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Separate but Taxed: A Rejection of the Steamlined Sales Tax Project through a Commerce Clause and Federalist Analysis

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Abstract

Sales and use taxes, which are levied by forty-five states, have long been an important source of revenue for state and local governments. The rigid structure of these long-standing taxes, however, has been strained by the rapid evolution of the online economy. As a result, the Multistate Tax Commission ("MTC") devised a plan, the Streamlined State Sales Tax Project ("STP"), to recapture some of the revenue that state and local governments might otherwise lose as consumer purchases migrate from local retailers to online sellers. This plan, approved reciprocally by the states, but not by Congress, was designed by state legislators to comply with legal guidelines articulated by the Supreme Court. This Comment argues, however, that if a foreign merchant challenges these laws, the STP would be declared unconstitutional based on a modern understanding of the Commerce Clause and a structural, federalist reasoning. Part I discusses the evolution of sales and use taxes and their importance to state and local governments. Part II discusses the rising tension between the structure of sales and use taxes and the structure of the American economy. Part II also documents the STP—the states' recent response to this tension—and explains the STP's legal underpinnings. Part III analyzes the potential legal challenges the STP would face from a foreign merchant and concludes that while it is likely constitutional on due process grounds, the STP is unconstitutional under the Commerce Clause based on stare decisis and federalist reasoning.

Keywords

Sales and use tax, Commerce Clause, Federalist, Streamlined State Sales Tax Project

COMMENT

SEPARATE BUT TAXED: A REJECTION OF THE STREAMLINED SALES TAX PROJECT THROUGH A COMMERCE CLAUSE AND FEDERALIST ANALYSIS

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INTRODUCTION

The next time you buy clothing, food, or a video, notice the difference between the sticker price and the amount you end up paying. In most areas, this difference, the sales tax, goes to the state, although some of the revenue may go to a local government.[1] The courts ruled long ago that state and local governments have the power to levy these taxes in a typical retail situation, where a customer buys a good from a store, because the transaction occurred within state or local boundaries.[2]

Now consider how many times you have purchased an item online in the past year. What if the merchant from whom you purchased the good did not own any property in your state? Did you still pay sales tax on that item? Does a state have authority over an online merchant who owns no property in the state, has no employees in the state, and has no understanding of the laws of the state? Can the state force the merchant to collect the taxes from you? As the number of online transactions continues to grow,[3] this hypothetical situation underscores a growing tension between state and federal government: Congress often passes legislation regulating interstate transactions, but as more of our transactions are interstate in nature, the states have begun to assert their own authority in order to preserve income.

Sales and use taxes, which are levied by forty-five states,[4] have long been an important source of revenue for state and local governments. The rigid structure of these long-standing taxes, however, has been

1. *See generally* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION §§ 12.01-12.02 (3d ed. 2005) (defining the sales tax and describing the growth of local and state sales taxes).

2. *See infra* notes 18-26 and accompanying text (surveying the Supreme Court's treatment of sales and use taxes).

3. *See infra* notes 77-79 and accompanying text (discussing the increasing importance of online transactions in America).

4. *See* Federation of Tax Administrators, State Sales Tax Rates, http://www.taxadmin.org/FTA/rate/sales.html (last visited Oct. 27, 2006) (listing the general, prepared food, prescription drug, and non-prescription drug sales tax rates for all states and the District of Columbia as of Jan. 1, 2006).

strained by the rapid evolution of the online economy.[5] As a result, the Multistate Tax Commission ("MTC") devised a plan, the Streamlined State Sales Tax Project ("STP"),[6] to recapture some of the revenue that state and local governments might otherwise lose as consumer purchases migrate from local retailers to online sellers. This plan, approved reciprocally by the states, but not by Congress, was designed by state legislators to comply with legal guidelines articulated by the Supreme Court.[7]

This Comment argues, however, that if a foreign merchant[8] challenges these laws, the STP would be declared unconstitutional based on a modern understanding of the Commerce Clause and a structural, federalist reasoning. Part I discusses the evolution of sales and use taxes and their importance to state and local governments. Part II discusses the rising tension between the structure of sales and use taxes and the structure of the American economy. Part II also documents the STP—the states' recent response to this tension—and explains the STP's legal underpinnings. Part III analyzes the potential legal challenges the STP would face from a foreign merchant and concludes that while it is likely constitutional on due process grounds, the STP is unconstitutional under the Commerce Clause based on stare decisis and federalist reasoning.

I. BACKGROUND: SALES AND USE TAXES EXPLAINED

A sales tax is a levy by a government entity on commercial transactions of tangible personal property; it is a consumption tax.[9] Only state and local governments have imposed sales taxes; there is

5. *See infra* notes 28-33 and accompanying text (identifying the challenges states face in the changing market).

6. This Comment will refer to the project as the Streamlined Tax Project, or STP, in an effort to avoid the erroneous implication of the official name that the project covers only sales taxes, and not use taxes. *See infra* Part I (explaining differences between sales and use taxes).

7. *See infra* Part II.B (explaining participating states' goals in creating the STP, including compliance with Supreme Court arguments to simplify taxation).

8. Within this Comment, the term "foreign merchant" refers to a domestic retailer who sells goods on the Internet, where the goods are delivered through a common carrier to a given state, while the merchant has no assets or employees within that state. References to foreign merchants in a historical context are to merchants who transacted business through catalog sales. For the sake of emphasis, this Comment may also refer to a foreign merchant as an Internet retailer to highlight the technology used in the transactions at issue today. For simplicity, this Comment does not consider the implications of truly foreign merchants—i.e., those merchants located, and solely operating, outside of the boundaries of the United States.

9. HELLERSTEIN & HELLERSTEIN, *supra* note 1, at § 4.12(2)(c).

no national sales tax in the United States.[10] Generally, state and local governments have exempted certain goods, and usually all types of services,[11] from taxation for two reasons. First, state governments were concerned that a broader sales tax might be too regressive—the lowest income earners bearing the highest percent of the tax relative to earnings.[12] Second, some argue that taxing only tangible goods eases the state's administrative burden of deciding which transactions to tax.[13] The states' approach to consumption taxation has been markedly different from that of much of the Western world, which has gradually moved to favor the value-added tax ("VAT").[14]

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10. *See* Gerald E. Auten & Eric J. Toder, *Federal Consumption Tax Proposals and the States*, *in* THE SALES TAX IN THE 21ST CENTURY 52, 53 (Matthew M. Murray & William F. Fox eds., 1997) (explaining that the federal tax structure focuses "primarily on the taxation of income, which can be thought of as the sum of consumption and saving"). The federal government does, however, levy excise taxes on designated goods, often with the policy goal of decreasing the use of those goods. *See* Babak A. Rastgoufard, *Too Much Smoke and Not Enough Mirrors: The Case Against Excise Taxes and for Gasoline Taxes*, 36 URB. LAW. 411, 417-20 (2004) (noting that while they have waned in importance, federal excise taxes comprised over three percent of federal revenues in 2000, and that excise taxes have become an increasingly important component of state income). *See generally* Brenda Yelvington, *Excise Taxes in Historical Perspective*, *in* TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION 31, 50-52 (William F. Shughart III ed., 1997) (chronicling the advent of excise taxes on seven types of products and services, including cars, firearms, and toxic chemicals).

11. *See* JOHN F. DUE & JOHN L. MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION 89-90 (2d ed. 1995) (noting exceptional states, such as Hawaii, New Mexico, and South Dakota, that tax most general services).

12. *See, e.g.*, U.S. Department of Treasury, Fact Sheet: State and Local Taxes, http://www.treasury.gov/education/fact-sheets/taxes/state-local.shtml (last visited Oct. 27, 2006) (labeling the state retail sales tax "a regressive tax" that "can pose problems"); Press Release, Tx. State Rep. Garnet Coleman, Coleman Warns Against Raising Regressive Sales Tax (Apr. 29, 2004), http://www.house.state.tx.us/news/release.php?id=804 (last visited Nov. 5, 2006) (cautioning that a hike in the state sales tax rate would unduly harm the state's poorest residents). *But see* DUE & MIKESELL, *supra* note 11, at 9-12 (cautioning that while several studies note the direct, inverse relationship between income level and the portion of income spent on sales taxes, this disparity may be exaggerated because of the relationship between sales taxes and the costs of factor production, the indexing of Social Security and welfare payments, and the lifetime income theory); Kenneth Trager & H. Frank Williams, *A Treatment of Intermediate Transactions and Supply Elasticities in the Incidence of Sales Tax*, *in* THE SALES TAX IN THE 21ST CENTURY, *supra* note 10, at 204, 215 (finding through regression analysis of data obtained in Florida that previous empirical findings purporting regressive consequences of sales and use taxes "can be explained largely by the [researchers'] various shifting assumptions" of the price elasticity of goods, rather than attributed to the tax scheme itself).

13. *See* DUE & MIKESELL, *supra* note 11, at 75 (adding that, aside from equity concerns, states may elect not to tax purchases on select tangible goods or services "to avoid collection problems" or merely because of successful lobbying efforts that "reflect the political strength of particular [trade] groups"); *cf. id.* at 91 (admitting that the primary reason that state and local governments have typically not taxed services is that "it is virtually impossible to delineate services that are production inputs from those that are consumption purchases."

14. *See generally* LAIM EBRILL, MICHAEL KEEN, JEAN-PAUL BODIN & VICTORIA SUMMERS, THE MODERN VAT 1-4 (2001) (explaining that a VAT, intended to replace consumption taxes such as a sales tax, is a levy that occurs at each stage of a good's

States began assessing sales taxes during the Great Depression.[15] Mississippi was the first state to impose a retail sales tax, in 1932, and many others soon followed.[16] Local governments also began imposing sales taxes, beginning with New York City in 1934.[17] In 1940, the Supreme Court upheld the constitutionality of the state sales tax, as assessed on typical retail sales within the state.[18] The Supreme Court later concluded that states could levy a sales tax on interstate transactions when the transaction itself involved a significant physical presence in the taxing state, even when the transaction also involved some physical presence in other states.[19]

It soon became apparent that states could not levy a sales tax on merchants who did not have a significant presence within the state, nor on transactions that occurred fully outside the state, even if the consumer subsequently brought the good into the state.[20] To create revenue in the face of such obstacles, states with sales taxes began to employ a companion tax, known as the use tax, levied on the same

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production process and "provi[des] for tax payable to be reduced by the tax paid [by the producer] in respect of purchases"); *id.* at 25-39 (concluding that empirical evidence of the VAT's supposed efficiency, in terms of raising government revenue and minimizing private economic distortions, has not fully confirmed economic theory, in part because data available for analysis is necessarily cross-sectional, rather than panel data); RICHARD W. LINDHOLM, VALUE-ADDED TAX AND OTHER TAX REFORMS 27-57 (1976) (describing the VAT system used in Europe, though it was originally conceived in the United States, and the minimal economic distortion the VAT causes in consumer habits and well-being).

15. H.R. REP. NO. 89-565, at 608 (1965).

16. William F. Fox, *Importance of the Sales Tax in the 21st Century*, *in* THE SALES TAX IN THE 21ST CENTURY, *supra* note 10, at 1, 1; *see* DUE & MIKESELL, *supra* note 11, at 3 (listing the effective year in which each state instituted a sales tax, and whether that tax was ever allowed to expire).

17. Fox, *supra* note 16, at 1. Local taxation issues are mentioned here merely to flag their importance. For simplicity, this Comment concentrates on the legal framework for state sales and use taxation under the STP and does not conduct a separate analysis of the authority of local sales and use taxation.

18. *See* Madden v. Kentucky, 309 U.S. 83, 92-93 (1940) (rejecting a Fourteenth Amendment challenge to a Kentucky bank deposit tax because the use of banks was not considered "a privilege of national citizenship" and noting that so long as state policies remained otherwise constitutional, "the power of the state over taxation is plenary"); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 45 (1940) (citing Gibbons v. Ogden, 9 Wheat. 1, 187 (1824)) (arguing that states operate within their constitutional powers so long as they do not impose a tax that interferes with commerce between multiple states or nations).

19. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 278-80, 288-89 (1977) (rejecting the contention of a carrier that shipped vehicles to Mississippi for retail sale that Mississippi could not levy a sales tax on this transaction because state taxation on the "privilege of doing business" in a state as part of an interstate transaction was a per se violation of the Commerce Clause).

20. *See* McLeod v. J.E. Dilworth Co., 322 U.S. 327, 328-30 (1944) (articulating the distinction between a sales tax, which restricts the freedom to purchase, and a use tax, which is levied upon the free use of an item, and explaining that while use taxes may be constitutional, they are not legally interchangeable with sales taxes, despite similar revenue-generating results).

types of tangible goods covered by sales taxes.[21] States have typically levied a use tax when the state could not tax the purchase itself, and have generally set the use tax at the same rate as their sales tax.[22] Under a use tax, the state taxes the citizen's use of the good, not its actual purchase, since the state only has clear authority over the citizen, not the foreign merchant. The use tax was meant to cover a gap in sales taxation, so a consumer is generally allowed to deduct from his use tax liability any sales tax that he paid to another state at the time of purchase.[23] Thus, the intended effect of the companion use and sales taxes was to assure that state residents paid at least the same total tax for a good, whether it was purchased in state or out of state.[24] Whether the tax was collected from the citizen or the merchant, it was the citizen's consumption of goods that funded the state coffers.

Courts have held that use taxes are within the states' power.[25] Indeed, the Supreme Court found that by instituting an equivalent use tax on tangible goods, a state effectively imposed a uniform tax burden on its citizens' consumption, regardless of where they bought an item.[26] While states possessed the power to tax the use or consumption of goods purchased out of state by residents, implementation of this power remained difficult.[27] Monitoring the purchase of all products by residents of a state was, and is, nearly impossible, and many residents today are not even aware of their use

21. HELLERSTEIN & HELLERSTEIN, *supra* note 1, at § 16.01.

22. *Id.*

23. *Id.* § 16.01(2) (explaining the history of sales tax and suggesting that this gap caused states to fear a loss of local merchants' business as well as a loss of revenue for the state).

24. *Id.*

25. *See* Madden v. Kentucky, 309 U.S. 83, 93 (1940) (decreeing that states maintain "the sovereignty to manage their own affairs except only as the requirements of the Constitution otherwise provide").

26. *See* Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 66 (1963) (citing Henneford v. Silas Mason Co., 300 U.S. 577 (1937)) (claiming that the controversy over use taxes was no longer whether a state may implement them, but whether it implements them in a manner that provides complete uniformity of consumption taxes within the state).

27. *See, e.g.*, U.S. GEN. ACCOUNTING OFFICE, GAO/GDC/OCE-00-165, SALES TAXES: ELECTRONIC COMMERCE GROWTH PRESENTS CHALLENGES; REVENUE LOSSES ARE UNCERTAIN 19-21 (2000), *available at* http://www.gao.gov/new.items/g600165.pdf#search=%22%22sales%20taxes%3A%20electronic%20commerce%20growth%20presents%20challenges%22%22 (conceding that, depending on assumptions, estimates of state losses in revenue due to an inability to collect use taxes from interstate Internet sales in 2003 varied between $2.5 billion and $20.4 billion); MICH. DEP'T OF TREASURY, FACTS ON INTERNET AND MAIL ORDER PURCHASES, http://www.michigan.gov/treasury/0,1607,7-121-1750_2143-5931—,00.html (last visited Oct. 30, 2006) (estimating that consumers neglecting to inform Michigan of remote purchases, and not paying the appropriate use tax, would cost the Michigan government $349 million in fiscal year 2005, affecting both educational and general funding).

tax obligations. Not surprisingly, then, use taxes yield much less revenue for states than sales taxes because collecting funds from consumers is much more difficult than from merchants.

Over time, enforcing sales and use taxes has increased in political importance because state revenue has, in large part, become dependant on these taxes.[28] As America's consumption habits change, states will face a number of challenges in order to continue extracting the same, or higher, revenue. For example, in 1970, U.S. consumers spent $357 billion on goods and $291.5 billion on services, a ratio of 1.22.[29] In 2005, consumers spent $3,590.9 billion on goods and $5,154.9 billion on services, a ratio of 0.70.[30] Because states generally tax only tangible goods, consumer substitution of services for goods has eroded the tax base for state sales and use taxes.[31]

In addition, American consumers have continually changed their methods of purchasing goods. Online retail sales have become a significant part of the American economy, projected to grow by more than twenty percent from 2005 to 2006.[32] In fact, recent research by the Department of Commerce indicates that local economies in communities where Internet access has been broadly available grew more rapidly between 1998 and 2002 than those of typical American communities.[33] Internet sales are more likely than traditional retail

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28. *See, e.g.*, Fox, *supra* note 16, at 2 (showing that, according to the Bureau of the Census, the share of state revenues derived from general sales and gross receipt taxes rose from 24.9% in 1962 to 33.0% in 1994); U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, STATE TAX COLLECTIONS: 2005, http://www.census.gov/govs/statetax/0500usstax.html (last visited Oct. 30, 2006) (showing that general sales and gross receipts taxes comprised 32.8% of all taxes collected by the states).

29. U.S. DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, TABLE 2.3.5: PERSONAL CONSUMPTION EXPENDITURES BY MAJOR TYPE OF PRODUCT, http://www.bea.gov/bea/dn/nipaweb/TableView.asp?SelectedTable=65&FirstYear=1970&LastYear=2005&Freq=Ann (last visited Oct. 30, 2006). Figures are in 1970 dollars and include both durable and non-durable goods.

30. *Id.* Figures are in 2005 dollars and include both durable and non-durable goods.

31. *See* Fox, *supra* note 16, at 3-4, 7 & Table 1.4 (showing the decline in the share of consumption of goods versus services from 1979 to 1995, and discussing the resulting loss in expected revenue for states).

32. Enid Burns, *Online Retail Revenues to Reach $200 Billion*, CLICKZ, June 5, 2005, http://www.clickz.com/showPage.html?page=3611181 (last visited Nov. 8, 2006) (summarizing a report conducted by Shop.org that projected total Internet retail sales of $211 billion in 2006, and that thirty-eight percent of online consumers will be first-time buyers).

33. U.S. DEP'T OF COMMERCE, MEASURING BROADBAND'S ECONOMIC IMPACT 4 (2006), http://www.eda.gov/ImageCache/EDAPublic/documents/pdfdocs2006/mitcmubbimpactreport_2epdf/v1/mitcmubbimpactreport.pdf (concluding that, since the end of 1999, communities with widespread broadband Internet access experienced more rapid growth in employment, business incorporations, and technology-oriented firms than communities without such access, yet finding no significant difference between these communities with respect to changes in average wages).

sales to involve a resident buying goods from an out-of-state citizen or business. Since Internet-based transactions will incur nearly unenforceable use tax liability, rather than sales tax liability, states again face dim prospects for revenue growth.

The prospect of a changing economy that conflicts with static laws governing state power is not a new problem. For example, in the early twentieth century, the advent of large corporations and interstate travel presented serious issues to the Due Process framework originally articulated by the Supreme Court in *Pennoyer v. Neff*,[34] which indicated that citizens could not seek relief in state courts without showing that the state met the rigid requirements of personal jurisdiction over the defendant.[35] By 1945, the Court confronted this tension by altering the requirements of personal jurisdiction.[36] Similarly, states formerly could not require merchants to collect taxes on sales that physically take place out of state unless that merchant owned property within the state,[37] though the Court has gradually migrated towards a similar contacts analysis.[38]

II. THE LEGAL LANDSCAPE OF SALES AND USE TAXATION

A. The Foundations of State Taxation of Out-of-State Sales

In 1967, the Supreme Court explained in *National Bellas Hess v. Illinois Department of Revenue* that while states were not strictly limited by territorial bounds to enforce taxation, state power was limited by two constitutional clauses[39]—the Due Process Clause of the Fourteenth Amendment[40] and the Commerce Clause.[41] Just as

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34. 95 U.S. 714 (1877).

35. *Id.* at 723-24 ("If the non-resident of a state has no property in the [s]tate, there is nothing upon which the [state's] tribunals can adjudicate.").

36. *See* Int'l Shoe Co. v. Washington, 326 U.S. 310, 319-20 (1945) (concluding that justice required that a company need merely decide to conduct business in a state in order to be subject to a state's judicial system because the privilege of doing business within a state also carries with it legal obligations). *See generally* Wendy Collins Purdue, *The Story of* Shaffer*: Allocating Jurisdictional Authority Among the States*, *in* CIVIL PROCEDURE STORIES 129, 129-34 (Kevin M. Clermont ed., 2004) (describing the erosion of strict territorial personal jurisdictional requirements in Supreme Court jurisprudence).

37. *See* Nat'l Bellas Hess v. Dep't of Revenue of Ill., 386 U.S. 753, 756, 759 (1967) (suggesting that state taxation of foreign corporations presented both Due Process and Commerce Clause concerns).

38. *See infra* notes 57–65 and accompanying text (noting that by 1992, the Court no longer deemed a strict physical presence rule fair in light of a more national economy).

39. *Id.* at 756.

40. U.S. CONST. amend. XIV, § 1.

41. U.S. CONST. art. I, § 8, cl. 3.

retailers within the state were obligated to comport with state tax policy, the Court explained, foreign merchants, such as mail-order retailers, were required to comply with state taxation laws unless these statutes overstepped either of two related tests.[42] First, a state can force a foreign merchant to remit sales or use taxes under the Due Process Clause if "the state has given anything [to the foreign merchant] for which it can ask return."[43] Second, a state can force a foreign merchant to remit sales or use taxes under the Commerce Clause only when the tax is "justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys."[44]

The Court concluded that for National Bellas Hess, an out-of-state mail-order company that did not engage in local advertising and conducted all transactions via a common carrier (such as the U.S. Postal Service), it was "difficult to conceive of commercial transactions more exclusively interstate in character."[45] These interstate transactions conducted solely via a common carrier lacked a sufficient "nexus" with the state—"some definite link, some minimum connection, between a state and the [entity] or transaction [the state] seeks to tax"—such as a merchant's physical presence within the taxing state.[46] Therefore, foreign merchants were not obligated to remit use taxes.[47] The Court noted one additional, practical concern: a merchant's mere interaction with an in-state

42. *Nat'l Bellas Hess*, 386 U.S. at 756 (acknowledging that the claims that the state use tax law violated the Due Process Clause and the Commerce Clause were "closely related").

43. *Id.* (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)). The Court's due process analysis is essentially an inquiry into the balance of forcing a foreign citizen to comply with a state law and providing justice for the party asking for enforcement—in this case, the state. *See infra* Part III.A (outlining due process jurisprudence and applying it to the STP).

44. *Nat'l Bellas Hess*, 386 U.S. at 756 (quoting Freeman v. Hewitt, 329 U.S. 249, 253 (1946)).

45. *Id.* at 759.

46. *Id.* at 756 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954)); *see, e.g.*, Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 362, 364 (1941) (ruling that Iowa could tax interstate sales destined for that state because the merchant owned retail outlets within Iowa, even though the Iowa retail outlets were not involved in the taxed transactions); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62, 64-66 (1939) (finding that the presence of two salesmen who solicited orders and stored and distributed merchandise in California constituted a physical presence of the Illinois firm within California, subjecting the transactions to California tax law).

47. *Nat'l Bellas Hess*, 386 U.S. at 758 (explaining that a state cannot legally impose use taxes upon a merchant "whose only connection with . . . the [s]tate is by common carrier or [the] mail").

customer could not constitute a substantial nexus.[48] Otherwise, a firm of almost any size would quickly be forced to comply with tax statutes from "every other political subdivision throughout the nation with power to impose sales and use taxes."[49] There were already 2,300 jurisdictions imposing such taxes in 1967.[50] By virtue of its sheer complexity, the Court reasoned, the local taxation system, as applied to purely interstate transactions, was contrary to "[t]he very purpose of the Commerce Clause."[51]

While the Court in *National Bellas Hess* suggested that without a merchant's physical presence within a state it would be difficult to justify burdening a foreign merchant with compliance with local taxation rules,[52] the justification for that pronouncement has gradually come under pressure. First, interstate transactions conducted through a common carrier have continued to grow in importance to the economy. By 1990, fifty-four percent of Americans had made a mail-order purchase in the previous year, and mail-order purchases accounted for fifteen percent of retail sales.[53] Second, the Court continued to adjust due process jurisprudence to comport with the changing economy and the resulting disputes. The Court allowed more tenuous contacts between a party and a given forum to serve as a sufficient basis on which to establish jurisdiction, so long as the contacts were voluntary.[54] Third, in 1977, the Supreme Court rejected previous case law that had supported the rule that a state could not directly tax transactions that were defined as interstate

48. *See id.* (citing *Miller Bros. Co.*, 347 U.S. at 344-45) (noting that a seller's newspaper and radio advertisement in a state where it has no retail outlets had not previously constituted a sufficient nexus for imposition of a use tax).

49. *Id.* at 759.

50. *Id.* at 759 n.12 (citing H.R. REP. NO. 89-565 (1965)). A more recent estimate pegs that figure at 7,500 jurisdictions that levy a retail tax. *See Streamlined Sales and Use Tax Agreement: States' Efforts to Facilitate Sales Tax Collection From Remote Vendors: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 108th Cong. 27 (2003) (statement of George S. Isaacson, Tax Counsel, Direct Marketing Association) (contending that the sheer number of new laws with which firms would be forced to comply under the STP outweighs any potential simplification of tax rates or collection mechanisms).

51. *Nat'l Bellas Hess*, 386 U.S. at 760.

52. *See id.* at 756-57 (quoting Freeman v. Hewit, 329 U.S. 249, 253 (1946)) (identifying the sole justification for state taxation of interstate commerce as the "fair share of the cost of the local government whose protection it enjoys," and listing several instances where the Court has upheld taxation of a foreign merchant, all of which include some physical presence in the state).

53. North Dakota v. Quill Corp., 470 N.W. 2d 203, 209, *rev'd*, 504 U.S. 306 (1992) (citing TIME, Nov. 26, 1990, at 63; DIRECT MARKETING, July 1990, at 30).

54. *See* Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985) (decreeing that a business that purposefully avails itself of the benefits of the taxing state has subjected itself to the state's legal authority).

commerce.[55] Instead, the Court applied a four-part test to assess the validity of a state tax on an interstate transaction.[56]

In 1992, the Supreme Court addressed these mounting tensions in *Quill Corp. v. North Dakota*.[57] While the Court acknowledged the growing importance of interstate transactions to the national economy,[58] the majority was more concerned with enunciating a finer distinction between the dual limitations on state power—the Commerce Clause and the Due Process Clause.[59]

The *Quill* Court noted that a due process analysis was fundamentally concerned with "traditional notions of fair play and substantial justice" for the foreign merchants, as portrayed in *International Shoe v. Washington*,[60] not the physical realities of the merchants' business.[61] In particular, the Court in *Quill*, in contrast to *National Bellas Hess*, applied the similar principles of personal jurisdiction and found that a firm was subject to the taxes of a state if it "purposefully directed" its activities to the forum in question.[62] The inquiry, the Court insinuated, was no longer merely a factual investigation into whether the firm in question owned a particular asset,[63] but whether the relationship between the firm and the state was a reasonable basis on which to enforce the law.[64] Specifically, the Court ruled that when a firm intentionally sent mailings to state

55. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 287 (1977) (emphasizing that the parties stipulated that the merchant had engaged in significant activities within Mississippi, and that the only issue was whether the interstate nature of the transaction barred state authority); *see also supra* note 19 (discussing the previous cases that the Court rejected in *Complete Auto*).

56. *Complete Auto*, 430 U.S. at 279 (ruling that state taxation is valid when the "tax [1] is applied to an activity with a *substantial nexus* with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state") (emphasis added).

57. 504 U.S. 298 (1992).

58. *See id.* at 303-04, 314 (agreeing with the North Dakota Supreme Court that far-reaching changes in the national economy and the evolution of cases rendered the *Nat'l Bellas Hess* holding obsolete).

59. *See id.* at 305 (stressing that "[t]he two constitutional requirements differ *fundamentally*, in several ways" and are "analytically distinct") (emphasis added); *see also* Int'l Harvester Co. v. Dep't of Treasury, 322 U.S. 340, 353 (1944) (Rutledge, J., concurring in part and dissenting in part) (recommending that judges approach Commerce Clause and Due Process Clause issues separately), *cited in Quill*, 504 U.S. at 305.

60. Int'l Shoe v. Washington, 326 U.S. 310 (1945).

61. *Quill*, 504 U.S. at 307 (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)).

62. *Id.* at 307-08 (quoting Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985)).

63. *See* Shaffer v. Heitner, 433 U.S. 186, 212 (1977) (applying the "notions of fair play and substantial justice" standard to jurisdiction over physical assets).

64. *See Quill*, 504 U.S. at 307 (favoring the flexible contacts inquiry over the more formalistic physical presence test).

residents, it subjected itself to personal jurisdiction, and therefore was also subject to that state's use tax under the Due Process Clause.[65]

The *Quill* Court noted that, in contrast to the Due Process Clause, the Commerce Clause does not explicitly prohibit state action in the absence of congressional action.[66] While outlining the history of the Commerce Clause's negative power,[67] the Court affirmed its narrow contemporary use of the doctrine.[68] That restricted approach prohibited states from imposing taxes only when the statute violated one of the four prongs of the test in *Complete Auto Transit, Inc. v. Brady*.[69] Indeed, the first prong of *Complete Auto*, that the tax must be applied to "an activity with a substantial nexus with the taxing state,"[70] aptly described the reasoning of *National Bellas Hess*—that a merchant's physical presence in the taxing state is the strongest indication of this nexus.[71] The Court cited supporting cases in which firms lacked a physical presence in the taxing state and the Court found that their minor contacts with the forum were insufficient to form a nexus under the Commerce Clause.[72] The *Quill* Court

65. *Id.* at 308; *cf.* Adventure Commc'ns., Inc. v. Ky. Registry of Election Fin., 191 F.3d 429, 435 (4th Cir. 1999) (applying a minimum contacts analysis to conclude that a Kentucky statute regulating West Virginia firms was within Kentucky's legislative jurisdiction). *But see Quill*, 504 U.S. at 319-20 (Scalia, J., concurring in judgment) (flagging the distinction between adjudicative jurisdiction and legislative jurisdiction, which are not identical, but have not fully been defined); *cf.* Gerling Global Reinsurance Corp. of Am. v. Low, 296 F.3d 832, 841 (9th Cir. 2002) (declaring that under a legislative Due Process analysis, a state cannot enforce its laws "beyond its borders so as to destroy or impair the right of citizens of other states to make a contract not operative within its jurisdiction, and lawful where made").

66. *Quill*, 504 U.S. at 309.

67. *See infra* Part III.B (explaining the strict dormant Commerce Clause doctrine and detailing the Court's use of it).

68. *Quill*, 504 U.S. at 309-11 (explaining the Court's decisions in prior cases such as *Bellas Hess* and *Complete Auto* and concluding that these cases are not inconsistent with its modern Commerce Clause jurisprudence).

69. *Id.* (citing P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION §§ 2:9-2:17 (1981)); *see also supra* note 56 (defining the four prongs of the *Complete Auto* test); *infra* Part III.B.1 (explaining that the *Complete Auto* Court intended to end lower courts' confusion over how to adjudicate disputes concerning state taxation power under the Commerce Clause).

70. *Complete Auto*, 430 U.S. at 279.

71. *Quill*, 504 U.S. at 311 (citing Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 559 (1977), which distinguished "between mail-order sellers with [a physical presence in the taxing] State and those . . . who do no more than communicate with customers in the State . . . by common carrier"); *see* Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 754, 758 (1967) (reaffirming the distinction between merchants who are physically present in the taxing state and those who are not).

72. *Quill*, 504 U.S. at 311. *Compare* Goldberg v. Sweet, 488 U.S. 252, 263 (1989) (finding that the route of an interstate telephone call, by itself, did not provide a substantial nexus for the state to tax that call), *and Nat'l Bellas Hess*, 386 U.S. at 758-59 (holding that the "receipt of mail [in the state, by itself,] provides insufficient nexus" for taxation), *with* D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988)

cautioned, however, that the "slightest" physical presence of a firm in the taxing state did not constitute a substantial nexus.[73]

The Court's explanation of what exactly constitutes a substantial nexus with a state has not been fully explored.[74] Some commentators contend that the Court's intention in *Quill* was to create a bright-line rule whereby a firm with any real physical presence within a state qualified as taxable under a state's ability to regulate transactions without violating the Commerce Clause.[75] Others see the *Quill* rule as more flexible, in which individual courts may determine the level of physical presence in a state needed to qualify as a substantial nexus.[76]

B. The States Devise the Streamlined Sales Tax Project to Preserve Revenue in the Internet Age

Amidst the continuing uncertainty over the extent of state taxation authority, common-carrier interstate transactions have gained importance to the national economy.[77] In particular, so-called e-commerce transactions, purchases made via the Internet,[78] have

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(concluding that a merchant had sufficient contacts with Louisiana where the firm both sent catalogs to Louisiana residents and maintained thirteen retail locations there), *and* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981) (upholding a Montana tax on the portion of coal extracted by a firm from within the state, because the physical presence of the good satisfied the criteria of substantial nexus).

73. *Quill*, 504 U.S. at 315 n.8 (declaring that the presence of "a few floppy diskettes" in North Dakota did not constitute a substantial nexus).

74. *See* Jaime Klima, *Mom & Pop v. Dot-Com: A Disparity in Taxation Based on How You Shop?*, 2002 DUKE L. & TECH. REV. 0028, 4-5 (2002) (contending that online retailers are unsure when their businesses have satisfied a definition of "substantial nexus").

75. *See Nat'l Geographic Soc'y*, 430 U.S. at 560 (rejecting the argument that a firm with a physical presence within a state that is wholly unrelated to the transaction at issue should not qualify as a substantial nexus with the state); H. Beau Baez III, *The Rush to the Goblin Market: The Blurring of* Quill*'s Two Nexus Tests*, 29 SEATTLE U. L. REV. 581, 595 (2006) (positing that "the *Quill* Court . . . created a simple bright-line test measured by physical presence in a state").

76. *See Nat'l Geographic Soc'y*, 430 U.S. at 555-56 (implying, through the term "sufficient nexus," that a slight physical presence in a state was not sufficient under the Commerce Clause); Dep't of Revenue v. Share Int'l, Inc., 676 So. 2d 1362 (Fla. 1996) (using several factors to determine whether a substantial nexus existed); Brown's Furniture, Inc. v. Wagner, 665 N.E.2d 795 (Ill. 1996) (including considerations of fairness to the merchant).

77. *See* U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, E-STATS: 2004, 2 (2006), *available at* http://www.census.gov/eos/www/papers/2004/2004reportfinal.pdf (last visited Oct. 30, 2006) (showing that while total domestic shipment revenues rose 7.6% from 2003 to 2004, shipments sent through e-commerce orders rose 14.4% over the same time period).

78. *See* U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, E-STATS: FREQUENTLY ASKED QUESTIONS, http://www.census.gov/eos/www/faq.html (last visited Oct. 30, 2006) (defining e-commerce as "the value of goods and services sold . . . [via] use of the internet, intranet, extranet, as well as proprietary networks that run systems such as Electronic Data Interchange").

become commonplace.[79] As the number of purchases with ambiguous tax liability continues to grow, the states have become increasingly concerned that their revenues may decrease.[80] Some firms have reacted to their understanding of the Court's taxation rules by legally bifurcating online operations from physical stores in an attempt to avoid a substantial nexus with taxing states.[81] On the other hand, those firms with a significant physical and online presence have attempted to cooperate with state taxing authorities in an effort to reduce legal costs.[82]

The potential loss of revenue from non-taxed online sales, however, did prompt states to join in a coordinated effort that they dubbed the Streamlined Sales Tax Project ("STP").[83] The STP, organized and executed by the Multistate Tax Commission ("MTC"), a policy and lobbying group of the collective states,[84] is an attempt to maintain the states' revenue base in the midst of a changing economy.[85] Member states appear concerned not only over the

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79. *See* U.S. DEP'T OF COMMERCE, E-STATS: 2004, *supra* note 77, at 2 (documenting $130 billion in 2004 consumer Internet purchases, the type of transaction that has replaced catalog sales); CARRIE JOHNSON, THE GROWTH OF MULTICHANNEL RETAILING 4 (July 2004), *available at* http://www.nga.org/cda/files/0407MULTICHANNEL.PDF (last visited Oct. 30, 2006) (estimating, based on data through 2003, that 2007 consumer Internet purchases will reach $204 billion).

80. *See* DONALD BRUCE & WILLIAM F. FOX, STATE AND LOCAL SALES TAX REVENUE LOSSES FROM E-COMMERCE: ESTIMATES AS OF JULY 2004 (DRAFT) 4 (2004), *available at* http://www.nga.org/Files/pdf/0407ecommerce.PDF (last visited Oct. 30, 2006) (estimating that state and local governments had already lost between $15.5 billion and $16.1 billion due to untaxed Internet sales in 2003).

81. The New Rules Project: Internet Sales Tax Fairness, http://www.newrules.org /retail/inttax2.html, (last visited Oct. 30, 2006) (highlighting the practice known as "entity isolation"). States have reacted in mixed ways to this legal strategy. *See id.* (finding that by 2005, six states had enacted legislation rejecting entity isolation as a valid means of avoiding state tax collection, while courts in three other states upheld entity isolation).

82. *See* Brian Krebs, *States Move Forward on Internet Sales Tax*, WASHINGTONPOST.COM, July 1, 2005, http://www.washingtonpost.com/wp-dyn/content/article/2005/07/01/AR2005070101475.html (last visited Nov. 9, 2006) (reporting that a suit brought by Illinois against several major retailers resulted in settlement, rather than protracted litigation).

83. *See* STREAMLINED SALES TAX GOVERNING BD., INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY 1 (2005), *available at* http://www.streamlinedsalestax.org/execsum0105.pdf (last visited Nov. 9, 2006) (claiming that the project is an effort to "simplify and modernize sales and use tax collection").

84. *See* About the Multistate Tax Commission, http://www.mtc.gov/About.aspx?id=40 (last visited Nov. 18, 2006) (outlining the composition and goals of the MTC).

85. *See* MULTISTATE TAX COMMISSION, FEDERALISM AT RISK, 4 (2003), *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Studies_and_Reports/Federalism_at_Risk/FedatRisk–FINALREPORT.pdf (last visited Oct. 30, 2006) (emphasizing that the MTC hopes that the STP "make[s] it easier for retailers, including remote sellers, to collect . . . tax[es]," though also admitting the collective states' concern over the increasing "ineffectiveness of state sales and use taxes" to collect revenues served as additional motivation to enact the STP).

possibly limited power to tax Internet commerce specifically, but also that, more broadly, the interstate nature of the economy will continually erode state authority.[86] The MTC has specifically cited federalist tensions with respect to recent congressional acts.[87] For example, a federal law enacted in 2000 prohibits a state from imposing corporate taxes on a firm that maintains no physical presence within that state.[88] Additionally, Congress has twice passed the Internet Tax Freedom Act, which forbids a state from imposing most taxes on Internet access service, among other prohibitions.[89] This Act, while directly relevant to the STP, does not specifically outlaw the collection of sales or use taxes, nor did federal legislators or other officials intend to undercut this state revenue source.[90]

Currently, forty-four states have agreed to participate in the STP.[91] These participating states have simplified their extraterritorial taxation laws as part of passing the STP's Uniform Sales and Use Tax Agreement.[92] The simplification of taxation is a direct response to the complexity of compliance arguments advanced by the Supreme

86. *See id.* at 3 (asserting that "[t]he authority to tax is a key element of state sovereignty" as outlined by the Constitution).

87. *See id.* at 27-31 (discussing both taxation and non-taxation federalist concerns shared by the states).

88. *See* Interstate Income Tax Act, 15 U.S.C. §§ 381-391 (2000) (limiting the states' ability to levy *income* taxes on the proceeds from sales collected by individuals, or businesses, who had no physical presence in the taxing state, but who ship orders to the taxing state). *But cf.* Tax Comm'r of W.Va. v. MBNA Am. Bank, No. 04-AA-157, 2006 WL 3455005 (W. Va. 2006) (concluding that the *Quill* decision applied only to state authority to levy sales and use taxes).

89. *See* 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act, §§ 1101-1104) (prohibiting states from levying taxes on Internet access services, collecting Internet-only taxes, such as taxes on emails or bandwidth, and instituting multiple taxation of e-commerce). This law expires on November 1, 2007. *See* Internet Tax Freedom Act § 1101(a) (extending the expiration of the act by four additional years).

90. Internet Tax Freedom Act § 1101(a)-(b) (prohibiting taxes on internet access but otherwise preserving the states' authority to impose taxes); *see* U.S. DEP'T OF COMMERCE, A FRAMEWORK FOR GLOBAL ELECTRONIC COMMERCE 4 (July 1, 1997), http://www.technology.gov/digeconomy/framewk.wpd (last visited Oct. 30, 2006) (declaring that the United States believes that "no *new* taxes should be imposed on Internet commerce") (emphasis added). *See generally* Brian Fagan, Note, *Taxation of Electronic Commerce: Avoiding an Inroad upon Federalism*, 49 DRAKE L. REV. 465, 470-74 (2001) (examining the overlapping introduction and passage of the Internet Tax Freedom Act and the discussion of goals for Internet taxation published by the Clinton Administration).

91. Press Release, The Streamlined Sales Tax Project, Sales Tax Simplification Agreement Becomes Effective Today and Launches Key Element: Amnesty Program (Oct. 3, 2005), *available at* http://www.streamlinedsalestax.org/press_rel/Press%20Release%20Inaugural%20Gov%20Board%20-%20Final.pdf (last visited Oct. 30, 2006).

92. STREAMLINED SALES TAX GOVERNING BD., INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY, *supra* note 83, at 1-2.

Court in both *National Bellas Hess* and *Quill*,[93] instituting a simpler taxation structure to which all participating states assent.[94] In particular, under the STP, merchants must choose to use one of three software programs that calculate the correct tax rate to charge the customer without any individual effort by the merchant.[95]

The states participating in the STP have agreed to five basic rules to determine the "source" of the sale for sales or use tax purposes. First, if the customer physically picks up the item from the merchant, that location is used for taxation purposes.[96] Second, if the customer does not pick up the product, and the merchant knows the destination of the product, then the destination state is designated the "source" state.[97] If neither of the above methods yields a "source" state, then the merchant may use any known location of the customer from the merchant's business records to designate a "source" state.[98] If none of the above options is available, the merchant uses the customer's billing address, obtained during the transaction.[99] Finally, if none of the above options is available, the merchant uses the origin of shipping, which is typically the merchant's location.[100]

Once a "source" state is determined, the merchant charges the consumer that state's tax rate.[101] The merchant's software is programmed to implement the five-step procedure and instruct the merchant to collect the appropriate level of tax.[102]

As a further reflection of the uncertainty of state power to tax interstate Internet sales, the STP also offers merchants an opportunity to gain amnesty for all past tax collection activity.

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93. *See* Nat'l Bellas Hess v. Dep't of Revenue of Ill., 386 U.S. 753, 759-60 (1967) (noting the "virtual welter of complicated obligations" that state taxation may impose on foreign merchants); North Dakota v. Quill Corp., 470 N.W.2d 203, 215 (N.D. 1991) (citing *Nat'l Bellas Hess* and considering the potential burden of complex tax obligations on foreign merchants); *see also supra* Part II.A (explaining the significance of these cases with regard to the power of states to tax interstate transactions).

94. *See* MULTISTATE TAX COMMISSION, FEDERALISM AT RISK, *supra* note 85, at 20-21 (explaining the origin of the STP).

95. STREAMLINED SALES TAX GOVERNING BD., INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY, *supra* note 83, at 2-3.

96. Streamlined Sales and Use Tax Agreement § 310(A)(1), *available at* http://www.streamlinedsalestax.org/SSUTA_Amended041806.pdf (last visited Oct. 30, 2006).

97. *Id.* § 310 (A)(2).

98. *Id.* § 310 (A)(3).

99. *Id.* § 310 (A)(4).

100. *Id.* § 310 (A)(5).

101. Anthony D. Milewski, Jr., *Streamlined Sales and Use Tax Agreement: Is Your Business Ready for Compliance?*, 2 SHIDLER J. L. COM. & TECH. 7 (Oct. 24, 2005) (citing Forest Lewis & Curtis Ruppal, *Streamlined Sales/Use Tax Biggest Change in 70 Years*, MICH. FORWARD 16 (Sept./Oct. 2004)).

102. STREAMLINED SALES TAX GOVERNING BD., INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY, *supra* note 83, at 2-3.

Amnesty is available in exchange for merchants adopting and implementing the STP software within twelve months of either: (1) the software becoming available; or (2) the applicable state joining the STP.[103] Some retailers have already taken advantage of the amnesty offer and are implementing STP systems.[104]

III. ANALYSIS OF THE STREAMLINED SALES TAX PROJECT

Any potential challenge by a foreign merchant reluctant to collect use taxes under the STP of a foreign state would have to assert that the STP is unconstitutional.[105] Thus, a plaintiff would have to demonstrate that the STP, as enforced, violated the Due Process Clause, the Commerce Clause, or the general structure of governance articulated in the Constitution.

Given the careful planning by the MTC, it would not be surprising if courts were to uphold the STP as constitutional. Practically speaking, the STP provides more certainty for merchants facing potential lawsuits, and allows the state revenues to grow with the economy. This Part shows, however, that this practical advantage is gained at the expense of deviating from established structures of governance. As discussed below, a challenge to the STP on due process grounds is not likely to succeed because the changing due process standards embraced by the Supreme Court have adapted to the interstate nature of the nation's commercial activities.[106] However, the Court is much more likely to accept a challenge to the STP as a violation of the Commerce Clause. Commerce Clause

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103. Streamlined Sales and Use Tax Agreement, § 402(A)(1).

104. Krebs, *supra* note 82.

105. A foreign merchant cannot challenge the STP as a violation of a federal statute because Congress has not passed a law that directly governs the legality of the STP. *See* S. 152 CONG. REC. S14191 (Dec. 20, 2005) (proposing to approve the STP through Congress' Commerce Clause authority). It is also unlikely that a foreign merchant could challenge the STP as a violation of a state constitution, not only because these documents are not designed to govern interstate law, but also because state constitutions tend to grant the broadest possible state legislative authority. *See, e.g.*, CA. CONST. art. IV §§ 1, 8(c)(3) (decreeing that "[t]he legislative power of this State is vested in the California legislature," and further implying that the legislature is authorized to levy taxes by stating that "statutes providing for tax levies . . . for the usual current expense of the state . . . shall go into effect immediately upon their enactment"); ME. CONST. art. IV, Pt. 3, § 1 (declaring that the state legislature "shall have full power to make and establish all reasonable laws and regulations for the defense and benefit of the people of this State, not repugnant to this Constitution, nor to that of the United States"). Finally, a foreign merchant cannot challenge the STP on the basis that it violates state law because state legislatures have replaced former taxing regimes with the STP. *See* Press Release, The Streamlined Sales Tax Project, *supra* note 91 (stating that all participating states had passed identical tax regulations).

106. *See infra* Part III.A (discussing the modern changes in due process case law).

jurisprudence has vacillated over time and has thus not provided clear guidance to states or foreign merchants as to when states may tax transactions of an interstate nature.[107] Finally, the Court may also be more likely to embrace a challenge to the STP on grounds that it is contrary to the federalist structure enunciated by the Constitution, as the STP allows the states to collectively encroach on federal power.[108]

A. The Streamlined Sales Tax Project Does Not Violate the Due Process Clause

The STP will likely survive a due process challenge, given the Court's broad approach to multiple jurisdiction disputes.[109] It is well established that a state has not violated a citizen's due process rights when that citizen has "purposefully availed" himself of the benefits and privileges of conducting business within the state because such purposeful action constitutes the minimum contact necessary for the state to obtain personal jurisdiction over that citizen.[110] Indeed, the Court has directly applied this standard to assess a firm's minimum contacts with a state in the context of catalog sales.[111]

While the Court has never ruled that catalog sales are analogous to Internet transactions, lower courts have begun to implicitly make that logical assumption. In *Mink v. AAAA Development, Inc.*,[112] for example, the Fifth Circuit identified a three-tiered classification of Internet activity for assessing a foreign firm's contacts with the forum state.[113] The court found that when a "defendant *clearly does business* over the Internet by entering into contracts with residents of other states . . . personal jurisdiction [over him] is proper."[114] The court classified a

107. *See infra* Part III.B (deciphering applicable commerce clause jurisprudence).
108. *See infra* Part III.C (analyzing the appropriate balance of power between state and federal government).
109. *See supra* Part II.A (analyzing the constitutional interplay of the Commerce Clause and the Due Process Clause in the Court's jurisprudence regarding interstate sales taxes).
110. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 475-76 (1985) (finding that a franchisee had "purposefully availed" itself of the Florida forum where the franchisee conducted business with a Florida franchisor and agreed to a contractual forum selection clause).
111. *See* Quill v. North Dakota, 504 U.S. 298, 308 (1992) (upholding the Court's pronouncement in *Burger King* that a firm need not be physically present in a state to be subject to its judicial enforcement; the firm need merely interact intentionally with the forum).
112. 190 F.3d 333 (5th Cir. 1999).
113. *See id.* at 336-37 (citing Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1124 (W.D. Pa. 1997)) (applying the principles of *Zippo* to AAAA to find that the firm's website, which allowed users to download an order form, but not directly to place an order, did not constitute grounds upon which AAAA was subject to personal jurisdiction).
114. *Id.* at 336 (emphasis added) (citing *Zippo*, 952 F. Supp. at 1124).

second tier of websites, "[i]n the middle of the spectrum" of contacts with the forum, where a firm operated a "website that allows a user to *exchange information* with a host *computer*."[115] In the last tier, in which personal jurisdiction is unlikely, the "defendant merely established a *passive website* that does nothing more than advertise on the website."[116] Thus, to the extent that contracts formed on the basis of a catalog solicitation have been replaced by similar transactions on the Internet, they are nonetheless intentional business transactions that satisfy a minimum contacts analysis.[117] Certainly, like a sale from a catalog, an Internet sale is more than a mere exchange of information; it is an example of a merchant clearly conducting business.[118]

Other circuits have not embraced the three-tiered classification of Internet activity, but have nonetheless held that any firm that willingly establishes and maintains a website open to commercial transactions has satisfied the purposeful minimum contacts requirements of personal jurisdiction.[119] In fact, some courts have considered the vast potential of direct Internet sales as a factor weighing towards declaring firms using the technology subject to general jurisdiction.[120] Based on federal courts' growing acceptance

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115. *Id.* (emphasis added) (citing Maritz, Inc. v. Cybergold, Inc., 947 F. Supp. 1328 (E.D. Mo. (1996)).

116. *Id.* (emphasis added) (citing Bensusan Rest. Corp. v. King, 937 F. Supp. 295 (S.D.N.Y. 1996), *aff'd*, 126 F.3d 25 (2d Cir. 1997)).

117. *See* Quill v. North Dakota, 504 U.S. 298, 308 (1992) (finding that catalog sales made "in continuous and widespread solicitation of business" within a state satisfied the minimum contacts requirement of the Due Process Clause); *Zippo*, 952 F. Supp. at 1126 (employing a minimum contacts test to assert personal jurisdiction over a website company that had 3,000 subscribers and seven contracts with Internet service providers within the forum state).

118. *Compare Mink*, 190 F.3d at 336 (finding a court lacked personal jurisdiction over a website that did not transact business, only posted information, over the Internet), *with Zippo*, 952 F. Supp. at 1126 (finding personal jurisdiction over website that entered sales contracts with state citizens over the Internet).

119. *E.g.*, Gator.com Corp. v. L.L. Bean, Inc., 341 F.3d 1072, 1079 (9th Cir. 2003) (applying a so-called "sliding scale" for Internet based firms: when firms clearly conduct business over the Internet, if the transactions are "continuous and systematic," then personal jurisdiction is appropriate); *cf.* Revell v. Lidov, 317 F.3d 467, 472 (5th Cir. 2002) (citing the important difference between cases involving commercial transactions, such as *Zippo* and *Mink*, and cases scrutinizing non-commercial websites, where "visitor[s] may participate in an open forum hosted by [a] website," and concluding that such non-commercial cases, such as defamation cases, should follow the guidelines articulated in Calder v. Jones, 465 U.S. 783, (1984)); Neogen Corp. v. Neo Gen Screening, Inc., 282 F.3d 883, 890 (6th Cir. 2002) (declaring that a state has personal jurisdiction over any firm operating a website "specifically intended [to] interact[] with residents of the state").

120. *See* Bancroft & Masters, Inc. v. Augusta Nat'l, Inc., 223 F.3d 1082, 1086 (9th Cir. 2000) (insinuating that regular and substantial Internet sales may serve as grounds for finding the existence of general jurisdiction, but finding that maintaining a passive website falls far short of the contacts necessary to approximate

of personal jurisdiction over firms with well-established Internet sites engaged in commercial activity, it is unlikely that a foreign merchant could successfully challenge the STP on due process grounds.[121]

B. The Streamlined Sales Tax Project Likely Violates the Commerce Clause

If a foreign merchant challenged the STP on Commerce Clause grounds, courts likely would be more receptive. Quite distinct from due process concerns, Commerce Clause challenges to state taxation have left considerable confusion in the judiciary.[122] In part, this confusion appears to stem from exactly which types of state actions the Commerce Clause prohibits. Additionally, the Supreme Court's attitude of how restricted the states are by the Commerce Clause has historically tended to sway along with its approach to libertarian ideals.[123] In reality, much of the confusion can be explained by the fact that in earlier decisions, the Court often, but not always, embraced a stricter interpretation of the Commerce Clause, often

physical presence). *But see Revell*, 317 F.3d at 471 (citing Access Telecom, Inc. v. MCI Telecomm. Corp., 197 F.3d 694, 717 (5th Cir. 1999) (dismissing the contention that even a frequently visited website could constitute grounds for general jurisdiction because "while [the foreign firm] may be doing business *with* Texas, it is not doing business *in* Texas"); Bird v. Parsons, 289 F.3d 865, 874 (6th Cir. 2002) (ruling that Ohio courts lacked *general* jurisdiction over a non-resident business that registered Internet domain names despite the fact that: (1) the defendant maintained a website open for commercial transactions with Ohio residents; and (2) over 4,000 Ohio residents had, in fact, registered domain names by using the defendant's website, while noting that Ohio did have *personal* jurisdiction over the firm).

121. *But see Quill*, 504 U.S. at 319-20 (Scalia, J., concurring in judgment) (stressing the distinction between adjudicative jurisdiction and legislative jurisdiction, though admitting that the Court has never fully enunciated these differences).

122. *See Quill*, 504 U.S. at 311-12 (explaining that the North Dakota Supreme Court had confused a Commerce Clause inquiry with a Due Process Clause inquiry); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 274-75 (1977) (bemoaning that the "perennial problem of the validity of a state tax [under the Commerce Clause]" has long been a "troublesome area" for the courts) (internal quotation omitted).

123. *Compare* Specter Motor Serv. v. O'Connor, 340 U.S. 602, 609-10 (1952) (stating that strictly interstate transactions, as opposed to those involving local business, could not be taxed by the states), Freeman v. Hewit, 329 U.S. 249, 276 (1946) (suggesting that the purpose of the Commerce Clause was to promote free trade among the states, and that allowing states to tax these transactions was contrary to this purpose), *and* Brown v. Maryland, 25 U.S. 419, 447-48 (1827) (declaring that the power to tax intercourse among the states resided solely in the realm of Congress), *with* D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988) (holding that firms engaged in interstate commerce must pay their "fair share" of the state tax burden), *Complete Auto*, 430 U.S. at 1084 (disavowing the formalistic approach of deciding which interstate transaction taxes were unconstitutional based on the language of the taxing statute), *and* Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256-59 (1933) (implying that state taxation of interstate commerce was illegitimate only in cases where foreign merchants experienced disparate tax treatment as compared to in-state merchants).

termed the "negative" or "dormant" Commerce Clause.[124] The dormant Commerce Clause barred states from taxing interstate commerce, regardless of the will of Congress, if that taxation significantly harmed the national interest.[125] The Court itself has admitted that the strength of the dormant Commerce Clause, however, has vacillated during the Court's history.[126]

1. A Commerce Clause analysis is governed by the Complete Auto *standards*

Recent Supreme Court decisions indicate that the Court generally uses the Commerce Clause only to strike down taxes violating one or more of the four prongs it enunciated in *Complete Auto*, eschewing a strict dormant Commerce Clause interpretation.[127] In *Complete Auto*, the Court clarified that state taxation of interstate commerce was constitutional when the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the [s]tate."[128] In applying the *Complete Auto* test, the Court claims to continue the Framers' vision of preventing the states from sapping the strength of interstate commerce for the sake of narrow interests.[129] Thus, the Court purports to satisfy the goals underlying the dormant interpretation of

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124. *See, e.g.*, Okla. Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 179-81 (1995) (confirming the Court's adherence to the dormant Commerce Clause, noting its purpose as a method for protecting interstate commerce, and discussing the "turns" in the Court's approach to the doctrine over the years).

125. *Id.* at 179-80 (explaining that, under this interpretation, the intent of the Framers was to avoid "economic Balkanization" initiated by state interests "that had plagued relations among the Colonies").

126. *Id.* at 180 (bemoaning that "the Court's understanding of the dormant Commerce Clause has taken some turns"). *See generally id.* at 179-84 (summarizing the jurisprudence of the dormant Commerce Clause and concluding that the Court had abandoned the "formalism" of the dormant Commerce Clause by 1977, when it issued the *Complete Auto* decision).

127. *Quill*, 504 U.S. at 309-11; *see, e.g.*, *Jefferson Lines*, 514 U.S. at 184 (identifying the central controversy in the case as satisfaction of *Complete Auto*'s second prong—fair apportionment of the tax); Goldberg v. Sweet, 488 U.S. 252, 259 (1989) (exploring the "wavering doctrinal lines" prior to *Complete Auto*'s four-part test).

128. *Complete Auto*, 430 U.S. at 279.

129. *See Jefferson Lines*, 514 U.S. at 180 (citing THE FEDERALIST NO. 42 (James Madison) and THE FEDERALIST NOS. 7 & 11 (Alexander Hamilton) as indications of the Framers' concern for the stability of national commerce, deemed a necessary ingredient for national political health); *see also* THE FEDERALIST NO. 32, at 80 (Alexander Hamilton) (Roy P. Fairfield ed., 1981) ("I am willing here to allow, in its full extent, the justness of the reasoning which requires that the individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants. And making this concession, I affirm that (with the *sole exception of [state] duties on imports and exports*) [the individual States] would . . . retain that authority in the most absolute and unqualified sense . . . .") (emphasis added).

the Commerce Clause without narrowly constricting states' ability to raise revenue.[130]

2. The Streamlined Sales Tax Project fails the substantial nexus requirement of the Complete Auto *test*

Confusion notwithstanding, if the Court were to apply the *Complete Auto* four-prong test to the STP, it could very well find the STP unconstitutional. The most controversial aspect of the STP is its relation to the first prong of *Complete Auto*, where the Court would examine whether the foreign merchant maintained a "substantial nexus" within the taxing state.[131] Given that the Court has not defined this phrase, scholars have noted that any attempt to discuss the phrase on its own is a frustrating exercise.[132] Additionally, the Court has habitually used the phrase without providing a full context for its historical use. For example, in *Oklahoma Tax Commission v. Jefferson Lines*,[133] the Court proclaimed that "[i]t has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State."[134] Yet this broad pronouncement was made without reference to the Court's own long-standing "safe harbor" principle, which exempted foreign firms that sold tangible goods to state residents solely through a common carrier.[135] The *Jefferson Lines* opinion also failed to mention that a very small quantity of goods might not qualify as a substantial nexus either, as was the case for several computer disks in the 1992 *Quill* decision.[136]

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130. *See Quill*, 504 U.S. at 303-04 (explaining that the *Complete Auto* decision was a direct rejection of the contention that any taxation of interstate commerce by the states was unconstitutional); *Jefferson Lines*, 514 U.S. at 179-80 (insisting that while not all attempts by states to tax interstate commerce without congressional authorization are unconstitutional, the Court has "consistently held [that the] language [of the Commerce Clause] contain[s] a further, negative command, known as the dormant Commerce Clause," though the Court has not strictly interpreted the clause).

131. *See Quill*, 504 U.S. at 311-12 (disputing the finding of the Supreme Court of North Dakota that the "substantial nexus" requirement under *Complete Auto*'s contemplation of the Commerce Clause is equivalent to the "minimum contacts" inquiry of the Due Process Clause, though admitting that confusion is understandable).

132. *See* Baez, *supra* note 75, at 597 (admitting that "it is useless to try to discern any substantive meaning from the phrases 'substantial nexus,' 'sufficient nexus,' or 'nexus aplenty' themselves").

133. 514 U.S. 175 (1995).

134. *Id.* at 184 (internal citation omitted).

135. *See Quill*, 504 U.S. at 315 (citing Nat'l Bellas Hess v. Dep't of Revenue of Ill., 386 U.S. 753 (1967)).

136. *Id.* at 315 n.8 (citing Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 556 (1977), to explain that there is an artificial threshold below which the court would ignore physical incursions by a foreign firm into a state).

However, there are several theories about what may constitute a substantial nexus, based on both case law and congressional intervention: the representational nexus theory; the strict or modified physical nexus theory; and the congressionally authorized nexus theory.[137] A review of each theory reveals that a foreign merchant selling through the Internet does not have a substantial nexus with a foreign state.

First, the representational nexus theory argues that strictly Internet-based retailers have a representational presence in the taxing state via the Internet service providers or other online services that consumers within the taxing state use to access the website.[138] For example, if a citizen of Ohio used a local service provider, such as a cable company, to access the Internet and complete a purchase from a website owned by a merchant whose only physical presence was in Maine, then the service provider acted as a conduit, physically linking the Maine merchant to the Ohio purchase. This theory is not without merit. In the past, the Court has held that certain representatives of a firm who were present within a state constituted a substantial nexus, satisfying the first prong of the *Complete Auto* test.[139] For example, in *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*,[140] the Supreme Court found that a firm without offices or property in Washington, but that nonetheless had sales representatives (who were not employees) within Washington, maintained a substantial nexus with the state.[141] Therefore, the Court held that subjecting the foreign merchant to business and occupation taxes was constitutional.[142] The Court rationalized that the act of

137. *See infra* notes 160-165 and accompanying text (demonstrating the unlikelihood that Congress would give states authorization to tax Internet sales). *See generally* Saba Ashraf, *Virtual Taxation: State Taxation of Internet and On-Line Sales*, 24 FLA. ST. U. L. REV. 605, 617-28 (1997) (defining and dismissing the possible arguments for states to assert a substantial nexus claim over e-commerce providers without physical operations in a state).

138. *See* Ashraf, *supra* note 137, at 619-20 (discussing the history of the representational nexus theory and the possibility of its application to taxation over Internet sales).

139. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (stating that state taxation is valid if, among other requirements, the "tax is applied to an activity with a substantial nexus with the taxing State").

140. 483 U.S. 232 (1987).

141. *See id.* at 249-50 (noting that Tyler Pipe's sales representatives, on Tyler Pipe's behalf, cultivated goodwill and positive customer relations in Washington's highly competitive market by routinely calling customers and soliciting orders).

142. *Id.* at 251 (agreeing with the Washington Supreme Court that a substantial nexus existed because company sales representatives were responsible for maintaining and protecting Tyler Pipe's market interests in the state); *see also* Ashraf, *supra* note 137, at 620 n.125 (acknowledging that a business and occupation tax is

soliciting business within a state was certainly a substantial portion of commerce, contributing to the firm's well-being; such acts could thus be taxed by a state.[143]

Scripto, Inc. v. Carson[144] presented a similar situation, where a foreign firm without any physical assets in Florida hired ten independent contractors to solicit orders in the state.[145] The Court found that Florida's use tax applied to the firm because the intentional actions of the independent contractors and the firm's continuous solicitation of business from the state constituted sufficient commercial activity to constitute a substantial nexus with Florida.[146] Some scholars have argued that, under these precedents, Internet service providers perform the identical function of the independent salesmen by regularly and continuously soliciting orders from within each state, thus constituting a substantial nexus.[147]

However, Congress has rejected the representational nexus theory as applied to Internet sales. Since October of 1998, The Internet Tax Freedom Act has prohibited states from claiming that a foreign, Internet-based firm maintains a substantial nexus with the state "solely as a result of . . . processing of orders through the out-of-State computer server of a provider of Internet access service or online services."[148] Since Congress has the explicit constitutional power to "regulate Commerce . . . among the several States,"[149] the Internet Tax Freedom Act has invalidated the representational nexus theory as applied to Internet retailers.[150]

Second, states may argue that a modified physical nexus requirement for Internet retailers constitutes a substantial nexus on which to base a use tax.[151] This argument posits that the in-state

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not identical to a use tax, but that the definition of substantial nexus used by the Court may well be the same, as applied to these taxes).

143. *See Tyler Pipe*, 483 U.S. at 249-50 (paying particular attention to the fact that Tyler Pipe received virtually all of its market information from its in-state sales representatives).

144. 362 U.S. 207 (1960).

145. *Id.* at 209.

146. *Id.* at 211 (dismissing the distinction between full-time employees and independent contractors as constitutionally insignificant for the purposes of a substantial nexus analysis).

147. *See* Ashraf, *supra* note 137, at 621-27 (considering, and then rejecting, three separate arguments defining internet service providers as representatives of the firm because these providers behave more like advertisers than active solicitors).

148. 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act, § 1104(2)(B)(ii)(II)).

149. U.S. CONST. art. I, § 8, cl. 3.

150. *See* Internet Tax Freedom Act § 1104(2)(B)(ii)(II).

151. *See* Ashraf, *supra* note 137, at 627-28 (clarifying that a modified physical nexus requirement would equate the virtual presence of the Internet with the physical presence required under a traditional substantial nexus analysis).

physical requirement of a firm's assets or representatives is based on an outdated understanding of commerce.[152] Just as the notion of fairness inherent in the courts' approach to personal jurisdiction had included the now-discarded requirement that one must have either property or be present within the state,[153] some argue that the Commerce Clause definition of fairness should likewise be updated.[154] This position contains two major flaws. First, the substantial nexus requirement has never been associated strictly with fairness to the litigating parties.[155] Indeed, the substantial nexus requirement is just one of four requirements instituted by *Complete Auto* to assure fair taxation on foreign firms; requirements two, three, and four already incorporate such fairness considerations.[156] Thus, fairness need not be considered within the definition of substantial nexus.[157] Second, Congress has clearly repudiated changing the definition of physical presence as it applies to Internet retailers. The Internet Tax Freedom Act specifically prohibits states from asserting a nexus claim "solely as a result of (I) the display of a remote seller's information of content on the out-of-State computer server" or "(II) the processing

152. *See generally id.* at 627-28 (theorizing that the Court could not have predicted the growth of non-physical, Internet-based transactions as a component of interstate commerce when it decided *Quill* in 1992); MULTISTATE TAX COMMISSION, FEDERALISM AT RISK, *supra* note 85, at 9-13 (attributing a greater reduction in state and local revenues versus the national economy during the post- September 11, 2001 period partly to a shift in the avenues of consumer transactions); Eric A. Ess, Comment, *Internet Taxation Without Physical Representation?: States Seek Solution to Stop E-Commerce Sale Tax Shortfall*, 50 ST. LOUIS U. L.J. 893, 917 (2006) (citing John E. Sununu, *The Taxation of Internet Commerce*, 39 HARV. J. ON LEGIS. 325, 334 (2002)) (likening the updating of taxation laws to conform to technology to the transformation of other laws, such as wiretapping statutes, which were updated to accommodate changes in communications technology).

153. *See supra* text accompanying note 34 (explaining the holding of *Pennoyer v. Neff*, 96 U.S. 714 (1878)).

154. *See, e.g.*, Baez, *supra* note 75, at 607-08 (interpreting the court's Commerce Clause analysis in *Brown's Furniture, Inc. v. Wagner*, 665 N.E.2d 795 (Ill. 1996) as centered on the fairness of taxing the defendant); *see also* Ashraf, *supra* note 137, at 627-28 (discussing the suggested use of a modified, or virtual, physical nexus requirement).

155. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992) (explaining that fairness to the litigating parties is a concern more aptly included in a Due Process determination, not a Commerce Clause analysis, which is primarily concerned with balancing state and federal interests); Tax Comm'r of W.Va. v. MBNA Am. Bank, No. 04-AA-157, 2006 WL 3455005 (W. Va. 2006) (agreeing that the purpose of *Quill* was to provide businesses with a clear guideline: businesses without a physical presence in a state had no substantial nexus with the state).

156. *See supra* note 56 (describing the four prongs of the *Complete Auto* test). In particular, note that prong two specifically asks whether a tax "is fairly apportioned." Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

157. *See* Baez, *supra* note 75, at 608 (lamenting that even though fairness should only come into play in a Due Process Clause analysis, federal courts continue to erroneously consider fairness in their Commerce Clause analysis).

of orders through [an] out-of-State computer server."[158] Clearly, through this language, Congress has exercised its power over interstate commerce to prevent states from expanding the definition of physical sales. Given the Court's concession that Congress should be granted the ultimate authority to apply the Commerce Clause,[159] the chances of a federal court expanding the definition of physical sales to Internet sales are remote.

Third, the states may succeed in applying the substantial nexus requirements to Internet sales through congressional definitions or action. Given current legislation, however, it appears unlikely that a court would find a substantial nexus for an Internet-based foreign merchant, barring some new congressional action.[160] The Court is not interpreting a blank slate; Congress has demonstrated an interest in the issue of states levying Internet sales taxes.[161] Congress has also demonstrated an interest in the issue of states levying income taxes on businesses engaged in interstate commerce.[162] In two directly related laws concerning state taxation authority, Congress has acted to limit state power.[163] In fact, Congress has instituted fifty-seven laws that attempt to preempt traditional state powers, showing that Congress is generally hostile to the accumulation of state power.[164]

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158. 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act § 1104(2)(B)(ii)(II)).

159. *See Quill*, 504 U.S. at 318 ("*Congress* is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.") (emphasis added).

160. *See Streamlined Sales and Use Tax Agreement: States' Efforts to Facilitate Sales Tax Collection From Remote Vendors*, *supra* note 50, at 1-2 (opening statement of Rep. Chris Cannon, Chairman) (warning that "[t]he [STP] marks a significant departure from the [state] sales and use tax system now in place in the United States" and noting that Congress will "first address . . . the concepts contained in the [STP] before considering legislative action").

161. *See* 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act §§ 1100-1104) (prohibiting certain state taxes on Internet access services).

162. *See* Interstate Income Tax Act, 15 U.S.C. §§ 381-391 (2000) (limiting the states' ability to levy income taxes resulting from the sales derived by individuals or businesses without a physical presence in the taxing state, but who ship orders to that state).

163. *See id.* § 381(a) (decreeing, in a bill passed in 1959, that "[n]o State, or political subdivision thereof, shall have the power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce" if the person or business earning the income has no physical presence within the state); 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act, §§ 1101-1104) (prohibiting states from levying taxes on Internet access services, collecting Internet-only taxes, such as taxes on emails or bandwidth, and instituting multiple taxation of e-commerce).

164. *See* MINORITY STAFF OF H.R. COMM. ON GOV'T REFORM, CONGRESSIONAL PREEMPTION OF STATE LAWS AND REGULATIONS 1 (June 2006), *available at* http://www.democrats.reform.house.gov/Documents/20060606095331-23055.pdf (last visited Nov. 11, 2006) (deeming usurping state authority to be necessary, even

Thus, given that Congress has never authorized the states to implement a tax scheme that broadly affects interstate commerce in the manner employed by the STP, states should not be able to assert a substantial nexus over foreign Internet retailers without new congressional authorization.[165]

3. A failure to comply with the Complete Auto *substantial nexus test violates the Commerce Clause*

Thus, while the Court no longer automatically applies a strict dormant Commerce Clause approach to state taxation cases,[166] it may nonetheless find the STP unconstitutional. Both recent case law and congressional action show that a reasonable interpretation of *Complete Auto*'s first requirement—that a foreign merchant maintain a substantial nexus with the taxing state—does not include Internet transactions.[167] The above review of the representational nexus, strict physical nexus, and congressionally authorized theories of what may constitute a substantial nexus reveals that none appears to satisfy the substantial nexus requirement for the STP.[168]

Note that the four prongs of the *Complete Auto* test are four separate *requirements* imposed on state taxes in interstate commerce; they are not factors to be weighed by the judiciary.[169] Indeed, lower courts

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though such preemption was intrusive and "[l]iterally hundreds of state laws . . . would be overridden"); *see also* MULTISTATE TAX COMMISSION, FEDERALISM AT RISK, *supra* note 85, at 28-29 (outlining the ten major characteristics of the intentional accumulation of federal power, at the expense of the states, that has occurred since the 1960s).

165. *See* U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power to regulate commerce among the states); Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992) (quoting Commonwealth Edison Co. v. Montana, 453 U.S. 609, 637 (1981) (White, J., concurring) ("Congress has the power to protect interstate commerce from intolerable or even undesirable burdens.").

166. *See supra* notes 124-130 and accompanying text (discussing the Court's historical and present approaches to the dormant, or negative, Commerce Clause).

167. *See, e.g.*, 47 U.S.C. § 151 (2006) (Historical and Statutory Notes, Internet Tax Freedom Act § 1101(a)) (explicitly prohibiting taxes on Internet access and electronic commerce, barring certain exceptions).

168. *See* Ashraf, *supra* note 137, at 628-29 (concluding that until Congress passes legislation that expressly allows state to employ use taxes on electronic interstate commerce, Internet sales taxes cannot meet the substantial nexus requirement).

169. *See* Barclays Bank, Plc v. Franchise Tax Bd., 512 U.S. 298, 310-11 (1994) ("Absent congressional approval, however, a state tax on [interstate] commerce will not survive Commerce Clause scrutiny if the taxpayer demonstrates that the tax (1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; *or* (4) is not fairly related to the services provided by the State") (citation omitted); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (decreeing that state taxation was valid when the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, *and* [4] is fairly related to the services provided by the state") (emphasis added).

have invalidated state taxes that they deem to violate just one of the four *Complete Auto* prongs.[170] Thus, a state argument that the Court should weigh the contention that the STP actually improves the prospects for fair apportionment of taxes (the second prong of *Complete Auto*), or lessens discrimination against interstate commerce (the third prong) are not relevant. Once a court finds that a foreign merchant lacks a substantial nexus with the taxing state (a first prong violation), as demonstrated above for the STP, then a court must find the tax in violation of the Commerce Clause. Therefore, the MTC cannot force foreign merchants using the Internet to comply with the STP.

C. The Streamlined Sales Tax Project Is Contrary to the Federalist Structure of the Constitution

For these reasons, it is entirely plausible that courts would embrace a foreign merchant's challenge of the STP under the Commerce Clause, asserting that the states lack a substantial nexus over a merchant without physical assets within some or all of the states enforcing the STP. If that argument fails, however, the foreign merchant could also resort to a structural argument under the Commerce Clause.[171] Thus far, challenges to the power of state taxation have been leveled against individual states.[172] For more than a decade, these individual state efforts to collect use taxes from foreign merchants were required by courts to comply with the *Quill* standards.[173] The STP laws, however, are significantly different from

170. *See, e.g.*, Cuno v. Daimler Chrysler, Inc., 386 F.3d 738, 743-46 (6th Cir. 2004) (holding that an Ohio tax, whose satisfaction of only the second prong of the *Complete Auto* test was in dispute, violated the Commerce Clause); Barringer v. Griffes, 1 F.3d 1331, 1335-39 (2d Cir. 1993) (declaring a Vermont tax unconstitutional and refusing to examine the third prong of *Complete Auto* where the parties agreed that the first and fourth prongs of *Complete Auto* were satisfied, and the court found that the tax violated the second prong of *Complete Auto*).

171. *See* Fagan, *supra* note 90, at 466 (citing Jason L. Riley, *Keep the Tax Man Off Line*, WALL ST. J., June 29, 1999, at A14) (claiming that the states' efforts to tax online sales of foreign merchants "has pitted the states against the federal government").

172. *See, e.g.*, Gen. Motors Corp. v. Tracy, 519 U.S. 278 (1997) (dismissing a firm's challenge of Ohio's policy of exempting in-state, regulated natural gas vendors from sales tax when it ruled that the state's regulation did not violate the Commerce Clause); Okla. Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 199-200 (1995) (finding an Oklahoma tax on bus tickets for interstate travel consistent with the Commerce Clause); Quill Corp. v. North Dakota, 504 U.S. 298, 307 (1992) (determining that a state, such as North Dakota, could only force merchants to collect use taxes when the firm willingly established a relationship with citizens of that specific state); Nat'l Bellas Hess v. Dep't of Revenue of Ill., 386 U.S. 753 (1967) (ruling that Illinois could not force an out-of-state mail order company that engaged in no local advertising to collect use taxes and remit them to the state).

173. *See, e.g.*, Dep't of Revenue v. Share Int'l, Inc., 676 So. 2d 1362, 1363 (Fla. 1996) (answering the district court's inquiry by confirming that it was appropriate

the state laws examined in recent cases because these new STP laws represent collective state action.[174] Thus, the *Quill* standards may no longer be the courts' most pressing concern when assessing the STP.

Instead, this collective state action broadly affects not only interstate commerce, but also the balance of federal and state power. Courts should find the STP unconstitutional not only because it may fail to comport with the Commerce Clause by violating the *Quill* standards, as discussed above, but also because the STP is contrary to the design of the Constitution. In particular, the STP's foundation of broad state power, articulated in the Tenth Amendment,[175] is subservient to Congress's narrow and explicit power to dictate the laws affecting interstate commerce.[176]

The ubiquity of these state laws—forty-four states have passed laws under the STP[177]—presents a majoritarian concern: if the people truly desired these laws, then their congressional representatives would pass them.[178] On the contrary, a resolution supporting the STP has been introduced in Congress (after the STP was supposedly in effect), but has not left committee.[179] Indeed, in 2003, the House of Representatives held a hearing to consider the validity of the STP,

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and accurate to read *Quill* as standing for the proposition that any activity by a business in a state other than strict mail order sales satisfies the substantial nexus requirement); Brown's Furniture, Inc. v. Wagner, 665 N.E.2d 795, 801 (Ill. 1996) (citing *Quill* as "[t]he most significant recent Supreme Court opinion" discussing the requirement that a business must maintain a substantial nexus with a state to be subjected to its taxation laws).

174. *See supra* notes 83-85 and accompanying text (highlighting the collective nature of the state action under the STP and the joint formation of the STP's rules); *see also supra* note 160 (showing that the new legal strategy of states under the STP has been flagged and discussed by Congress).

175. U.S. CONST. amend. X (proclaiming that any "powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States").

176. U.S. CONST. art. I, § 8, cl. 1 & 3 (declaring that "Congress shall have power to . . . regulate commerce . . . among the several states").

177. *See* Press Release, The Streamlined Sales Tax Project, *supra* note 91 (advocating the states' interests in creating a tax system that, according to the local governments, simplifies tax procedures and reduces burdens on state business communities).

178. *But cf.* League of Latin Am. Citizens v. Perry, 126 S. Ct. 2595, 2614-16 (2006) (cautioning that if the criteria of Thornburg v. Gringles, 468 U.S. 30, 78-79 (1986), are met, then a congressional districting plan might be unconstitutional with respect to minority voting rights). More importantly, note that implicit in the *League of Latin Am. Citizens* decision is the premise that, as a general matter, it is entirely constitutional for congressional districts to be gerrymandered by the state, and thus, Congress may not represent the true will of the people. Then again, if it is the state legislature that has the power to influence political success for federal legislators, it is actually more puzzling why Congress has not endorsed the STP.

179. S. 152 CONG. REC. S14191 (Dec. 20, 2005).

although it did not endorse it.[180] One could certainly construe this lack of action as tacit refusal by Congress to endorse the STP.[181]

Just as the Court has analyzed the structure of the Constitution to limit federal executive power, it likely would examine the federalist roots of the Constitution to limit state power. The Supreme Court has found that the nation's executive, which has broad constitutional authority,[182] is most constricted when it acts pursuant to a power that has been specifically granted to Congress, and Congress has not delegated that power to the President.[183] Analogously, a state's broad authority to govern should likewise be narrowly construed in arenas in which specific authority is constitutionally delegated to Congress.[184]

While this argument embraces the Court's tendency to maintain a separation of powers among the three branches of the federal government, the same underlying principle holds for the separation between state and federal power.[185] Just as the powers of the

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180. *Streamlined Sales and Use Tax Agreement: States' Efforts to Facilitate Sales Tax Collection From Remote Vendors: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 108th Cong. 148 (2003).

181. *But see* New Economy Tax Fairness Act, S. 664, 107th Cong. (2001) (proposing, essentially, to endorse the *Quill* decision, and explicitly stating that a state citizen's mere use of Internet technologies to buy goods from foreign firms does not create a substantial nexus with a state, thereby repudiating the STP). However, like the resolution in support of the STP, this bill has not passed. *See supra* note 179 and accompanying text (noting the stalled resolution in support of the STP).

182. *See* Hamdi v. Rumsfeld, 542 U.S. 507, 581-82 (2004) (Thomas, J., dissenting) (citing Dames & Moore v. Regan, 453 U.S. 654, 678 (1981), for the proposition that courts need not scrutinize cases in which the executive has been granted power through broadly worded constitutional or legislative language); Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 634 (1952) (Jackson, J., concurring) (characterizing executive power granted to the president by the Constitution as "comprehensive and undefined").

183. *See* Hamdan v. Rumsfeld, 126 S. Ct. 2749, 2800-01 (2006) (Kennedy, J., concurring in part) (finding that the President did not have broad authority in the field of military justice because Congress had consistently passed rules regulating the subject); *Youngstown Sheet & Tube Co.*, 343 U.S. at 637 ("When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb.").

184. *Cf.* U.S. CONST. amend. X (establishing the supremacy of the federal government regarding powers that are specifically delegated to the United States, but reserving other unnamed powers to the several States); *supra* notes 182-183 (describing the limitations of the President's powers, particularly in areas where Congress has expressly exercised its own power).

185. *Compare* THE FEDERALIST NO. 51, at 255 (James Madison) (J.R. Pole ed., 2005) (advocating an "interior structure of the [federal] government, as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places"), *with* THE FEDERALIST NO. 46, at 280 (James Madison) (J.R. Pole ed., 2005) ("The federal and State governments are in fact but different agents and trustees of the people, *instituted with different powers*, and designated for different purposes.") (emphasis added).

President are broadly painted,[186] the powers of the states are broadly articulated in the Constitution, which states that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States."[187] Neither presidential nor state powers can include authority that the Constitution explicitly delegates to Congress.[188] Just as the Court must guard against the unauthorized concentration of power in the hands of the executive, an explicit assurance of congressional authority should also be a protection against the tyranny of concentrated power of the state governments.[189]

In this case, the Constitution clearly delegates the power to regulate interstate commerce to Congress, not to the states.[190] While it is safe to say that the Commerce Clause does not give Congress the power to regulate all aspects of citizens' interaction in this nation,[191] the Supreme Court has certainly allowed Congress to regulate all manner of business transactions that cross state lines.[192] The STP, by its nature, goes against the spirit of the principles of federalism,[193] as

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186. *See* U.S. CONST. art. II, § 1 (stating that "[t]he executive power shall be vested in a President of the United States of America," though not explicitly defining executive power); *Youngstown Sheet & Tube Co.*, 343 U.S. at 634 (Jackson, J., concurring) (characterizing executive power under the Constitution as "comprehensive and undefined").

187. U.S. CONST. amend. X; *see* THE FEDERALIST NO. 45, at 253 (James Madison) (J.R. Pole ed., 2005) (proclaiming that "[t]he powers delegated by the proposed Constitution to the federal government are few and defined," while the powers "which are to remain in the State governments are numerous and indefinite").

188. *See* United States v. Curtiss-Wright Exp. Corp., 299 U.S. 304 (1936) (listing in explicit detail the powers that the Constitution grants the President, Congress, and the States, and reiterating that these powers are separate unless otherwise lawfully delegated).

189. *See* INS v. Chadha, 462 U.S. 919, 961 (1983) (noting that the nation's Framers were wary of the power of state legislators, and thus reserved power for a federal legislative check by specifying congressional authority). *But cf.* THE FEDERALIST NO. 45, at 252 (James Madison) (J.R. Pole ed., 2005) (assuring the public that "[t]he State governments will have the advantage of the federal government, whether we compare them in respect to the immediate dependence of the one on the other . . . [or in respect] to the powers respectively vested in them").

190. U.S. CONST. art. I, § 8, cl. 1 & 3.

191. *See* United States v. Lopez, 514 U.S. 549, 560 (1995) (maintaining that Congress may only assert its commerce clause authority over matters that involve interstate "economic activity").

192. *See id.* (noting the constitutionality of congressional regulation of mining, restaurants, and credit-related transactions because these activities are economic in nature).

193. *See* THE FEDERALIST NO. 45, at 254 (James Madison) (J.R. Pole ed., 2005) ("If the new Constitution [is] examined . . . it will be found that the change which it proposes [from the Articles of Confederation] consists much less in the addition of new powers to the Union, than in the invigoration of its original powers. *The regulation of commerce, it is true, is a new power*; but that seems to be an addition which few oppose.") (emphasis added). *Compare* THE FEDERALIST NO. 32, at 169 (Alexander Hamilton) (J.R. Pole ed., 2005) (assuring citizens that "the State Governments would

well as the spirit of the Commerce Clause,[194] as the states attempt to assert a power that has been granted to Congress, but never explicitly delegated to the states.

That the STP muddies constitutionally delegated lines of authority should certainly outweigh the practical clarifications that the STP admittedly provides. The consolidation of state taxation procedures under the STP does delineate a clear method for states to extract revenues from interstate sales while avoiding the risk of double taxation, a goal that the Court has embraced.[195] Indeed, state advocates may argue that since the STP merely requests foreign merchants to implement one simple software program to facilitate taxation, the STP complies with the Court's preference for "pragmatism" over "formalism" when assessing interstate transactions.[196] Yet the STP's fulfillment of the second of four prongs outlined in *Complete Auto* is insufficient to overcome the STP's deficiencies. First, as previously discussed, the satisfaction of one of *Complete Auto*'s four criteria cannot come at the expense of any of the other three.[197] Second, the Court does not regard constitutional delineations of power as merely formal boundaries that it may ignore for the sake of simpler transactions. In fact, the Court's preference for simplicity over formalism extends only as far as the wording of tax statutes, certainly not to constitutional principles.[198] Quite to the contrary, the Court approaches issues delineating constitutional roles

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clearly retain all the rights of sovereignty which they before had, and which were not by [ratification of the Constitution] *exclusively* delegated to the United States"), *with* U.S. CONST. art. I, § 8, cl. 1 & 3 ("Congress shall have power to . . . regulate commerce . . . among the several states."), *and* U.S. CONST. amend. X ("The powers *not delegated to the United States* by the Constitution, nor prohibited by it to the states, are reserved to the states") (emphasis added).

194. *See* McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944) ("The very purpose of the Commerce Clause was to create an area of *free trade* among the several States.") (emphasis added).

195. *See* Goldberg v. Sweet, 488 U.S. 252, 260-61 (1989) (stating that the primary purpose of *Complete Auto*'s second prong of fair apportionment "is to ensure that each State taxes only its fair share of an interstate transaction"); W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 257 (1938) (praising state taxes levied on interstate sales where gross receipts are apportioned because "it is a practical way of laying upon the commerce its share of the local tax burden without subjecting [the transaction] to multiple taxation").

196. *See* Okla. Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 183 (1995) (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)) (illustrating that the Court is less interested in parsing specific language of specific tax statutes and far more concerned over the practical effects the tax may have on merchants).

197. *See supra* Part III.B.3 (emphasizing that the four prongs of *Complete Auto* are not factors, but are each independently required by the Court to comply with the Commerce Clause).

198. *Complete Auto*, 430 U.S. at 279 (contending that when considering state tax statutes under the Commerce Clause, courts should examine "not the formal language of the *tax statute* but rather its practical effect") (emphasis added).

studiously, with frequent reference to The Federalist as a guide.[199] One therefore cannot ignore the argument that the STP appears to be not only incongruent with the plain language of the Constitution, but also contrary to the principles outlined in The Federalist. Thus, barring congressional action, courts should also reject the STP as contrary to the federalist design of the Constitution.

CONCLUSION

While the MTC clearly attempted to frame the STP in a manner acceptable under current constitutional jurisprudence, in order to allow the states to recover perceived "lost" revenue by coordinating with one another, there are at least two lines of reasoning available to declare the STP unconstitutional. While the goals of the STP seem entirely reasonable, the STP operates in a legal gray area, where, in the absence of congressional approval, state regulation of interstate commerce might be constitutional, but has hardly been endorsed by Congress. Shrewdly, the MTC included a risk-reward program within the STP, offering merchants the opportunity to comply with the regulations on a voluntary basis. Thus, the MTC might avoid a legal challenge of the STP, should merchants find compliance cheaper than protest.

Any online merchant without a true physical presence in a state can challenge the STP, as applied by that state.[200] First, the foreign merchant can challenge a state's claim that, under a current understanding of the Commerce Clause, the merchant maintains a substantial nexus with the state. A merchant could dispel all three expansive notions of a substantial nexus by pointing to contrary congressional intent, in conjunction with current jurisprudence.

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199. *See* Ira C. Lupu, *Time, the Supreme Court, and The Federalist*, 66 GEO. WASH. L. REV. 1324, 1329-30 (1998) (analyzing the frequency of citations to The Federalist in Court opinions and finding that opinions in the 1980s and 1990s cited this authority much more frequently than those in prior eras); James G. Wilson, *The Most Sacred Text: The Supreme Court's Use of the Federalist Papers*, 1985 BYU L. REV. 65, 68-73 (1985) (asserting that the increased citation to The Federalist by the Court has coincided with the rise of the assertion that understanding historical context is more important than interpreting the plain language of disputed law or clause).

200. By design, this Comment assumes that the foreign merchant would have standing to bring this suit. Many challenges to the STP would also satisfy the ripeness requirement, since merchants must begin to implement the STP immediately, or risk legal action by the states. *See* Texas v. United States, 523 U.S. 296, 300 (1998) (stating that a claim cannot be ripe if it depends upon future, uncertain events before the dispute materializes). It is entirely possible that a challenge to the STP might arise when a state prosecutes a foreign merchant pursuant to the STP. Given the amount of money in controversy here, it would be surprising if no state or merchant entered into a legal dispute over the constitutionality of the STP within the next several years.

Second, the merchant can also claim that the STP should be struck down on the structural basis of the Constitution. Under the STP, the states have collectively acted without the approval of Congress, and with Congress' tacit disapproval, pursuant to the Commerce Clause—an arena designated for congressional governance.

Thus, despite the careful planning of the MTC, courts should find the STP unconstitutional.