Rethinking Business Privilege Taxes in the Internet Age

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Patricia L. Shoenberger*

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I. INTRODUCTION

“By prohibiting States from discriminating against or imposing excessive burdens on interstate commerce without congressional approval, [the dormant Commerce Clause] strikes at one of the chief evils that led to the adoption of the Constitution, namely, state tariffs and other laws that burdened interstate commerce.”1 The Supreme Court of Ohio emphasized this quote, both in its majority opinion and in Justice Kennedy’s dissenting opinion, in the case of Crutchfield Corp. v. Testa.2 This 2016 case involved a constitutional challenge to Ohio’s commercial-activity tax (“CAT”) by Crutchfield Corporation (“Crutchfield”), a company that had no connection to Ohio other than the shipment of goods to customers located in Ohio by way of the United States Postal Service or other common carrier.3 The CAT is imposed on each person or business receiving gross-receipts of $500,000 or more from goods that were “ultimately received [in Ohio] after all transportation [was] completed.”4 Crutchfield argued that the tax was unconstitutionally applied due to a lack of substantial nexus with the state of Ohio because it had no physical presence there; however, the Supreme Court of Ohio disagreed, finding that physical presence, while sufficient, is not necessary to impose a business privilege tax.5 The Court held that there only needs to be “an adequate quantitative standard,” and the $500,000 minimum threshold constituted such a standard.6

The majority opinion distinguished seemingly applicable case law in two ways. First, it excluded, as distinguishable, any case law decided prior to Complete Auto Transit, Inc. v. Brady (“Complete Auto”).7 The Crutchfield court noted that the Complete Auto decision lifted the ban on all taxation for the privilege of engaging in interstate commerce imposed by Spector Motor Service, Inc. v. O’Connor.8 Instead, Complete Auto imposed a four-part test under which state taxation of interstate commerce is analyzed today.9 Second, the court contrasted business privilege taxes, which tax

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1. Crutchfield Corp. v. Testa, 88 N.E.3d 900, 914, 916 (Ohio 2016) (alteration in original) (emphasis omitted) (quoting Comptroller of Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1794 (2015)).
2. Id.; see also id. at 916 (Kennedy, J., dissenting).
3. Id. at 902.
4. Id. at 902-03.
5. Id. at 904, 910.
6. Id. at 910.
7. Id. at 908; see also Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288 (1977).
8. Crutchfield, 88 N.E.3d at 907; see also Complete Auto, 430 U.S. at 289; Spector Motor Serv. v. O’Connor, 340 U.S. 602, 609 (1951) (holding that states cannot tax “the privilege of doing interstate business”), overruled by Complete Auto, 430 U.S. at 28.
business gross-receipts, with sales and use taxes, which tax individual purchases. It reasoned that, because the individuals being taxed were different, the cases concerning sales and use taxes, such as *Quill Corp. v. North Dakota*, were not applicable law for the case at hand. Justice Kennedy, in his dissenting opinion, stated, “The majority relies on the absence of United States Supreme Court decisions directly on point and treats this case as though it exists in a vacuum. It does not.”

*Crutchfield* raises an interesting dilemma for current e-commerce sellers: Should states be permitted to impose business privilege taxes on Internet-based companies, whose sole connection to the state is customers’ receipt of goods through the mail? The answer is that the current scheme of state business privilege taxes present unconstitutional burdens on interstate commerce, and Congress should enact legislation which sets an economic percentage maximum and clarifies the many questions these tax schemes raise. The analysis begins with the foundation of the dormant Commerce Clause implied in the Constitution, and an overview of the major applicable and comparable case law beginning with *Complete Auto* and shifting to the interpretation of the four prongs of the *Complete Auto* test. Next, an analysis of what e-commerce is and its current state provides necessary information for the application of the *Complete Auto* test to business privilege taxes on Internet-based retailers. Finally, a look at the negative legal and economic impacts of these taxes on Internet-based interstate commerce leads to a conclusion that the current state business privilege tax scheme is unconstitutional and, as a result, Congress should enact legislation concerning Internet-based retailers.

13. *Id.* at 904; see also *Diversified Ingredients, Inc. v. Testa*, No. 4:15-CV-1935RLW, 2016 WL 2932160, at *1, *3 (E.D. Mo. 2016) (holding the federal district court lacked jurisdiction to hear a dispute regarding Ohio's Commercial Activity Tax and Diversified Ingredients, Inc., an online company with no connection to Ohio other than the shipment of commodity pet food ingredients to customers located in Ohio); *Overstock.com, Inc. v. N.Y. State Dep't of Taxation & Fin.*, 987 N.E.2d 621, 626 (N.Y. 2013) (holding New York's Internet Tax constitutional as applied to Overstock.com, Inc. and Amazon.com, LLC because the companies contracted with local website owners to solicit sales via advertisements. "The bottom line is that if a vendor is paying New York residents to actively solicit business in this state, there is no reason why that vendor should not shoulder the appropriate tax burden.")
II. FROM THE COMMERCE CLAUSE, FOUND IN THE
CONSTITUTION, THE SUPREME COURT HAS INFERRED THE
EXISTENCE OF THE DORMANT COMMERCE CLAUSE, WHICH CONTROLS
WHEN A STATE MAY TAX INTERSTATE COMMERCE.

A. The Origins of the Dormant Commerce Clause

One of Congress’s most important enumerated powers is the
Commerce power, because it allows Congress to legislate a broad
array of topics. 14 The Constitution states, “The Congress shall have
Power . . . To regulate Commerce with foreign Nations, and among
the several States, and with the Indian Tribes.” 15 From this provi-
sion, the Supreme Court has inferred the principle that state and
local laws are unconstitutional if they place an undue burden on
interstate commerce. 16 “If Congress has legislated, the question is
whether the federal law preempts the state or local law . . . .” 17 If
Congress has not passed legislation either in support of or invali-
dating state and local laws, those laws can be challenged as “unduly
impeding interstate commerce.” 18 The latter is referred to as the
dormant Commerce Clause. 19

Congress, however, has neither passed nor invalidated business
privilege taxes imposed on Internet-based companies whose only
contact with the state is the shipment of goods to customers therein;
therefore, any state business privilege tax, including the Ohio CAT,
falls under the dormant Commerce Clause. 20 As demonstrated by
the discussion below, the Supreme Court has, throughout recent
history, recognized the difficulty of applying the dormant Com-
merce Clause to interstate commerce considering changing busi-
ness environments and a technologically advancing society.

14. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW PRINCIPLES AND POLICIES 250 (Richard
A. Epstein et al. eds., 5th ed. 2015).
15. U.S. CONST. art. I, § 8, cl. 3.
16. CHEMERINSKY, supra note 14, at 444.
17. Id.
18. Id.
19. Id.
Cong., 2d Sess. (2018) (deciding that the Marketplace Fairness Act, which proposes a uniform
sales tax on Internet purchases, would be unduly burdensome to small businesses and harm-
ful to the economy).
B. The Establishment of the Complete Auto Test

From the conception of the dormant Commerce Clause until 1977, the Supreme Court enforced the rule that no state was permitted to directly tax interstate commerce. In 1977, however, Complete Auto was decided, and the Court refused to adopt a per se rule to govern state taxation of interstate commerce; instead, the Court established a four-part test. Complete Auto Transit, Inc., a Michigan corporation, transported vehicles for General Motors Corporation ("General Motors"). General Motors would assemble cars outside of Mississippi, ship them into Mississippi via railway, and Complete Auto Transit, Inc. would then load the cars onto its trucks for transport to the Mississippi dealers. Mississippi imposed a business privilege tax on Complete Auto Transit, Inc. for its activity in the state. The Supreme Court of Mississippi sustained the tax, reasoning that Complete Auto Transit, Inc. was "dependent upon the State for police protection.

The Supreme Court of the United States affirmed the decision and found the law constitutional. It reasoned that Complete Auto Transit, Inc. argued only that the tax was unconstitutional because it "was imposed on nothing other than the 'privilege of doing business' that is interstate." The argument was based on the Spector Rule, which said taxes on the privilege of doing business could not be applied to activities that are part of interstate commerce, but the Court decided to overrule the Spector Rule. Instead, it held that a tax would be sustained "against [the] Commerce Clause challenge 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." The Court, however, did not apply


22. CHEMERINSKY, supra note 14, at 479.


24. Id.

25. Id. at 276-77.

26. Id. at 277.

27. Id. at 289.

28. Id.

29. Id. at 277-78, 288-89.

30. Id. at 279.
the new test to these facts because Complete Auto Transit, Inc. did not argue any of the elements.\textsuperscript{31} The elements of the \textit{Complete Auto} test became the new focus of state taxation challenges. What follows is a step-by-step analysis of those four elements.

1. \textit{The Substantial Nexus}

States can only tax interstate commerce when there is a “substantial nexus” between the individual being taxed and the state imposing the tax.\textsuperscript{32} Prior to the “substantial nexus” inquiry established in \textit{Complete Auto}, the Court used the physical presence test, which was first established ten years prior to \textit{Complete Auto} in a case involving an Illinois use tax.\textsuperscript{33} In 1967, the Department of Revenue (“Department”) in Illinois sued National Bellas Hess (“National”), a mail-order corporation incorporated in Delaware with its principal place of business in Missouri.\textsuperscript{34} The case concerned an Illinois tax placed on customers who purchased goods from an out-of-state company for use within the state of Illinois.\textsuperscript{35} The Department sued National, claiming the company had to collect the use tax from its customers and pay the Department.\textsuperscript{36} The Illinois Supreme Court required National to pay the tax even though National had no contacts with the state of Illinois other than twice-a-year catalogs, occasional “flyers,” and merchandise orders delivered to its customers by mail or common carrier.\textsuperscript{37} On appeal to the Supreme Court of the United States, National argued the tax violated the Due Process Clause and was an “unconstitutional burden upon interstate commerce.”\textsuperscript{38}

The Court said the analyses for Due Process and the dormant Commerce Clause were similar because the main question in both was whether the individual was “accorded the protection and services of the taxing State.”\textsuperscript{39} It held the tax unconstitutional as an undue burden on interstate commerce, reasoning there is a “sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than

\begin{itemize}
  \item \textsuperscript{31} Id. at 289.
  \item \textsuperscript{32} Id. at 279.
  \item \textsuperscript{34} Id. at 753-54.
  \item \textsuperscript{35} Id. at 754.
  \item \textsuperscript{36} Id.
  \item \textsuperscript{37} Id. at 754-55.
  \item \textsuperscript{38} Id. at 756.
  \item \textsuperscript{39} Id. at 757.
\end{itemize}
communicate with customers in the State by mail or common carrier.”

Following *National Bellas Hess*, the Court clarified in *Quill Corp. v. North Dakota* that, while an individual may have the significant contacts necessary for Due Process, that does not automatically make those contacts sufficient to establish a substantial nexus under the *Complete Auto* test. *Quill*, a Delaware corporation, had offices and warehouses in Illinois, California, and Georgia, but sold office equipment and supplies to customers and businesses nationwide. *Quill* solicited sales through “catalogs and flyers, advertisements in national periodicals, and telephone calls.” North Dakota imposed a use tax on “retailers,” defined as “every person who engages in regular or systematic solicitation of a consumer market in the state,” including mail-order companies without property or employees in North Dakota. The State sued to compel *Quill* to pay the tax.

At trial, the court found for *Quill*, holding “the case indistinguishable from *National Bellas Hess*.” Further, it found that the State failed to show a nexus allowing it to define “retailer” as it did. The Court reasoned that “the State had not shown that it had spent tax revenues for the benefit of the mail-order business.” The North Dakota Supreme Court reversed. It reasoned that the increase in mail-order business and the recent decisions involving the Commerce Clause made *National Bellas Hess* an inappropriate test in the current economic and legal setting.

The Supreme Court of the United States reversed, holding the tax unconstitutional. It established there is a difference in the analyses of the Due Process Clause and the dormant Commerce Clause because the two have different legislative intents. The “relevant inquiry under *Complete Auto* was whether ‘the state has provided some protection, opportunities, or benefit for which it can

40. *Id.* at 758.
42. *Id.* at 302.
43. *Id.*
44. *Id.* at 302-03 (quoting N.D. CENT. CODE § 57-40.2-01(6) (1991)).
45. *Id.* at 303.
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.* at 319.
52. *Id.* at 305.
expect a return.”

In addition, the Court further clarified, while its decisions after Complete Auto demonstrate a move toward more flexible balancing rules, the bright-line physical presence test had not been overruled. It reasoned that a bright-line test, while not appropriate for every situation, furthers the ends of the dormant Commerce Clause by “firmly establish[ing] the boundaries of legitimate state authority,” “encourag[ing] settled expectations,” and “foster[ing] investment by business and individuals.”

In 2018, the Supreme Court of the United States overruled the physical presence requirement established in Quill and National Bellas Hess. South Dakota enacted a law requiring out-of-state sellers to collect and remit sales tax if, “on an annual basis, [they] deliver more than $100,000 of goods or services into the State or engage in 200 or more separate transactions for the delivery of goods or services into the State.” Wayfair, Inc.; Overstock.com, Inc.; and Newegg, Inc. are all merchants that easily meet the thresholds imposed by South Dakota’s law, but the companies have no employees or real estate in South Dakota. South Dakota filed a declaratory action seeking an injunction requiring these merchants to register for licenses to collect and remit sales tax. Respondents moved for summary judgment, arguing that the Act is unconstitutional.

The Supreme Court of the United States overruled the physical presence requirement established in National Bellas Hess and Quill. The Court reasoned that the physical presence requirement is arbitrary and artificial, and in the changing economic landscape, it ignores “substantial virtual connections to the State.”

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53. Id. at 304 (quoting State by Heitkamp v. Quill Corp., 470 N.W.2d 203, 216 (N.D. 1991)).
54. Id. at 314.
55. Id. at 315-16.
57. Id. at 2089.
58. Id.
59. Id.
60. Id.
61. Id.
62. Id.
63. Id. at 2099.
64. Id. at 2092, 2095.
Further, the Court stated, “The physical presence rule [Quill] defines has limited States’ ability to seek long-term prosperity and has prevented market participants from competing on an even playing field.”65 Finally, the Court reasoned that “other aspects of the Court’s Commerce Clause doctrine can protect against any undue burden on interstate commerce, taking into consideration the small businesses, startups, or others who engage in commerce across state lines.”66

The Supreme Court, in a case involving Tyler Pipe Industries, Inc. (“Tyler Pipe”), demonstrated that while physical presence can be a flexible standard, there still must be some type of intentional availment of the state’s consumer market.67 Tyler Pipe challenged the state of Washington for a refund of a business privilege tax, arguing the company lacked a sufficient nexus for the tax to be constitutionally imposed.68 Tyler Pipe sold pipes, fittings, and drainage products in the state of Washington.69 It had no offices, property, or employees located within the state of Washington; however, it did contract with an independent contractor out of Seattle to take care of its daily sales business with customers.70 Both the trial court and the state supreme court held that these sales representatives established a nexus with the state.71 The state supreme court specifically held that the classification of “independent contractor” instead of “agent” was irrelevant.72 It held that the representative acted daily on behalf of the company, calling on customers and soliciting orders with whom Tyler Pipe has long-standing relationships, and that this action helped to increase market share for Tyler Pipe in Washington.73 The Supreme Court of the United States agreed with this reasoning, and held there was a substantial nexus.74

The majority opinion in Crutchfield held that Tyler Pipe stands for the concept that physical presence is a sufficient standard for substantial nexus, but not a necessary standard.75 While this is an accurate analysis of the holding, the Crutchfield majority failed to recognize that the Court in Tyler Pipe certainly implied that, in the

65. Id. at 2096.
66. Id. at 2098.
68. Id.
69. Id.
70. Id.
71. Id.
72. Id. at 250.
73. Id. at 249.
74. Id. at 250-51.
75. Crutchfield Corp. v. Testa, 88 N.E.3d 900, 912 (Ohio 2016).
very least, the company must target that state to establish a nexus.\textsuperscript{76} The Court quoted the reasoning of the state supreme court, stating:

As the Washington Supreme Court determined, “the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales.” The court found this standard was satisfied because Tyler’s “sales representatives perform any local activities necessary for maintenance of Tyler Pipe’s market and protection of its interests . . . .”\textsuperscript{77}

The key phrases in this quote are “activities . . . significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales” and “local activities necessary for maintenance.”\textsuperscript{78} The likely premise behind nexus is that the company is targeting that state in order to establish customer relationships.

The substantial nexus portion of the \textit{Complete Auto} test concerns the nexus between the state and the seller and does not consider the activity sought to be taxed.\textsuperscript{79} In \textit{National Geographic Society v. California Board of Equalization}, National Geographic Society appealed a decision by the California Supreme Court requiring it to pay a business privilege tax.\textsuperscript{80} National Geographic Society was a District of Columbia (“D.C.”) nonprofit corporation focused on science and education.\textsuperscript{81} The corporation had two offices in California whose purpose was to solicit advertising for the monthly magazine.\textsuperscript{82} The D.C. offices ran a mail-order business selling maps, atlases, globes, and books.\textsuperscript{83} The California office activities had no connection to the sales from the D.C. offices.\textsuperscript{84} The California Supreme Court found the liability of tax violated neither Due Process

\begin{footnotes}
\item[76.] \textit{Tyler Pipe Indus.}, 483 \textit{U.S.} at 250-51.
\item[77.] \textit{Id.} (quoting \textit{Tyler Pipe Indus. v. Dep’t of Revenue}, 715 \textit{P.2d} 123, 125-26 (Wash. 1996)).
\item[78.] \textit{Id.}
\item[79.] \textit{Id.}
\item[80.] \textit{Id. at 554}.
\item[81.] \textit{Id. at 552}.
\item[82.] \textit{Id.}
\item[83.] \textit{Id.}
\item[84.] \textit{Id.}
\end{footnotes}
nor the Fourteenth Amendment. It concluded “the ‘slightest presence’ of the seller in California established sufficient nexus between the State and the seller.”

The Supreme Court of the United States affirmed the decision; however, it did not agree with the “slightest presence” standard. It reasoned that the “maintenance of two offices” and “solicitation by employees” were much more than the “slightest presence.” The Court disagreed with the National Geographic Society’s argument that “there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller’s activity within the State.”

This implies that in cases involving business privilege taxes, the gross-receipts being taxed must stem from some type of in-state activity.

Based on the above cases and their application of the Complete Auto test, there are four key takeaways regarding the substantial nexus requirement. First, the National Bellas Hess physical presence test, which was reaffirmed in Quill Corp., has been overruled, and is no longer applicable law. Second, Quill Corp. established that the Complete Auto test requires more than just the “minimum contacts” standard for Due Process, and that the test is focused on what the taxpayer owes the state for usage of its resources. Third, Tyler Pipe demonstrated that, while physical presence can be a flexible standard, there still must be some type of intentional availment of the state’s consumer market. Fourth, National Geographic Society reinforced that the “slightest presence” was not a sufficient nexus, and implied that there must be some in-state activity that results in gross-receipts in order for those gross-receipts to be taxed.

2. Fair Apportionment

Fair apportionment refers to the concept that the tax should only be focused on the business activities completed within the state imposing the tax, and that a state cannot tax activities in another

85. Id. at 554.
86. Id. at 555.
87. Id. at 556.
88. Id.
89. Id. at 560.
The policy behind fair apportionment is to avoid multiple taxation of gross-receipts. Further, a tax is fairly apportioned when it is both internally and externally consistent.

Internal consistency concerns the structure of the tax. In order to determine whether a tax is internally consistent, one must ask "whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." The policy behind internal consistency is to ensure states are only taxing their fair share of interstate commerce; therefore, if an activity might be subject to multiple taxation, it goes against policy. For example, Central Greyhound Lines, Inc. v. Mealy involved an internal consistency issue. Central Greyhound Lines, Inc. operated a bus that transported patrons from one point in New York to another point in New York; however, 43% of the route was through both Pennsylvania and New Jersey. New York sought to impose a tax on the gross receipts from ticket sales of the bus line. The Tax Commission of New York upheld the tax, and the state courts affirmed that decision. Central Greyhound appealed, arguing that the tax was unconstitutional because the service was interstate commerce.

The Supreme Court reversed and found the tax to be unconstitutional as written. It was significant that neither Pennsylvania nor New Jersey were imposing taxes on the gross receipts from the mileage traveled within their state. Although the taxes were not implemented at that point, the mileage could have reasonably been subject to taxation in those states as well. Based on this reasoning, the Court found that permitting New York to tax the out-of-state portion of the travel was an undue burden on interstate commerce. It did, however, hold that the tax could be apportioned in

95. Id.
96. Id. at 185.
97. Id.
98. Id.
99. Id.
100. See 334 U.S. 653, 660 (1948).
101. Id. at 654, 660.
102. Id.
103. Id. at 655.
104. Id. at 654.
105. Id. at 664.
106. Id. at 662.
107. Id.
108. Id.
a way that would fall within the test, but that the restructuring of
the apportionment was up to the state.\textsuperscript{109}

External consistency is not concerned with the fact that an iden-
tical statute will be imposed in another state, but it is instead con-
cerned with the possibility of two different statutes having identical
effects.\textsuperscript{110} For example, in \textit{Oklahoma Tax Commission v. Jefferson
Lines, Inc.}, the Court analyzed an external consistency problem in-
volving a sales tax.\textsuperscript{111} Jefferson Lines, Inc. ("Jefferson") a Minne-
sota corporation, ran a bus line in Oklahoma.\textsuperscript{112} Oklahoma imposed
a sales tax on tickets for trips originating in Oklahoma.\textsuperscript{113} Jefferson
collected the sales tax on tickets for travel within the state, but not
on tickets originating in Oklahoma and terminating in another
state.\textsuperscript{114} After Jefferson filed for bankruptcy, the Tax Commis-
sioner filed to collect the unpaid taxes.\textsuperscript{115}

Jefferson opposed the imposition of tax liability, arguing that the
tax "present[ed] the danger of multiple taxation."\textsuperscript{116} The Bank-
rruptcy Court, the District Court, and the Court of Appeals all
agreed with Jefferson,\textsuperscript{117} but the Supreme Court of the United
States granted certiorari and reversed.\textsuperscript{118} It held the tax was "ex-
ternally consistent, as reaching only the activity taking place
within the taxing State, that is, the sale of the service."\textsuperscript{119} The
Court refused to extend the holding in \textit{Central Greyhound} because,
here, the business and the customer would each be taxed for the
same activity, but neither party would be taxed twice.\textsuperscript{120} It is im-
portant to note, however, that external consistency still only in-
volves activities taking place within the state.\textsuperscript{121} Business privilege
taxes that tax activities outside of the state likely would not be ex-
ternally consistent because there is a risk of multiple taxation of
the same activity.

\textsuperscript{109} Id. at 663.
\textsuperscript{111} Id.
\textsuperscript{112} Id. at 178.
\textsuperscript{113} Id.
\textsuperscript{114} Id.
\textsuperscript{115} Id.
\textsuperscript{116} Id.
\textsuperscript{117} Id.
\textsuperscript{118} Id. at 179.
\textsuperscript{119} Id. at 190.
\textsuperscript{120} Id. at 190.
\textsuperscript{121} Id. at 196.
3. Discrimination

Under the Complete Auto test, state taxes may not discriminate against out-of-state businesses.\(^{122}\) Taxes are discriminatory when they are levied on either “the privilege of doing interstate business within the state” or on “some local event so much a part of interstate business as to be in effect a tax upon the interstate business itself.”\(^{123}\) In one case addressing discrimination, Memphis Natural Gas Company (“Memphis”), a Delaware Corporation, was operating a pipeline through Arkansas, Louisiana, Mississippi, and Tennessee.\(^{124}\) One hundred thirty-five miles of the pipeline ran through Mississippi.\(^{125}\) Mississippi imposed a “franchise or excise tax” on any corporation “doing business” in the state.\(^{126}\) Memphis petitioned the Tax Commission of Mississippi for review of the tax, arguing the tax was “prohibited by the Commerce Clause.”\(^{127}\) The Tax Commission approved the tax and the Court of Appeals reversed.\(^{128}\) The Supreme Court of Mississippi approved of the tax and reasoned that the state was not attempting to tax interstate commerce, but was being compensated for “its protection of lawful activities carried on in this State by the corporation, foreign or domestic.”\(^{129}\)

The Supreme Court of the United States affirmed the decision.\(^{130}\) It agreed with the state supreme court’s reasoning that Mississippi did not “attempt to tax the privilege of doing an interstate business” or to gain anything other than “compensation for the protection of the enumerated local activities of ‘maintaining, keeping in repair and otherwise in manning the facilities.’”\(^{131}\) It also found that the activities were not essential enough to interstate commerce to warrant protection under the Commerce Clause.\(^{132}\) The Court noted that taxing activities outside the boundaries of the state is beyond the power of the state, but the activities in this case were those that “the state, not the United States, gives protection.”\(^{133}\) The policy here appears to limit a state’s authority to those activities conducted within its state boundaries because that state is the one

\(^{124}\) Id. at 80-81.
\(^{125}\) Id. at 81.
\(^{126}\) Id.
\(^{127}\) Id. at 82.
\(^{128}\) Id.
\(^{129}\) Id.
\(^{130}\) Id. at 96.
\(^{131}\) Id. at 93 (quoting Stone v. Memphis Nat. Gas Co., 29 So. 2d 268, 270 (Miss. 1947)).
\(^{132}\) Id. at 95.
\(^{133}\) Id. at 96.
funding any type of protection or support. Once the state starts taxing activities beyond its boundaries, it is no longer providing support for those activities, and it is instead taxing interstate commerce itself.

4. Fair Relation to State Services

The policy behind non-discriminatory taxes takes shape in the requirement that the tax be fairly related to state services. A tax requiring businesses to share in the state tax burden is only justified when it relates to the extent of the contact with that state. For example, in Commonwealth Edison Co. v. Montana, four Montana coal producers and eleven of their out-of-state customers sought refunds from a Montana tax on the extraction of coal. The trial court upheld the tax, and the Montana Supreme Court affirmed. The Montana Supreme Court reasoned that the extraction of coal was an intrastate activity; therefore, it was not subject to the Commerce Clause. The coal producers appealed to the Supreme Court of the United States, arguing that “the amount collected under the Montana tax is not fairly related to the additional costs the State incurs because of coal mining.”

The Supreme Court held that the tax was fairly related to state services because Montana imposed it as a general revenue tax. It said the test for fair relation is not a comparison between the amount taxed and the cost to the state associated with the activity; instead, “the test is closely connected to the first prong of the Complete Auto test.” It reasoned, “the measure of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a ‘just share of state tax burden.’” Essentially, fair relation does not mean the state may only tax the exact fair market value of its protective or supportive services; however, it does have

134. See id. at 93-96.
135. Id. at 95.
137. Id.
138. Id. at 613.
139. Id.
140. Id. at 613-14.
141. Id. at 620.
142. Id. at 621.
143. Id. at 625-26.
144. Id. (quoting W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).
to ensure that the tax is “reasonably related to the extent of the contact.”

C. The Internet Age and E-Commerce

It is now possible for a business to have a large percentage of its revenue come from a state where it technically conducts no business and has no contacts other than communications with customers via the Internet. In terms of the Commerce Clause, the Internet is changing the way we look at state borders. The Internet itself has no borders, and, therefore, our concept of interstate commercial activity broadens.

With the dawn of the Internet-age, the already complicated interstate commerce question became more complicated due to electronic commerce (“e-commerce”). E-commerce is “all electronically mediated information exchanges between an organisation [sic] and its external stakeholders.” E-commerce is a large portion of the retail market and is continuing to grow: “the estimate of U.S. retail e-commerce sales for the third quarter of 2018, adjusted for seasonal variation, but not for price changes, was $130.9 billion, an increase of 3.1 percent (±0.5%) from the second quarter of 2018.” For purposes of this article, e-commerce will be focused on “[s]ell-side e-commerce,” or “transactions involved with selling products to an organisation’s [sic] customers.” Sell-side e-commerce involves not only the order from the customer, but the marketing efforts leading up to those orders.

E-commerce challenges the dormant Commerce Clause because it allows customers to order products directly from a website and have them delivered to their home. The business, in turn, can conduct its affairs by simply using United States mail services. For example, Amazon.com is a large-scale online retailer. Customers visit the website and search for whatever product they are looking for, anything from electronics to groceries, and they add the product

145. Id.
148. CHAFFEY, supra note 146, at 14.
149. Id. at 17.
to their “cart.”151 The consumer then goes to their “cart,” and pro-
cceeds to “check-out.”152 They input their payment information and
shipping information, and complete their purchase.153 Once the
purchase is complete, Amazon fulfills the orders and ships the prod-
ucts directly to the consumer. Customers can do the same on
smaller scale websites. For example, Lulu’s is an online clothing
retailer where customers can make a purchase online and have the
products delivered directly to the consumer’s home without Lulu’s
ever having to act in the state the customer is located.154

The evolution becomes even more strenuous when we see new
business models forming. For example, Ipsy is a subscription-based
company providing skin care and make-up products to customers.155
Customers first create an account and fill out a survey regarding
what their product preferences are.156 The company then fills a bag
full of sample products and ships the bag to the consumer.157 The
subscription costs around $10 per month.158 In these cases, the cus-
tomer is not even the one choosing their products; they are just sign-
ing up to receive samples.159

Another example is a company like Etsy, which provides a plat-
form for individuals who sell crafts.160 On Etsy, a seller creates
their own store.161 All orders go to the seller, the seller fulfills the
order, and the seller sends out the package.162 The consumer, how-
ever, only ever interacts with the Etsy platform.163 They order from
Etsy.com, and Etsy communicates with the seller. Technically, un-
der the business privilege tax model currently in place in Ohio,
these individuals could be subject to business privilege taxes if they
meet the minimum revenue requirement.164 The issue becomes is
the tax imposed on the individual seller, Etsy.com, or are both the
seller and Etsy taxed for the same sale?

Mail-order companies were the prequel to the Internet-based
companies that are so popular today. Decisions involving mail-or-
der companies provided some insight into how to navigate the

151.  Id.
152.  Id.
153.  Id.
156.  Id.
157.  Id.
158.  Id.
159.  See id.
161.  Id.
162.  Id.
163.  Id.
164.  See Crutchfield Corp. v. Testa, 88 N.E.3d 900, 902-03 (Ohio 2016).
dormant Commerce Clause issues, but they still are not an exact roadmap. Technology has allowed the basic business model structure to evolve. There are significant differences between mail-order companies and Internet-based companies, including marketing and payment activities. The major difference is that mail-order companies used to have to target customers directly based, at least partly, on location by physically mailing them advertisements or catalogs; however, Internet-based companies can target customers directly through the Internet. In fact, the Supreme Court has established intentionally targeting customers as a factor in the Due Process analysis to establish sufficient contacts. Today, however, it is possible for an advertisement to end up in a state the company did not intentionally target.

While companies can still advertise to target specific states, they can now target specific individuals without concern for where those individuals live. For example, search engine optimization is “[a] structured approach used to increase the position of a company or its products in search engine natural or organic results listings (the main body of the search results page) for selected keywords or phrases.” In other words, companies can target customers based on the search terms they use. Social media marketing is also a large portion of online advertising. Here, companies develop social media pages and allow customers to interact with the brand and other customers. These forms of marketing do not focus on the geographic location of the customer, but on customers’ preferences and actions.

Another option is e-mail marketing, where companies compile lists from customers in order to develop relationships. These are often in the form of advertisements and deal emails companies send to potential customers to entice them into making a purchase. There are two ways a customer can “opt-in” for advertisements, including “Single Opt-in” and “Double Opt-in,” also known as “Confirmed Opt-in.” “Single Opt-in” requires subscribers merely to

165. See Burger King Corp. v. Rudzewicz, 471 U.S. 462, 475-76 (1985).
166. CHAFFEY, supra note 146, at 20.
167. Id.
168. Id. at 21.
169. Id.
170. Id.
172. Id.
insert their e-mail address in a subscription form and press “enter.”¹⁷⁴ “Double Opt-in” or “Confirmed Opt-in” requires both submission of an e-mail address and confirmation, usually achieved through a link sent to the submitted e-mail.¹⁷⁵ Most retail websites will have an option that allows users to set up an account.¹⁷⁶ When the account is set up, the user must submit an e-mail address.¹⁷⁷ Companies will either automatically opt-in the account holder, and provide a way to opt-out if preferred, or customers can select a box allowing them to opt-in.¹⁷⁸ With this changing environment, it is time to question whether or not business privilege taxes imposed on Internet-based companies are unconstitutional under Complete Auto, and if there is a constitutional way to impose these taxes.

III. THE CURRENT IMPOSITION OF BUSINESS PRIVILEGE TAXES ON INTERNET-BASED COMPANIES IS UNDULY BURDENSOME ON INTERSTATE COMMERCE AND SHOULD BE HELD UNCONSTITUTIONAL.

State business privilege taxes imposed on Internet-based companies, whose only contacts with the state are through the mail system, are unconstitutional under Complete Auto because of the significant burden they impose on interstate commerce. First, these taxes do not meet the substantial nexus portion of Complete Auto¹⁷⁹ because, even under Wayfair, the only nexus these companies have with their customers is communication via the Internet. In fact, because of technological changes, they have less nexus in general than even National Bellas Hess had. The insufficient physical activity in National Bellas Hess was mailing catalogs and advertisements;¹⁸⁰ however, now, companies do not even have to physically send advertisements into a specific state, or even target a specific state at all. Instead, companies place advertisements in e-mails, on social media platforms, or on search engines, and customers visit the company websites. Unlike in Tyler Pipe and National Geo-

¹⁷⁴. Id.
¹⁷⁵. Id.
¹⁷⁶. See, e.g., LULUS, supra note 154.
¹⁷⁷. Id.
¹⁷⁸. Id.
graphic Society, these companies do not even have independent contractors or associates who generate gross-receipts in the state, and therefore there is no in-state activity that leads to revenue generation.

The argument has been made that the physical presence test is unworkable and is inconsistent with a test balancing the interaction between the company and the state. For example, when comparing Internet-based companies to traditional mail-order companies, Pamela Swidler argues that a balancing test is inconsistent with the physical presence test. The two tests, however, are not inconsistent. A court could require a physical presence, while still balancing how significant that presence is against the tax imposed. The overruling of the physical presence test is not the end of the issue because we still do not have an answer of what constitutes a substantial nexus. The policy behind the substantial nexus requirement is that the corporations affording themselves of the benefits of the state pay their fair share of the burdens on that state. A physical presence in a state presents much more of a burden on that state than a virtual one, and no intentional availment of the market presents even a slighter burden on the state. Therefore, there must be at least some kind of intentional availment of state resources, otherwise the corporations are being taxed for the activities of their customers and not their own use of state resources.

In National Geographic, the slightest presence was not enough to establish a substantial nexus. There is no specific test showing when a substantial nexus exists, but it can hardly be said that a business that has no sales associates in the state, has no offices in the state, conducts no business on property in the state, and does not intentionally advertise in the state could have a substantial nexus with the state. The only connection is that a customer happened to have the product shipped to the state. There is really no slighter presence, other than a customer simply viewing the website using a computer within the state.

The cost of complying with potentially fifty different state tax codes would be highly burdensome to companies. Technology has evolved to make it easier for companies to handle compliance with

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183. Id. at 571.
184. CHEMERINSKY, supra note 14, at 481.
Business Privilege Taxes

state taxes. Data analytics is a huge part of the business world today, and it is benefitting many companies because companies can track countless trends, potentially including where customers are likely to order from and send products. There is no way, however, for a company to be able to predict with certainty which state’s business privilege taxes they would have to pay because states have varying definitions of what certain products are and if and how they are taxed. It goes against any conception of fairness that the business should share in the miniscule burden on a state where they simply ship goods.

That is not to say that if the company is making a substantial profit from the state’s consumer base, it should not be deemed to have a substantial nexus and bear a tax burden to those customers; however, the burden should be proportional. In Wayfair, respondents argued during oral argument that the average Internet sale is $84, and at 200 transactions that only equals out to less than $17,000 not the $100,000 threshold South Dakota imposed. Their point is that the requirements are highly inconsistent. Further, South Dakota’s economy is vastly different than that of a state like California or New York. Two hundred transactions in either of those states equating to $17,000 of gross income is not fairly comparable to their economies. States will likely be able to impose tax regimes that take advantage of Internet sellers and will burden burgeoning business by increasing compliance costs. Those regimes will likely widely vary, and will not provide consistent support proportionate to the use of the state market.

State business privilege taxes do not impose any greater cost on Internet-based companies than they do on local companies; however, they are still discriminatory because they tax the privilege of

189. Id. at 55.
190. See id.
doing interstate business. Online companies are selling to customers just as companies located within the state's borders are. The conglomeration of these taxes could be financially detrimental to a business, especially when that business may not be sophisticated enough to track the amount sold or shipped to each state; such as a seller on Etsy. Swidler claims that the physical presence requirement has the effect of burdening local retailers that operate physical stores in multiple states. Her argument is that these local retailers must keep track of all the state taxes imposed on them, but because the online retailers do not qualify for taxation, they do not bear the cost of compliance. The Court has already stated the Commerce Clause was not meant "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." Its not that Internet companies should be exempt from paying taxes, but that they should not pay taxes in states that they have a miniscule connection with.

Additionally, the Court has held that a tax on the privilege of doing interstate business is discriminatory. The business conducted by Internet-based retailers is inherently interstate business. They are not conducting business in any state specifically, but in the virtual realm of the Internet. Further, to the extent that e-commerce could be considered a local activity, the activity is so inherent to interstate commerce that it should be afforded the protection of the Commerce Clause. Memphis Natural Gas Co. held that activities protected by the United States and not the state itself were considered beyond the boundaries of the state. Mail services are one of the services protected by the United States government and not state governments.

Lastly, privilege taxes on Internet-based companies are not fairly related to the protections provided by the state. These companies use almost no protection or services provided by the state. They are not even driving on the roads of the states; the mail trucks are. "[T]he measure of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of state

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192. Swidler, supra note 182, at 569-70.
193. Id.
196. Id. at 95.
The taxes imposed in these cases are not a “just share” of the state tax burden because the minimal extent of the companies’ contacts with the state impose, at best, a miniscule burden on those states.

IV. CONGRESSIONAL ACTION ESTABLISHING A MAXIMUM THRESHOLD FOR NEXUS AND CLARIFYING THE MANY DIFFERENCES AMONG STATE DEFINITIONS FOR INTERNET-BASED COMPANIES IS MUCH NEEDED, AND IT IS A BETTER WAY TO SUBJECT THESE COMPANIES TO TAXATION WHILE NOT UNDULY BURDENING INTERSTATE COMMERCE.

The dormant Commerce Clause only applies to those activities on which Congress has not spoken, but Congress has the power to establish guidelines for imposing gross-receipts taxes on Internet-based companies.\textsuperscript{199} If Congress were to pass legislation on the privilege tax issue, then the analysis would fall squarely within the Commerce Clause of the Constitution.\textsuperscript{200} Under the Commerce Clause, Congress can regulate channels of interstate commerce, instrumentalities of interstate commerce, and activities substantially affecting interstate commerce.\textsuperscript{201} The Internet is an instrumentality used in interstate commerce, and could even be considered a channel. Congress would be well within its power to establish guidelines for Internet business privilege taxes, and such legislation would alleviate the difficulties that arise from state business privilege taxes on Internet-based companies.

In fact, Congress has demonstrated such power in the past regarding net income taxes with the enactment of Public Law 86-272:

Congress passed Public Law 86-272 in 1959 to protect out-of-state corporations from state income taxes when the corporation’s only in-state activity was salespeople soliciting sales from customers in the state. Nexus for net income tax purposes is not established merely because sales of tangible personal property are solicited within the states. The states are prohibited under Public Law 86-272 (P.L. 86-272) from imposing a net

\begin{itemize}
\item \textsuperscript{199} “The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence [sic] and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.” U.S. CONST. art. I, § 8, cl. 1.
\item \textsuperscript{200} U.S. CONST. art. I, § 8, cl. 3.
\item \textsuperscript{201} United States v. Lopez, 514 U.S. 549, 558-59 (1995).
\end{itemize}
income tax on an out-of-state entity if the entity’s only connection with the state is the solicitation of orders for tangible personal property, if those orders are accepted and shipped or delivered from outside the state.  

Not only does P.L. 86-272 demonstrate Congress’s ability to impose guidelines and limits on a state’s ability to tax out-of-state sellers, it also demonstrates Congress’s willingness to do so. P.L. 86-272 currently does not apply to gross-receipts taxes; however, that does not mean that similar guidelines should not be imposed for gross-receipts taxes.

As for the legal benefits, a federal law would clear up much of the confusion surrounding this area of taxation. Internet sales place a much larger burden at the federal level than they do at the state level because most of the protections and services these e-commerce retailers are using are federal, not state. It follows policy that the tax should reimburse the cost of the burden on the federal government. Further, a federal law would alleviate the need to place state boundaries on the Internet. Finally, federal legislation would address the complex issue of not only the definition of substantial nexus, but also other definitions that are commonly different among states, such as the definition of a service or the definition of a specific type of good (i.e. candy bar, clothing, etc.).

The federal legislation would also provide for a better framework for Internet-based companies resulting in possible economic benefits. First, better compliance leads to higher investment in government programs, which is the purpose of taxation, and may lead to company investment in the marketplace. “Good compliance outcomes begin with good legislation.” The federal guidelines would likely be complied with more than differing individual state taxes, and, therefore, would result in less court costs to resolve disputes. One federal law is much more easily complied with than fifty different state laws. When the law is ambiguous, it allows taxpayers to act in unintended ways, creating disputes over interpretation. Therefore, where there is good, clear legislation, there is less enforcement and litigation costs. Where enforcement and litigation

204. Id. at 43.
205. Id.
costs are diminished, the government can spend more money funding government programs.

Second, when the law is clear, companies can more easily comply with it,\textsuperscript{206} thereby reducing their compliance costs and investing back into their companies and the economy. Compliance costs are those costs that an individual incurs above the actual cost of the tax, and can include accounting costs and other indirect costs.\textsuperscript{207} “Psychological” costs, like stress of compliance on the workforce, can also be a factor.\textsuperscript{208} A federal tax would provide a much clearer requirement than multiple state laws. The direct compliance costs would be reduced because there would be less interpretation of multiple laws, and a better interpretation of one law. Companies would have more money to reinvest either into their products and people, or into the economy at large. The indirect costs, such as psychological costs, would be reduced because compliance is less complex, allowing the companies’ workforces to focus more on things such as new developments and business expansion. Better compliance means that expected revenues can be met and these Internet-based companies would be better able to foresee their annual taxation obligations. The money saved in compliance could be reinvested, providing more growth opportunity for a better e-commerce market, and potentially investment in the state.

V. CONCLUSION

Under the current Complete Auto framework, state business privilege taxes on Internet companies whose only contacts with the state are the shipment of products to customers are an unconstitutional burden on interstate commerce. Congress should enact legislation that provides guidelines for state Internet business privilege taxes that would both clarify the legal landscape and provide economic benefits from greater compliance and reinvestment. The advancing technological society we live in today provides its own difficulties when interpreting the law, especially the dormant Commerce Clause. When the dormant Commerce Clause was first established, the Internet and the potential to do business without ever being present in the state was likely an inconceivable idea. While case law has tried to keep up with the changing e-commerce environment, it has not made the murky issue any clearer. This area of the law is likely not going to remain stagnant, but, instead,

\textsuperscript{206} Id.
\textsuperscript{207} Id. at 37.
\textsuperscript{208} Id.
new technological advances will create more confusion. If no action is taken by Congress, the burden on interstate commerce will only get worse.