N.Y. Sup. Ct. 2009).

¹⁰⁹ *Id.* at 849.

¹¹⁰ *Id.*

¹¹¹ Courtney Rubin, *Is an Internet Sales Tax Coming Soon?*, Inc.com, July 30, 2010, <http://www.inc.com/news/articles/2010/07/bill-would-allow-Internet-sales-tax.html>.

¹¹² H.R. 5660, 111th Cong. (2d Sess. 2010).

¹¹³ *Gibbons v. Ogden*, 22 U.S. 1, 199-200 (1824).

¹¹⁴ Rubin, *supra* note 112.

Even though isolated legislators have attempted to overrule the physical presence requirement in the past,¹¹⁵ Congress has chosen to retain the physical presence test for one significant reason: it makes sense. Entities that sell over the Internet still pay taxes on those sales, in the form of state income tax in the state in which they are located. To allow other states to impose a tax opens the door to double taxation, greatly inhibiting retail businesses in the midst of a severe recession. Allowing these taxes could prove detrimental to the country's recovery, causing businesses to declare bankruptcy and ultimately causing a larger negative impact on the states than the positive benefits the taxes would otherwise create.

Conclusion

The Supreme Court was clear in *Bellas Hess* that states cannot constitutionally impose a tax on an out-of-state entity that has no physical presence within the state.¹¹⁶ Since the Court's decision in *Quill*, state legislators and courts have been in a state of confusion, making certiorari necessary to clarify the state of the law. The Asworth opinion, in which the Kentucky Court of Appeals essentially admitted to guessing what the Supreme Court intended, demonstrates the alarming lack of clarity [*727] that courts currently feel in interpreting what constitutes permissible taxation.¹¹⁷ Although the Supreme Court has established a test, the courts and legislatures are confused as to the applicability of the test. Thus, it is essential that the Court grant certiorari to resolve the issue.

When the Court does grant certiorari to clarify the essential nexus for out-of-state taxation, the test that the Court should apply is obvious: it is the same test it has applied for thirty-four years, since its decision in *Bellas Hess*. The reasons for requiring physical presence are clear: first, and most importantly, the Commerce Clause requires such a test.¹¹⁸ For nearly 200 years, the Supreme Court of the United States has interpreted the Commerce Clause to restrict states from regulating commerce between the states.¹¹⁹ To allow a state to impose a tax on a corporation with no connection to the taxing state, merely because the corporation has customers ordering from within the state, allows states to regulate the flow of interstate commerce and imposes an unconstitutional burden on out-of-state corporations.

Additionally, the physical presence test is required to establish a bright-line rule for courts to apply in the future. The "minimum contacts" test for personal jurisdiction is insufficient to provide courts with sufficient guidance for when taxation is appropriate. As technology develops and corporations find new ways to market and sell to customers, the need for clarity in the law will grow. The Court can, and should, take this opportunity to clarify the essential nexus standard to avoid endless future lawsuits.

The current state of the law is unclear. Neither courts nor legislatures know what to do because several cases have obscured the line establishing what is and is not unconstitutional taxation. It is time for the Court to grant certiorari and reaffirm the validity of the physical presence test for out-of-state taxation.

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¹¹⁵ See H.R. 2230, 101st Cong. (1st Sess. 1989); S. 480, 101st Cong. (1989); S. 2368, 100th Cong. (1988); H.R. 3521, 100th Cong. (1987); S. 1099, 100th Cong. (1987); H.R. 3549, 99th Cong. (1985); S. 983, 96th Cong. (1979); S. 282, 93d Cong. (1973).

¹¹⁶ *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 758 (1967).

¹¹⁷ *Revenue Cabinet v. Asworth Corp.*, No. 2007-CA-002549-MR, 2009 Ky. App. LEXIS 229, at *11 (Ky. Ct. App. Nov. 20, 2009), cert. denied, 131 S. Ct. 1046 (2011).

¹¹⁸ U.S. Const. art. 1, § 8, cl. 3.

¹¹⁹ *Gibbons v. Ogden*, 22 U.S. 1, 199-201 (1824).