Physical Presence in Cyberspace: As Electronic Commerce Takes Off, Does Quill Leave Local Merchants in the Dust

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Physical Presence in Cyberspace: 
As Electronic Commerce Takes Off, Does Quill Leave Local Merchants in the Dust?

During the 1990s, computer science has dramatically changed the way people learn, work, communicate, and trade. The Internet has emerged as one of the most influential and extensive technologies available to date. When the United States government granted public access to the Internet ("Net") in 1991, it was a relatively unknown communication network accessible to only a small group of scientists and academians. Once commerce began to tap its vast potential, the driving force of the market quickly shaped the Net into a thriving commercial super-highway.

Today, the Net functions as a powerful tool for conducting business-to-business as well as business-to-consumer transactions. In fact, some companies, such as Amazon.com, have abandoned traditional methods of trade altogether and operate entirely on-line. The use of electronic networks allows an enterprise to operate from any location, provide uninterrupted service and customer support, increase market area, increase


2. NOEL ESTABROOK, TEACH YOURSELF THE INTERNET IN 24 HOURS 16-17 (1997). Originally known as ARPAnet, the Net started in 1973 as a communications research project initiated by the U.S. Defense Advanced Research Projects Agency. The goal of the project was to develop communication rules, called protocols, to enable computer networks to exchange information. Id. at 16.

3. Amazon.com is a large online bookseller that does not operate retail stores or carry an inventory. DAVID KOSIUR, UNDERSTANDING ELECTRONIC COMMERCE 5 (1997).

4. Id.
cost efficiency, operate several different ventures at once, and test new ideas.\(^5\) Although electronic commerce offers many benefits, states face the problem of collecting sales and use taxes for goods and services purchased on-line. The United States Supreme Court decision, *Quill Corporation v. North Dakota*,\(^6\) requires that a nonlocal seller have a physical presence before a state can compel it to collect and remit use tax.\(^7\)

Net transactions take place over a vast network of telephone lines and are not subject to geographical or physical boundaries. Thus, an out-of-state seller may advertise its goods and services over the Net using an electronic storefront and not be compelled to collect and remit use tax for sales made to in-state residents.

This comment explores whether the physical presence test enunciated in *Quill* has outlived its usefulness within the context of the electronic storefront. The following paragraphs demonstrate that the *Quill* decision creates hardships for, and discriminates against, merchants who maintain physical presences within the taxing state. Part I provides an introduction to electronic commerce and the Net. Parts II and III discuss sales and use taxes, respectively. Part IV outlines the development of decisions regarding the collection and remittance of use tax from out-of-state sellers. Part V discusses the *Quill* decision and establishes that (1) the Court's analysis deviates from precedent, (2) the physical presence test fails when applied to electronic commerce, and (3) such failure results in discrimination against sellers who have physical presences. Finally, Part VI discusses alternative methods by which a taxing state may collect sales and use tax on Net sales from nonresident sellers.

I. INTRODUCTION TO ELECTRONIC COMMERCE AND THE INTERNET

A. Overview of Electronic Commerce

Electronic commerce has been defined as the process of conducting


\(^7\) Quill Corp., 504 U.S. at 317-18. Physical presence requires more than advertising through common carrier or mail. Id. at 315 (citing National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 758 (1967)). It may include owning property, operating a retail outlet, or merely having a sales force present in the state. Id. at 306-307 (citing Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939); Nelson v. Sears Roebuck & Co., 312 U.S. 359 (1941), and Scripto, Inc. v. Carson, 362 U.S. 207 (1960)).
business over electronic networks as opposed to via traditional methods such as in person, by mail, or by telephone. This definition includes both business-to-business and business-to-consumer transactions. Electronic commerce is not new. Companies have been conducting business in this way since the 1960s, mainly in the form of Electronic Data Interchange ("EDI").

In its most common form, EDI consists of a value-added network ("VAN"), which links commercial purchasers and suppliers together over a system of electronic mailboxes. Through these mailboxes, the parties electronically exchange preapproved business forms, such as purchase orders, quotations, bills of lading, and invoices. Because of the high cost of setting up electronic trading agreements on the VAN, only large corporations subscribe to the service. EDI remains the primary method by which corporations exchange purchasing data with their suppliers.

B. Electronic Commerce and the Internet

In recent years, electronic commerce has experienced substantial growth in the form of Net transactions. This is the result of a large number of new companies engaging in Net commerce. In addition, many EDI service providers have taken steps to make EDI transactions available over the Net.

8. KOSIUR, supra note 3, at 7-10; Robert D. Hof et al., The "Click Here" Economy, BUS. WK., June 22, 1998, at 125.
9. In addition, banks have used Electronic Fund Transfer since the 1960s to transfer funds over a dedicated electronic network. KOSIUR, supra note 3 at 1, 267.
10. An EDI service provider will generally manage the VAN. Id. at 56-57.
11. Id. at 266-67.
12. It can cost as much as $50,000 to add an additional supplier to the VAN. Andy Reinhardt, Log On, Link Up, Save Big, BUS. WK., June 22, 1998, at 138.
13. In addition to the expense of setting up a VAN, EDI does not allow much flexibility regarding which business forms may be exchanged. KOSIUR, supra note 3, at 56-57; Reinhardt, supra note 12, at 134.
14. The value of EDI-based transactions is presently fourteen times greater than that of business-to-business Net transactions. Those figures, however, are expected to even out in approximately five years. Reinhardt, supra note 12, at 136.
15. For example, OpenEDI is a series of specifications that standardizes all purchaser EDI data formats so that such data is simpler to translate and transmit over the Net. KOSIUR, supra note 3, at 57. In addition, many EDI service providers now offer a service called WebEDI which converts EDI data into a format that can be transmitted over the Net. Reinhardt, supra note 12, at 137-38. Some EDI subscribers, such as EcCo., also map EDI data from the purchaser and convert it to a form that the supplier's personal computer can read. Reinhardt, supra note 12, at 138.
The Net consists of a decentralized collection of networks, which share common rules of communication called transmission control/internet protocols ("TCP/IP Protocols"). The Net offers several ways to transmit information, such as e-mail, File Transfer Protocol ("FTP"), and newsgroups. Most commercial information, however, travels along the World Wide Web ("Web").

The Web has had a dramatic effect on both business-to-business and business-to-consumer transactions. Business-to-business transactions (which account for eighty percent of the electronic commerce conducted on the Net) concern the sale and purchase of goods and services between commercial entities; such transactions include advertising, customer support, and communication. The Web allows businesses to operate more efficiently and cheaply and facilitates the growth of new kinds of enterprises; for example, Amazon.com (an on-line bookseller without retail stores or inventory), Kantara and Software.net (on-line sellers of commercial software packages), and FastParts (on-line seller of surplus

16. Several other types of available networks include the following: intranets, which comprise a company's internal network; extranets, which are two or more intranets linked together; and virtual private networks, which occur when an intranet is run through the Net. KOSIUR, supra note 3, at 32-34.

17. A TCP determines the maximum size of a particular transmission over the network. KOSIUR, supra note 3, at 276. An IP provides an address for a particular location and controls the routing of network information. Id. at 269. An electronic address can be compared to a physical street address and is commonly referred to as a "domain name." Gregory A. Ichel, Comment, Internet Sounds Death Knell for Use Taxes: States Continue to Scream over Lost Revenues, 27 SETON HALL L. REV. 643, 643 (1997); ESTABROOK, supra note 2, at 12.

18. E-mail, described as "the cornerstone of all communications on the Internet," is an exchange of electronic messages and/or data files over the Net. ESTABROOK, supra note 2, at 56. It is a fast, easy, and inexpensive way for individual subscribers to communicate on a one-to-one basis. Id. at 55.

19. FTP is a collection of "libraries" established for downloading any type of digital file, including text, multimedia, and application files. FTP libraries have limited access and are not suitable for widespread commercial application. ESTABROOK, supra note 2, at 220-21.

20. A newsgroup consists of a system of news servers that "post" related groups of information to bulletin boards. Subscribers then read these postings. Newsgroups function primarily to exchange information on related topics and do not welcome commercial activity. ESTABROOK, supra note 2, at 106-12.

21. The Web embodies a vast network of server and client computers. ESTABROOK, supra note 2, at 28-29.

22. Peter Coy, You Ain't Seen Nothin' Yet, BUS. WK., June 22, 1998, at 130. Businesses are expected to exchange $17 billion in goods by the end of the year and a massive $327 billion by the year 2002. Hof et al., supra note 8, at 124 (citing figures from Forrester Research, Inc.).

23. KOSIUR, supra note 3, at 4.

24. Id. at 5. See also Heather Green & Seanna Browder, Cyberspace Winners: How They Did It, BUS. WK., June 22, 1998 at 156.

25. Id. at 5-6.
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Business-to-consumer transactions primarily involve the sale of goods and services from commercial sellers to consumers. Although such transactions account for only twenty percent of the business conducted on-line, the value of such transactions is expected to exceed $5.1 billion in 1999.

States generally do not have difficulty in collecting sales or use tax on business-to-business transactions. Most large commercial entities keep accurate accounting records. In addition, larger businesses may be subject to periodic audits by the taxing state. Less formal business forms, such as a general partnership or sole proprietorship, however, may not be subject to audits and, therefore, exhibit a lower level of compliance.

Consumer purchases pose the greatest problem regarding the collection of sales and use taxes. Consumers rarely keep records of their purchases and many do not realize that they are subject to the tax. Accordingly, this Comment primarily addresses consumer purchases and the business-to-business transactions of informal commercial entities.

C. Electronic Storefronts

Companies marketing to consumers commonly advertise and sell their products on-line using a web site. A web site is an electronic address that accommodates a collection of site documents. A web site consists of a cover or home page and contains related documents. Hypertext links within the site allow visitors to access different pages or even different sites.

26. Hof et al., supra note 8, at 126.
27. Coy, supra note 22, at 130.
29. Corporations, limited liability companies, limited liability partnerships, and limited partnerships all must file forms that are a matter of public record.
30. The United States Supreme Court noted that collecting use tax from consumers presents "a difficult administrative problem." Miller Bros. Co. v. Maryland, 347 U.S. 340, 343 (1954); See also infra Part IV and Saba Ashraf, Virtual Taxation: State Taxation of Internet and On-Line Sales, 24 FLA. ST. U. L. REV. 605, 611 (1997).
31. Saba Ashraf, supra note 30, at 611.
32. ESTABROOK, supra note 2, at 29.
33. Id.
34. Id. at 30. A hypertext link is ordinarily indicated by colored text within the web document. Double clicking on the link with a mouse connects the user to other pages or web sites. Id.
A commercial web site used for the purpose of selling goods and services over the Net is called an electronic storefront.\textsuperscript{35} Such storefronts have the capability to operate like physical retail outlets.\textsuperscript{36} They usually contain an elaborate home page, professional computer-generated graphics, a banner and subtitle, main and sub-menus, and hypertext links.\textsuperscript{37} In addition, electronic storefronts offer features that allow individuals visiting them to interact with the storefront. Such features include provisions for customer service, multimedia capabilities, an on-line catalogue, downloadable files, and customer questionnaire and credit card authorization forms.\textsuperscript{38}

The increasing number of electronic storefronts on the Net has created a need to organize them. A group of storefronts housed in a single Net location is referred to as a cybermall.\textsuperscript{39} Cybermalls offer convenience, easy access, and one-stop shopping and may one day become as commonplace as conventional retail malls.\textsuperscript{40}

Electronic storefronts have already had a tremendous impact on the marketplace. Consumers now have the ability to bargain hunt for the most competitive prices, and small businesses have the means to compete with corporate giants. Doing business over the Net ultimately affects the way states collect tax revenue from such sales. The following paragraphs provide an introduction to sales and use tax and the constitutional issues surrounding each.

II. SALES TAX

A sales tax is a tax on the sale of goods and services.\textsuperscript{41} The seller commonly adds the percentage of the tax to the purchase price and collects it at the point of sale. Sales tax rates and exemption schedules often vary from state to state. In addition, some states allow municipalities and

\textsuperscript{35} See GONYEA, supra note 5, at 39-41.
\textsuperscript{36} Id. at 41.
\textsuperscript{37} Id. at 57-66.
\textsuperscript{38} Id.
\textsuperscript{39} Id. at 43. CommerceNet, for example, operates a prosperous cybermall. Id. In addition, Compuserve provides a subscriber membership to a collection of electronic storefronts, including big names such as J.C. Penney and Sears. Ashraf, supra note 30, at 607. Cybermalls may also be dedicated to the sale of a particular product, such as AutoMallUSA.com, which houses a group of automobile dealers.
\textsuperscript{40} GONYEA, supra note 5, at 42.
counties to levy their own sales tax.\textsuperscript{42} Sales tax revenues provide a significant source of income for numerous states.\textsuperscript{43}

The Commerce Clause\textsuperscript{44} prohibits a state from exacting a sales tax upon goods and services purchased beyond state borders.\textsuperscript{45} This limitation significantly impaired the ability of states to collect sales tax as interstate commerce expanded in the late 1930s. Consumers could avoid the tax by simply purchasing goods outside their state of residency. In response to this practice, state legislatures enacted the use tax.\textsuperscript{46}

III. USE TAX

A use tax is a tax imposed on tangible personal property\textsuperscript{47} that has been purchased out of state but brought into the taxing jurisdiction for use and consumption.\textsuperscript{48} A use tax entitles a state to collect a consumption tax on goods that would have been taxed had they been purchased in state.\textsuperscript{49} Because of the difficulty of collecting use tax from individual consumers, the out-of-state seller usually bears the administrative burden of collecting and remitting the tax.\textsuperscript{50}

\begin{itemize}
\item \textsuperscript{42} For example, Missouri currently has 136 local taxing jurisdictions. AMERICAN BAR ASSOCIATION, SALES & USE TAX DESKBOOK 26.16-.18 (D. Michael Young et al. eds., 1997-98 ed.).
\item \textsuperscript{43} The push for imposition of state sales taxes arose out of the Great Depression. In 1947, revenue collected from sales tax provided the second largest source of income for 48 states. PAUL J. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 148 (1953). Sales tax still remains a vital source of revenue, especially for states that do not impose an income tax. Texas, for example, derives more than one-half of its annual revenues from sales and use tax. John Sharp, Virtual Taxation: Electronic Commerce Poses Problems for State Tax Collections, GOVT. FIN. REV. Aug. 1996 at 36.
\item \textsuperscript{44} U.S. CONST. art. I, § 8. "The Congress shall have the Power To... regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes..." Id.
\item \textsuperscript{45} McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944) (striking down an Arkansas tax on sales made to Arkansas residents by a Tennessee company because the seller did not maintain a place of business in Arkansas and all of the sales in question occurred in Tennessee). But see, Norton v. Illinois, 340 U.S. 534 (1951) (upholding a gross receipts tax regarding sales routed through an in-state office to an out-of-state office).
\item \textsuperscript{46} HARTMAN, supra note 43, at 161-62.
\item \textsuperscript{47} See, e.g., Monamotor Oil Co. v. Johnson, 292 U.S. 86 (1934) (upholding a use tax on gasoline); Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938) (upholding a gross receipts tax on advertising space); D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24 (1988) (upholding a use tax on catalogues distributed within the state). Today, use statutes often include services as well. See, e.g., TEX. TAX CODE ANN. §§ 151.005(3) and 151.0101(a) (West 1998).
\item \textsuperscript{48} BLACK'S LAW DICTIONARY 1073 (6th ed. 1991).
\item \textsuperscript{49} HARTMAN, supra note 43, at 162.
\item \textsuperscript{50} See supra note 30. Early constitutional challenges to this practice met with little success.
\end{itemize}
A use tax advances two fundamental policies. First, it preserves state sales tax revenues by discouraging tax avoidance.\textsuperscript{51} Application of the tax eliminates any savings for consumers who purchase goods out of state. Second, it protects local sellers from losing business to out-of-state merchants.\textsuperscript{52}

The United States Supreme Court has consistently sustained the constitutionality of the use tax. As early as 1937,\textsuperscript{53} the Court upheld a Washington state use tax challenged as violative of the Commerce Clause.\textsuperscript{54} Justice Cardozo reasoned that the Washington law\textsuperscript{55} did not levy the tax against the interstate sale, but rather taxed the “privilege of use after commerce [was] at an end.”\textsuperscript{56} The Court refined this holding in \textit{Western Livestock v. Bureau of Revenue.}\textsuperscript{57} \textit{Western Livestock} concerned the collection of a gross receipts tax\textsuperscript{58} levied against the sale of advertising


\textsuperscript{51} "It is one of the well-known functions of the integrated use and sales tax to remove the buyers' temptation ‘to place their orders in other states in the effort to escape payment of the tax on local sales.'" Nelson v. Sears Roebuck & Co., 312 U.S. 359, 363 (1941)(citing Henneford v. Silas Mason Co., 300 U.S. 577, 581 (1937).

\textsuperscript{52} Hartman explains that "[t]he unfortunate result of such bargain hunting abroad is not merely a short-changing of the state's coffers, but local merchants whose transactions are subject to the local sales tax find themselves at a competitive disadvantage with an extra-state seller whose sales are subject to no sales tax." HARTMAN, supra note 43, at 161.

The United States Supreme Court has recognized the need to protect local merchants from out-of-state competition. \textit{See, e.g.,} Miller Bros. v. Maryland, 347, U.S. 340, 343 (1954); National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551 (1977).


\textsuperscript{54} Henneford, 300 U.S. at 588.

\textsuperscript{55} \textit{Id.} at 580. To avoid double taxation, the Washington statute provided for a credit if the purchaser had already paid Washington sales tax. \textit{Id.} The statute also offered a credit for taxes paid to other states. \textit{Id.} The Court noted in dicta that this allowance was merely permissive, not mandatory. \textit{Id.} at 587.

\textsuperscript{56} \textit{Id.} at 582. \textit{Henneford} concerned a Washington State use tax levied against construction machinery brought into the state from an out-of-state contractor. \textit{Id.} at 579. The statute was challenged on the basis that the state could not tax an interstate sale under the Commerce Clause. \textit{Id.} at 581. \textit{See also,} General Trading v. State Tax Comm'n of Iowa, 322 U.S., 335 (1944) (holding that use tax does not violate the Commerce Clause).

\textsuperscript{57} 303 U.S. 250 (1938).

\textsuperscript{58} A gross receipts tax is a levy against a company's pre-tax earnings. BLACK'S LAW DICTIONARY 485 (6th ed. 1991). The taxing state collects a percentage of the total gross income generated from business transacted within the state. A tax against gross receipts functions much like a sales tax in that the amount of the tax depends upon the volume of in-state sales. The New Mexico statute challenged in \textit{Western Livestock} promulgated a tax
space in an interstate trade magazine.\textsuperscript{59} The Court upheld the tax on the basis that it did not subject interstate commerce to additional local exactions.\textsuperscript{60} The Court asserted that "it was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business."\textsuperscript{61} Together Henneford and Western Livestock stand for the proposition that states possess the power to enact use taxes as long as the tax on the interstate sale does not exceed the amount paid by local commerce.

This concept was recently endorsed by the Court in Associated Industries of Missouri \textit{v.} Lohman.\textsuperscript{62} \textit{Lohman} addressed the issue of whether a compensating use tax\textsuperscript{63} may be greater than its corresponding sales tax.\textsuperscript{64} The Court determined that it could not.\textsuperscript{65} The Commerce Clause and Due Process Clause\textsuperscript{66} prohibit state governments from taxing interstate sales at a higher rate than local sales.\textsuperscript{67}

Once the Court had established a constitutional basis for the enactment of state use tax statutes, retailers challenged the application of the tax under the Due Process Clause. These early cases examined under what circumstances a state may reach beyond its borders to compel an

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\textsuperscript{59} Western Livestock, 303 U.S. 250 at 251 (citing 1934 N.M. Laws Spec. Sess., ch. 7, § 201, subd. I.)

\textsuperscript{60} Id. at 259-61. The Court rejected the rule that the tax of interstate gross receipts was unconstitutional per se. Instead, the Court acknowledged that interstate commerce may be required to "pay its way." Such "price," however, may not exceed the burdens placed on local commerce. \textit{Id.} at 258. Thus, the Commerce Clause protects interstate commerce from sustaining "the cumulative burdens not imposed upon local commerce." \textit{Id.} at 256.

\textsuperscript{61} Id. at 254.

\textsuperscript{62} 511 U.S. 641 (1994).

\textsuperscript{63} The "compensatory tax" doctrine authorizes a state to burden interstate commerce through a use tax as long as the state imposes an equal burden on intrastate commerce through a sales tax. \textit{Lohman}, 511 U.S. at 645. The use tax challenged in \textit{Lohman} did not necessarily correspond to a local sales tax. \textit{Id.}

\textsuperscript{64} Id. at 644-45. The Court found that the Missouri tax violated the negative Commerce Clause powers by discriminating against out-of-state sellers. \textit{Id.} at 654.

\textsuperscript{65} \textit{Id.} at 648-52.

\textsuperscript{66} U.S. CONSTIT. amend. XIV. "[N]or shall any State deprive any person of life, liberty, or property, without due process of law." \textit{Id.}

\textsuperscript{67} \textit{Lohman}, 511 U.S. at 649-52. The Court rejected the state's argument that its taxing scheme had a negligible impact on interstate commerce. \textit{Id.} at 652. The state claimed that the tax was valid because most out-of-state purchases were made by persons domiciled in jurisdictions that had a local sales tax equal or greater than the compensating use tax. \textit{Id.} at 645.
IV. LAW GOVERNING COLLECTION OF STATE USE TAX FROM OUT-OF-STATE SELLERS

A. Early Cases

Due process requires the presence of minimum contacts before a state may exercise personal jurisdiction over a nonresident party. Thus, for a state to extend its taxing power to sales made by an out-of-state seller, the seller must have established minimum contacts with the taxing state. Traditionally, this has been a relatively easy standard to satisfy. In Wisconsin v. J.C. Penney, Co., the Court found sufficient contacts when "the taxing power exerted by the state [bore] a fiscal relation to protection, opportunities and benefits given by the state." J.C. Penney concerned a corporate levy for the privilege of declaring and receiving dividends. J.C. Penney, Co. ("J.C. Penney") received income from business conducted in Wisconsin but maintained its headquarters in New York. Applying a functional analysis, the Court held that the declar-
tion of dividends in New York did not dissolve the nexus between the Wisconsin sales and the tax on income derived from those sales.\textsuperscript{77}

One year later, the Court addressed a similar due process issue involving the Iowa Use Tax Act.\textsuperscript{78} Sears Roebuck & Co. ("Sears"), a New York corporation, had a permit to do business in Iowa and operated retail stores there.\textsuperscript{79} The state of Iowa sought to impose a use tax not only on retail sales, but also on mail order sales made to Iowa customers.\textsuperscript{80} Sears alleged that the mail order sales were completely unrelated to its retail business and should be exempt from the tax.\textsuperscript{81} The Court disagreed and upheld the tax on the basis that the retail sales carried the same tax burden as did the mail order sales.\textsuperscript{82} Because Sears possessed a permit to do business in Iowa (and maintained retail outlets there), the company received "benefits from Iowa for which [Iowa] has the power to exact a price."\textsuperscript{83} Both J.C. Penney and Sears Roebuck established a nexus based upon the opportunity to conduct in-state business.\textsuperscript{84} Sears Roebuck added the notion that once contacts occur, any local sales are subject to the taxing power of the state.\textsuperscript{85}

The Court later expanded the ways in which its requirements for contacts may be satisfied to include the presence of traveling salesmen\textsuperscript{86} and independent contractors.\textsuperscript{87} General Trading Co. v. State Tax Commis-

\textsuperscript{76} A state cannot tax the privilege of doing business. See Western Livestock v. Bureau of Revenue, 303 U.S. 250 (1938). Choosing not to invalidate the Wisconsin Privilege Dividend Act based on its name, the Court construed the statute to enact an income tax rather than a tax on the privilege of doing business. J.C. Penney, Co., 311 U.S. at 442.

\textsuperscript{77} J.C. Penney, Co., 311 U.S. at 445. The Court permitted the tax because it was based upon sales made to Wisconsin residents. Id. at 446.

\textsuperscript{78} Nelson v. Sears Roebuck & Co., 312 U.S. 359 (1941). The Iowa Use Tax Act imposed a "two per cent tax on gross receipts from sales of tangible personal property sold at retail in the state to consumers or users." IOWA CODE § 6943.103 (1939).

\textsuperscript{79} Sears Roebuck & Co., 312 U.S. at 362. Sears Roebuck & Co. operated twelve retail stores in Iowa. Id. at n.3. In addition, it mailed 600,000 small and 427,000 large catalogues to Iowa residents in 1937. Id.

\textsuperscript{80} Id. at 362.

\textsuperscript{81} Id. at 362-64.

\textsuperscript{82} Id. at 364-66. In fact, the Court viewed Sears Roebuck & Co.'s argument as purporting "to found a constitutional right on the practical opportunities for tax avoidance which its method of doing business affords Iowa residents ..." Id. at 366.

\textsuperscript{83} Id. at 365. The "benefits" received from Iowa include the privilege to do business there and any incidents or advantages following therefrom. Id. at 364

\textsuperscript{84} In Sears Roebuck & Co., this also included the existence of retail stores. See supra note 78.

\textsuperscript{85} The Court quickly affirmed the Sears Roebuck & Co. decision in Nelson v. Montgomery Ward & Co., 312 U.S. 373 (1941).

\textsuperscript{86} See General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335 (1944).

sion of Iowa also concerned the Iowa Use Tax Act. General Trading addressed the issue of whether Iowa may enforce the tax against a Minnesota corporation that did not maintain a place of business in Iowa. Unlike Sears, General Trading Co. ("General") was not licensed to do business and did not own property located in the state. The company did, however, solicit orders through traveling salesmen stationed there. The Court found that the presence of the salesmen constituted sufficient contacts to enable Iowa to enforce the tax.

In Scripto, Inc. v. Carson, the Court explored whether the state of Florida could require a Georgia corporation to collect and remit use tax for the sale of "mechanical writing instruments" to Florida residents. Scripto, Inc. ("Scripto") did not own property or employ salesmen in Florida. Instead, it solicited orders through jobbers who were independent contractors. The Court again found a sufficient nexus between the state and the sale of goods to Florida customers. As in Sears Roebuck, the Court declined to excuse state tax liability on the basis of a company's method of doing business.

The cases discussed above demonstrate how easily a taxing state can establish minimum contacts. The Court has, however, set limits. A state cannot impose the collection of use taxes upon a seller who neither enters nor reaches out toward the taxing jurisdiction. In Miller Brothers Co.

88. General Trading Co., 322 U.S. at 336-37. Iowa sought to require General Trading Co. to collect and remit the tax because of it was a "retailer maintaining a place of business in Iowa." Id. at 336.
89. Id. at 336, 337.
90. Id. at 337.
91. Id. at 338-39. The Court asserted that requiring the presence of retail stores "is constitutionally irrelevant to the right of Iowa . . . to exact a use tax . . . ." Id. at 338. The focus should remain on the sale of personal property to the Iowa resident "who is paying taxes to sustain his own state government." Id.
94. Id. at 207. The Florida statute imposed a "tax at the rate of three percent of the retail sales price . . . collectible from all dealers as herein defined on the sale at retail, . . . of tangible personal property." Fla. Stat. ch. 212.06(1) (1958). "Dealer," as defined under the statute, "means and includes every person who solicits business either by representatives or by the distribution of catalogs or other advertising matter and by reason thereof receives and accepts orders from consumers in the state . . . ."
95. Scripto, Inc. v. Carson, 362 U.S. at 208-09.
96. Id. at 209.
97. Id. at 211.
98. Id. at 212. "True, the 'salesmen' are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance." Id. at 211. See supra note 82.
v. Maryland, the Court refused to uphold a Maryland use tax levied against a Delaware corporation. Miller Brothers Co. ("Miller") operated a small retail store in Delaware and solicited orders only in person. Maryland residents had to actually travel to Delaware to purchase the goods. The Court espoused that "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Given that Miller had virtually no connection with the state of Maryland, the Court determined that there was not a sufficient nexus for Maryland to enforce the tax.

The early case law indicates that, in most instances, a merchant who conducted business within a state formed sufficient contacts to trigger the application of a use tax. With the growth of mail order sales, however, out-of-state merchants performed a great volume of business while maintaining contacts only through common carrier or the U.S. mail. The following line of United States Supreme Court decisions, beginning with the 1967 decision of National Bellas Hess, Inc. v. Department of Revenue of Illinois, specifically address the due process issues raised in connection with mail order sales.

B. Later Cases Involving Mail Order Catalogue Sellers

Confronted with a fast-growing mail order industry, the Court departed from precedent when it decided National Bellas Hess. National Bellas Hess, Inc. ("National") was a nationwide mail order house in-

100. The statute levied an excise tax "imposed on the use, storage or consumption in this State of tangible personal property purchased from a vendor within or without this State." MD. ANN. CODE art. 81, § 369 (1951). It further provided that "[e]very vendor engaging in business in this State . . . shall collect the tax." MD. ANN. CODE art. 81, § 371 (1951). "Engaging in business" is defined as the "selling or delivering in this State . . . tangible personal property . . . [through] a subsidiary agent . . . salesman, canvasser or solicitor operating in this State." MD. ANN. CODE art 81 § 368 (1951).
101. Miller Bros. Co. v. Maryland, 347 U.S. 340, 341-42. Maryland premised its argument on the fact that Miller (1) placed newspaper and radio advertisements, (2) circulated flyers, (3) delivered merchandise to Maryland residents via common carrier, and (4) delivered merchandise to Maryland residents via its own delivery truck. Id.
102. Id. at 341. In addition, Miller did not actively solicit business in Maryland. Id.
103. Miller, supra note 101, at 343.
104. Id. at 344-45.
105. Id. at 346-47.
106. 386 U.S. 753 (1967).
107. National was a clothing retailer that sold approximately 4,000 items through its catalogue. National Bellas Hess, Inc., 386 U.S. at 760-61 (Fortas, J., dissenting).
corporated in Delaware with its principal place of business in Missouri. Because of National's large volume of sales to Illinois residents, Illinois attempted to compel National to collect and pay use tax. National neither had a place of business nor employed representatives in Illinois. Its only connection with the state was through catalogue mailings to Illinois customers.

For the first time, the Court considered whether this type of solicitation entitled a state to compel a nonlocal seller to collect and remit use tax. The Court drew a clear distinction between businesses that have property or resources within a state and those that "do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business." The Court refused to enforce the tax against a seller whose sole contact with the taxing state was by mail or common carrier. To do otherwise would severely impair the ability of sellers such as National to conduct business. In addition, the Court feared the negative cumulative effect of local taxes on interstate commerce. Because National did not have any "retail outlets, solicitors or property within [the] State[,]" the Court struck down the tax.

108. Id. at 753-54. National was licensed to do business in Delaware and Missouri. Id. at 754.
109. Illinois assessed taxes against $2,174,744 of in-state sales over a 15-month period. Id. at 761 (Fortas, J., dissenting). National's net sales for 1961 were approximately $60,000,000. Id. at 760-61 (Fortas, J., dissenting).
110. Any "retailer maintaining a place of business in this State" must collect and remit use tax to the Department of Revenue. ILL. REV. STAT. ch. 120 § 439.3 (1965). The act encompasses any retailer "[e]ngaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State." ILL. REV. STAT. ch. 120 § 439.2 (1965).
112. Id. at 754-55. National sent out catalogues semiannually to a customer base of more than 5,000,000. Id. at 754, 761 (Fortas, J., dissenting). This figure does not include bulk mailings of "flyers." Id. at 761 (Fortas, J., dissenting).
113. "Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." Id. at 759.
114. Id. at 756-58.
115. Id. at 758. This language has been interpreted as "creat[ing] a safe harbor for vendors." Quill Corp. v. North Dakota, 504 U.S. 298, 315 (1992).
116. National Bellas Hess, 386 U.S. at 758. "[T]he Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only contact with customers in the State is by common carrier or the United States mail." Id.
117. Id. at 759. "[I]f the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote." Id.
118. Id. at 759-60. The Court noted that, as of 1965, there were more than 2,300 local taxing jurisdictions and at least eight taxing rates. Id. at 760.
119. Id. at 758.
120. Id. at 760.
Approximately ten years later, the Court addressed a similar issue in *National Geographic Society v. California Board of Equalization.* 121 *National Geographic Society* concerned the state of California's effort to enforce its use tax against the mail order sales of the National Geographic Society ("National Geographic"). 122 National Geographic was a nonprofit organization headquartered in the District of Columbia, where it conducted a mail order enterprise. 123 It also maintained two branch offices in California, which performed services unrelated to its mail-order sales. 124 Relying on *Sears Roebuck* 125 and its progeny, the Court held that the presence of the offices provided a sufficient nexus for California to impose the tax. 126 This decision marked a return to the due process analysis 127 that the Court had abandoned in *National Bellas Hess.* 128

Shortly after handing down *National Geographic Society*, the Court announced a four-part test combining due process and commerce clause analyses. This test was applied to determine the constitutional validity of the Mississippi privilege tax. 129 In *Complete Auto Transit*, the state of Mississippi sought to compel Complete Auto Transit, Inc. ("Complete Auto") to remit a five percent tax for the privilege of doing business within the state. 130 Complete Auto was a Michigan company that transported automobiles for General Motors Corporation. 131 It alleged that the

122. *National Geographic Soc'y*, 430 U.S. at 552-54. California sought to collect use tax on $83,596.48 of mail order goods purchased by California residents. Residents ordered the goods from *National Geographic Magazine* and the company then shipped the items from the District of Columbia and Maryland. *Id.* at 554.
123. *Id.* at 552. Customers could order items such as books and maps. *Id.*
124. *Id.* The California offices organized National Geographic's monthly magazine, the *National Geographic Magazine*. *Id.*
125. Nelson v. Sears Roebuck & Co., 312 U.S. 359 (1941); *See supra Part IV(A).*
126. The fact that National Geographic carried on some sort of business was enough. This was true even though the operations of the branch offices remained separate from those of the magazine. *See supra note 82.*
127. "The question presented by this case is whether [National Geographic's] activities at the offices in California provided sufficient nexus between the out-of-state seller appellant and the State—as required by the Due Process Clause." *National Geographic Soc'y*, 430 U.S. at 554.
130. *Complete Auto Transit, Inc.*, 430 U.S. at 274-76. The statute enacted a tax "for the privilege of engaging or continuing in business or doing business within this state to be determined by the application of rates against gross proceeds of sales or gross income . . . equal to five per cent." *MISS. CODE ANN.* §§ 10105, 10109 (1972).
131. *Complete Auto Transit, Inc.*, 430 U.S. at 276. The vehicles in question were shipped by rail from General Motors plants to Jackson, Mississippi. Complete Auto then transported the vehicles by truck from Jackson to dealers throughout the state. Because the vehicles were originally shipped from outside of Mississippi, the Mississippi courts presumed that Complete Auto performed services as part of an interstate transaction and the United States Supreme Court
Mississippi statute taxed the “privilege” of doing business within the state.\textsuperscript{132} The Court focused on the effect of the tax adopting a practical rather than formalistic approach.\textsuperscript{133} The Court devised the following four-part test.\textsuperscript{134} The test requires that (1) the seller's activity have a substantial nexus with the taxing state,\textsuperscript{135} (2) the tax be fairly apportioned,\textsuperscript{136} (3) the tax be nondiscriminatory,\textsuperscript{137} and (4) the tax be related to services provided by the taxing state to the seller.\textsuperscript{138} The Court determined that, as applied to Complete Auto, the Mississippi tax satisfied all four elements and upheld the statute.\textsuperscript{139}

C. Quill Corp. v. North Dakota

The Court’s decision in Quill Corp. v. North Dakota\textsuperscript{140} reaffirmed the agreed. \textit{Id.}

\textsuperscript{132} Id. at 278. When Complete Auto was decided, a tax upon the privilege of doing business within a state was considered unconstitutional per se. \textit{Id.} See Spector Motor Service v. O'Connor, 340 U.S. 602 (1951) and Freeman v. Hewit, 329 U.S. 249 (1946).

\textsuperscript{133} The Court discarded the semantic distinction between direct and indirect burdens on commerce and overruled Spector Motor Service and Freeman. Complete Auto Transit, Inc., 430 U.S. at 280-81, 283-86, 288.

\textsuperscript{134} Complete Auto Transit, Inc., 430 U.S. at 279.

\textsuperscript{135} The first prong of the test sets forth a due process requirement for a constitutional nexus. A similar requirement is found in Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560 (1975) (a sole employee in the state of Washington functioned as a liaison between Standard Pressed Steel Co. and its primary customer, Boeing Company; because the employee performed activities vital to Standard's business in Washington, the Court found a sufficient nexus).

\textsuperscript{136} The second prong of the test mandates that the tax apply only to funds generated within the taxing state and prohibits discrimination against interstate commerce. This concept can be traced to Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948) (a tax is fairly apportioned when it only includes capital invested within the state).

\textsuperscript{137} The third prong of the test prohibits discrimination against interstate commerce.

\textsuperscript{138} The fourth prong of the test specifies contacts required under the Due Process Clause. This idea is also encountered in Wisconsin v. J.C. Penney, Co., 311 U.S. 435 (1940) (explaining that rights associated with the privilege to do business in the state constitute a service provided by the state and are related to corporate revenues). See also Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948) (holding that "local incidents" of manning, maintaining and keeping local pipeline in repair constitute services from the state which are related to income generated by the pipeline).

\textsuperscript{139} Complete Auto Transit, Inc., 430 U.S. at 289.

\textsuperscript{140} 504 U.S. 298 (1992). The Court granted certiorari after the Supreme Court of North Dakota upheld the tax. Quill Corp., 504 U.S. at 301-02. See Heitkamp v. Quill Corp., 470 N.W.2d 203 (N.D. 1991). Arguing that National Bellas Hess should be overruled, the court in Heitkamp explained that "[t]he economic, social, and commercial landscape upon which Bellas
physical presence test set forth in National Bellas Hess. Quill addressed whether the state of North Dakota could require an out-of-state mail order catalogue seller to collect and remit use tax for sales made to North Dakota customers. Quill Corporation ("Quill") was a Delaware corporation with offices in Illinois, California, and Georgia. Quill did not have an office, property, or employees in North Dakota but grossed more than $1,000,000 in mail order catalogue sales to North Dakota residents. The issue before the Court was whether North Dakota could obligate Quill to collect and remit use tax for its North Dakota sales.

To decide this question, the Court performed a two-part analysis. First, it clearly differentiated between constitutional nexus under a due process analysis and constitutional nexus under a commerce clause analysis. The Due Process Clause concerns issues of "fundamental fairness," whereas the Commerce Clause concerns the "structure and effect of state regulation on the national economy." Due process jurisprudence has established a minimum contacts requirement. Commerce Clause jurisprudence, however, as set forth in Complete Auto requires a "substantial nexus." Because the substantial nexus requirement serves

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Hess was premised no longer exists . . . 'mail order' has grown from a relatively inconsequential market niche into a Goliath now more accurately delineated as 'direct marketing.' Heitkamp, 470 N.W.2d at 208. Applying the four-part test of Complete Auto, the court determined that Quill had substantial presence in the state. Id. at 216. "Quill has availed itself of modern technology to engage in an extensive, continuous, and intentional solicitation and exploitation of the State's consumer market and has thereby established an ubiquitous presence in the State." Id.

142. Heitkamp, 470 N.W.2d 203, 204-05. North Dakota exacts a tax upon goods "purchased for storage, use, or consumption within the State." N.D. CENT. CODE § 57-40.2-01 (1991). The statute further provides that any "retailer maintaining a place of business in" the state must collect and pay the tax. N.D. CENT. CODE § 57-40.2-07 (1991). The term "retailer" includes "every person who engages in regular or systematic solicitation of a consumer market in this state." N.D. CENT. CODE § 57-40.2-01(6). The phrase "regular solicitation" means "three or more separate transmittances of any advertisement or advertisements" within a twelve-month period. N.D. ADMIN. CODE § 81-04.1-01-03.1(3) (1991).
143. Quill Corp., 504 U.S. at 302-03.
144. Id. at 302.
145. Quill was the sixth largest vendor of office supplies in the state. Heitkamp, 470 N.W.2d at 216. It annually shipped 230,000 flyers and catalogues to its 3,500 North Dakota customers. Id.
146. Quill Corp., 504 U.S. at 303.
147. Id. at 312-13. "Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies." Id. at 312.
148. Id. at 312.
149. Id.
150. Id. at 311.
as a "means for limiting state burdens on interstate commerce," it demands more of a relationship than a minimum contacts.\textsuperscript{151} The Court therefore concluded that "a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that state required by the Commerce Clause."\textsuperscript{152}

Second, the Court defined "substantial nexus." When applying Complete Auto's four-part test, the Court incorporated physical presence as an element under the first and fourth parts of the test.\textsuperscript{153} Thus, to satisfy the substantial nexus requirement, a party must have physical presence; that is, own property, maintain a retail store, or station employees within the taxing state.\textsuperscript{154} Because Quill did not have physical presence in North Dakota, the Court exempted it from paying the tax.

Further supporting its argument, the Court strongly emphasized the need for a bright-line test in this area. Such a rule "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes."\textsuperscript{155} In addition, the Court maintained that Complete Auto did not overrule National Bellas Hess and that the concept of physical presence remained good law.\textsuperscript{156} Finally, the Court justified its reliance on National Bellas Hess based upon the "doctrine and principles of stare decisis."\textsuperscript{157}

Justice Scalia based his concurrence largely upon the doctrine of stare decisis.\textsuperscript{158} In addition, he recognized that businesses had long relied on the physical presence test and advised against "visit[ing] economic hardship upon those who took us at our word."\textsuperscript{159}

Justice White, in dissent, argued that the majority had no basis for claiming that the Commerce Clause requires a more stringent standard

\begin{enumerate}
\item<151> Quill Corp., 504 U.S. at 313.
\item<152> Id.
\item<153> Id. at 313-15.
\item<154> Id. at 315.
\item<155> Id. at 315. The Court also highlighted the fact that the "Bellas Hess Rule has engendered substantial reliance and has become part of the basic framework of a sizable industry." Id. at 317.
\item<156> Quill Corp., 504 U.S. at 314. The Court asserted that decisions regarding sellers who had a physical presence within the taxing state "do not directly conflict with the rule of Bellas Hess or compel that it be overruled." Id.
\item<157> Id. at 317.
\item<158> Id. at 320 (Scalia, J., concurring). Justice Scalia stated that, "[u]nlike the Court, however, I would not revisit the merits of [National Bellas Hess], but would adhere to it on the basis of stare decisis." Id.
\item<159> Id. at 321 (Scalia, J., concurring).
\end{enumerate}
for finding a nexus than does the Due Process Clause. He noted that even the majority could not find "authority for this novel interpretation of our cases." The holding in Complete Auto, as were the cases upon which it relied, was based on a due process nexus analysis.

The dissent also questioned why the majority sustained the ruling in National Bellas Hess and did not give it "the complete burial it justly deserves." Even assuming that the Court's interpretation of prior case law had merit, National Bellas Hess no longer applies to modern society. The dissent contended that "in today's economy, physical presence frequently has very little to do with a transaction a State might seek to tax."

V. ANALYSIS OF THE QUILL DECISION

A. Quill Searches for Black Letter Law

Justice White's dissent validly criticizes the majority opinion. Despite the complex reasoning the majority offers for sustaining the physical presence test, earlier case law simply does not support such an analysis. With the exception of National Bellas Hess, previous decisions have consistently employed a minimum contacts due process argument. None of the previous decisions, not even National Bellas Hess, even hinted at the distinction that the Court went to painstaking efforts to establish. In this regard, Justice White's dissent is on point.

The Court, however, expressed valid reasons for adopting a bright-line test in this area. A steadfast rule is needed to offer guidance to lower courts and provide security to the commercial sector. Unfortunately, the Court's decision has adversely affected the taxing authority of local jurisdictions.

160. *Id.* at 325 (White, J., dissenting).
161. *Quill Corp.*, 504 U.S. at 325 (White, J., dissenting).
162. *Id.* at 326-28 (White, J., dissenting).
163. *Id.* at 322 (White, J., dissenting).
164. *Id.* at 327-28 (White, J., dissenting).
166. Saba Ashraf, supra note 30, at 609.

Nine out of ten executives of American companies engaged in buying and selling over the Internet called for clarification in the governing regulations. An overwhelming fifty-one percent of the 291 executives surveyed (of companies with gross revenues in excess of $50 million) stated that the lack of clarity in state and local tax laws governing electronic commerce was inhibiting their involve-
B. The Issue: Physical Presence v. Economic Presence

The big question Quill attempts to answer is, when does a state have the ability to extend its taxing power to a non-resident seller? Under traditional due process theory, a state's power to tax would attach when the seller establishes minimum contacts.\(^{167}\) Under National Bellas Hess, it would attach only when the seller is physically present.\(^{168}\)

Both the dissent in Quill and the majority in the underlying North Dakota Supreme Court decision, Heitkamp v. Quill Corp., argued for a due process standard that incorporates the concept of "economic presence."\(^{169}\) Economic presence refers to a seller's performance of "extensive, continuous and intentional solicitation."\(^{170}\) Examples of contacts indicating economic presence include market base, gross sales, and volume of sales. This standard seems to demand more than minimum contacts but less than physical presence.\(^{171}\)

Physical presence, however, as enunciated in National Bellas Hess is simply that: physical presence within state borders. The court in Heitkamp asserted that "technological advances have made physical presence within the jurisdiction meaningless in modern commerce."\(^{172}\) Although a seller may lack physical presence, it can still take advantage of its economic presence and remain exempt from state use or sales tax obligations.\(^{173}\) If out-of-state sellers can conduct business within a state and not be required to collect use tax, then states and local merchants face the
same dilemma they did before the enactment of use tax statutes. It is especially important to keep this disparity in mind when discussing physical presence within the context of electronic commerce.

VI. APPLICATION OF QUILL TO INTERNET COMMERCE

A. The Problem with Physical Presence

The court in Heitkamp describes the mail order industry as "essentially offering a 'department store by mail.'" In many ways, commerce over the Net resembles mail order sales. In fact, several companies that previously conducted mail order businesses have recently converted their sales operations to deal exclusively through the Net. There are, however, significant differences between mail order sales and sales over the Net.

Use of the Net greatly reduces the need for physical presence outside the state in which the seller maintains its principal place of business. Doing business over the Net diminishes the necessity for distribution centers, customer service centers, and on-site employees. For example, Amazon.com is a bookseller that has no inventory or retail stores. In addition, Kaplan Education Centers has just recently launched a law school, Concord University School of Law, which will operate completely on-line without a campus, library, or professors.

A web site reaches a potentially unlimited national and international market. Unlike catalogue and telephone solicitations, web sites are not necessarily targeted to a specific geographic location. The creator of the site makes it available on the Net so that potential customers will “visit” the site. A potential buyer “visits” a Web site much like he or she would visit a store.

These differences clearly give companies who sell products over the Net an advantage over those who engage in mail order sales. In addition

174. See supra Parts II and III.
175. Heitkamp, 470 N.W.2d at 209.
176. Ashraf, supra note 30, at 628.
177. For example, Gateway Computers moved from selling computers by telephone to selling via the Net; Nets Inc. converted its printed catalogue to an on-line catalogue. KOSIUR, supra note 3, at 117-31, 133-49.
178. Id. at 5.
to commercial benefits, Net vendors also have an advantage regarding state use tax. Net transactions do not have geographical boundaries. Use of the net for commercial sales also facilitates the creation of "virtual" companies, which do not maintain a place of business. Because of this, such companies do not satisfy the physical presence test mandated by Quill. As a result, companies that conduct business over the Net will likely be exempt from collecting and paying state use tax.

B. Application of the Quill Test Is Discriminatory

The application of Quill's physical presence test in the context of selling over the Net discriminates against traditional and mail-order sellers. Both out-of-state sellers with physical presence and Net sellers share in the economic benefit of selling goods and/or services to residents within the state. However, Net sellers do not bear the burden of collecting and remitting use tax, while out-of-state sellers with physical presence do.

Relieving a company of its use tax burden offers significant benefits. In addition to enabling a seller to offer items at a "discounted" price, it saves the seller the administrative cost of collecting the tax. It also gives the seller repose in that it will not be liable for any deficiency judgments or penalties. There currently exist more than 6,000 local and state taxing jurisdictions, each with a different tax rate. Understandably, an interstate seller who must collect use tax may, despite its best efforts, find itself liable for tax deficiencies.

C. States Will Lose Substantial Revenues

Another aspect of the physical presence test is that, as Net sales in-

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180. Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992). The Court has historically struck down the multiple local taxation of interstate commerce. See Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256 (1938) ("[W]ithout the protection of the commerce clause [interstate commerce] would bear cumulative burdens not imposed on local commerce."). The Court in both National Bellas Hess and Quill, acknowledged that the complexity and sheer number of taxing jurisdictions might easily place an undue burden upon interstate commerce. Quill Corp., 504 U.S. at 313 n.6; National Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 759-60 (1967). Providing further explanation, the Court in National Bellas Hess noted that "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions . . . ." National Bellas Hess, Inc., 386 U.S. at 759-60.
crease, states will lose substantial sales and use tax revenues. States that do not have an income tax will experience the greatest losses. As a result, states such as Texas have begun to tax Net services and the use of telephone lines. Congress has addressed the symptoms of this national problem with the Internet Tax Freedom Act, which places a four-year moratorium on additional Net taxes. This bill treats only the symptom, not the problem. Despite urgings from the Court, Congress has repeatedly failed to pass comprehensive federal legislation in this area.

To bend the inflexible requirements of the physical presence test, some have sought to expand or redefine the definition of physical presence. The representational nexus theory, for example, shifts focus to an agent of the seller in an attempt to overcome the substantial nexus problem presented in Quill. Under the representational nexus test, a commercial on-line service, telecommunications provider or banking and financial system is designated as the seller's agent. These entities will most likely have physical presence in the taxing state even if the seller does not. The representational nexus theory has not, however, met with much success. Net service providers and banks may support the seller's business, but they do not perform services on its behalf. One author has suggested that state legislatures merely expand the definition of physical presence to include "virtual presence." This proposal,

182. TEX. TAX CODE ANN §§ 151.0101 and 151.0035 (West 1998); 34 TEX. ADMIN. CODE 3.342 (West 1998); Nineteen other states have enacted similar exactions. Steve Forbes, Don't Strangle this Baby with Taxes, FORBES, Feb. 23, 1998, at 27.
185. See Ichel, supra note 17, at 660-63.
186. See Ashraf, supra note 30, at 621-29.
187. Id. at 622-24. This theory is based on the idea that the service provider acts as the seller's in-state representative. Id. at 622. The argument fails because the service provider merely delivers the seller's information as the postal service delivers catalogues. Id. at 622-23.
188. Id. at 624-26. Under this concept, the telecommunications company that supports and facilitates Net transmissions is deemed to be the agent of the seller. Like the argument concerning service providers, this argument fails because the telecommunications company only transmits information. Id. at 625.
189. Id. at 626-27. Like service providers and telecommunication companies, banks also facilitate the seller's business through credit card payment systems. Id. at 626. Banks, however, do not act on behalf of, or promote the seller's business. Id.
190. Id. at 627-29. "By changing and expanding the definition of physical presence, and in effect equating nonphysical presence in a state with physical presence, the state legislative bodies would be writing the constitutional requirement of physical presence out of existence." Id. at 628.
however, is really based on an argument for economic presence and would not withstand a challenge under Quill. "Virtual presence" means that a seller does not have physical presence in the state but does enough business in that state over the Net to warrant exacting a tax.

VI. RESOLUTION OF THE PROBLEM WITH QUILL

At the heart of the Quill decision lies the question of when a state can compel a nonresident seller to collect and remit use tax. An effective solution to this problem would give sellers notice regarding collection responsibilities, minimize the administrative burden on nonlocal sellers, provide equitable treatment to all merchants, and preserve the revenues of the taxing state. The following discussion explores two judicial and two legislative solutions.

A. Adopt a Due Process "Minimum Contacts" Standard

One suggestion, which was offered by the North Dakota Supreme Court in Heitkamp v. Quill, Corp.,\(^{191}\) is to utilize an economic presence standard. The court proposed a "flexible substantive approach," which would involve a review of "the totality of the circumstances, on a case-by-case basis, with special emphasis upon the economic realities presented."\(^{192}\) Adoption of an economic presence standard would eliminate preferential treatment of out-of-state sellers. In addition, it would maintain state use tax revenues by targeting businesses that have a significant economic impact in the state. Allowing decisions to be made on an individual basis, however, would only add to the uncertainty surrounding use tax obligations. This standard fails to provide guidance for either the business world or the judiciary.

B. Keep the "Physical Presence" Standard

Another possibility is to retain the physical presence standard enunciated in Quill. Physical presence clearly establishes the boundaries of a

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state’s taxing authority. As discussed, however, this standard produces inequitable results when applied to electronic commerce. Keeping physical presence as the determinative factor in allocating use tax collection responsibilities would place local sellers at a disadvantage. In addition, a physical presence requirement would diminish state use tax revenues as sales over the Net increase.

C. Keep Sales Tax and Require Sellers To Submit Informational Returns

A possible legislative solution is to require all out-of-state sellers to file informational returns. This would lessen the administrative burden on the seller and eliminate the threat of deficiency judgements. An informational return would also benefit the taxing state by providing enough information so that the tax may be collected from the individual consumer. The buyer would be exempted from the tax by producing a valid exemption certificate. Sales taxes would be unaffected and would be collected at the place of purchase.

This alternative would provide the best legislative solution because it would shift the burden of tax collection away from the nonresident seller to the states themselves. A mandatory informational return would also give sellers notice of their use tax obligations.

D. Abolish Sales Tax and Require All Sellers To Collect Flat Rate Use Tax

Finally, Congress may choose to eliminate sales tax and allow states to collect a flat rate use tax. Treating all transactions as out of state would end the disparate treatment between local and nonlocal sellers. All vendors would understand that they are responsible for collecting and remitting the tax. Moreover, the adoption of a flat rate tax would ease the administrative burden on sellers. No longer would states be able to add a county use tax rate. The rate of tax paid would depend upon where the goods were shipped, which sellers could easily track.

CONCLUSION

At present, the issue raised in Quill remains unanswered. Although the Court has attempted to develop a standard by which a state may compel an out-of-state seller to collect use tax, these efforts have fallen
short of a workable solution. On the hand, the adoption of an economic presence test or due process analysis fails to provide a definitive rule concerning use tax collection liability. On the other hand, Quill's physical presence requirement lacks the flexibility necessary to address the non-physical characteristics of Net sales.

The best way to reach a balanced solution that protects the interests of both sellers and states is through the legislature. One approach would be to relieve nonlocal sellers from collection liability by requiring only informational returns. Another would be to eliminate sales tax and have sellers remit a flat rate use tax based on the shipment destination. Unfortunately, Congress has yet to enact this type of legislation. However Congress chooses to solve this dilemma, the problem of collecting use tax on Net transactions will only get worse if no action is taken.

Jenine Elco Graves