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IF IT AIN'T BROKE DON'T FIX IT: AN ARGUMENT FOR THE CODIFICATION OF THE QUILL STANDARD FOR TAXING INTERNET COMMERCE

SIDNEY S. SILHAN*

INTRODUCTION

The Internet has become a part of everyday life, both personal and professional, as well as a pivotal element in many businesses' strategic plans.\(^1\) Internet-related business ranges from basic Internet and database access to gambling, banking or stock tracking and trading; indeed, this feeble list barely scratches the surface of the Internet's capabilities.\(^2\) Users who purchase goods and services off the Internet are responsible for much of this increased use,\(^3\) and like

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2. The Internet Tax Freedom Act defined e-commerce as "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access." See Internet Tax Freedom Act § 1004(3), 47 U.S.C. § 151 (1998). For actual volume detail, see National Governor's Association, Sales Shift from Brick and Mortar Retail Sales to On-line Sales (visited Feb. 11, 2000) <http://www.nga.org/internet/SalesShift.asp> (indicating that between 1999 and 2002 sales over the Internet will jump from $18 billion to $76 billion); see also Press Release, Ernst & Young, Season's E-Tail Sales Figures Expected to Reach $12-15 Billion (visited Nov. 10, 1999) <http://www.ey.com/news/releases/110999.asp> (indicating that the number of respondents to their annual survey who did at least 10% of their shopping on-line jumped from 23% to 67% between 1998 and 1999, and that 19% (up from 4%) will do 50% or more of their shopping on-line).

any other purchase, sales and use taxes will often apply.4 Because such taxes directly affect the coffers of most states,5 and the inherent ability of Internet sales to escape taxation,6 states want to be very much involved in the development of an Internet tax policy.7 Their involvement to date is advisory only, because the states are prevented from imposing any new taxes5 on Internet business, also known as e-commerce, until at least October 2001, and potentially for an additional three to five years.9 This moratorium is imposed by the Internet Tax Freedom Act10 ("ITFA"), which Congress passed and

4. How they apply and the items to which they apply is itself a complicated issue. See Dale Yancey et al., Electronic Commerce Snare Sellers in Multistate Tax Web, 63 PRACT. TAX STRATEGIES 260 (1999) (listing twenty different factors that can determine where an Internet sale has taken place and which state should tax it).

5. Sales taxes are a principal revenue source for state and local governments. Forty-five of the fifty states, plus the District of Columbia, impose a sales tax (Alaska, Delaware, Montana, New Hampshire, and Oregon do not impose sales or use taxes). See 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION § 2.01 (3d ed. 1998). In the year ending March 31, 1998, general sales taxes equated to over $155 billion, representing between 21% (New York) and 80% (Nevada) of total state taxes collected. See Cline & Neubig, supra note 3, at tbl.1; see also GOV'T AND FIN. BRANCH, CENSUS BUREAU, U.S. DEPT OF COMMERCE, QUARTERLY SUMMARY OF STATE AND LOCAL TAX REVENUE (1999) (estimating total collections for 1999 at $237 billion). Rates range from .875% to 11%; note, however, the recent proposal by the ACEC Business Caucus to reduce tax rates across the board. See ADVISORY COMM'N ON ELEC. COMMERCE, DRAFT COPY OF REPORT APPROVED BY ADVISORY COMMISSION ON ELECTRONIC COMMERCE, BNA DAILY TAX REPORT 15 (Mar. 31, 2000) <http://www.ecommercecommission.org>.

6. See Cline & Neubig, supra note 3, at 14, for figures; see also David Hardesty, E-Commerce Commission Calls For a New Tax System, E-COMMERCE TAX NEWS (visited Feb. 21, 2000) <http://ecommercetax.com/doc/092099.htm> (indicating that sales taxes would reduce online shopping by at least 25%).

7. The American states are not alone in their concerns. In November 1999, the European E-Business Tax Group, a consortium of companies and consultants, released its paper outlining invoicing requirements that directly impact European countries' taxation of the Internet. See EUROPEAN E-BUSINESS TAX GROUP, RESPONSE TO THE COMMISSION WORKING PAPER ON TAX AND ELECTRONIC COMMERCE (Nov. 1999). Also note reference to international e-commerce regulation and cooperation with the World Trade Organization (WTO), proposing permanent support of the WTO's individual moratorium on tariffs and duties for electronic transmissions, in ADVISORY COMM'N ON ELECT. COMMERCE, supra note 5, at 31.

8. A new tax is defined as a tax on Internet access charges that was not in place (and enforced) before October 21, 1998. See Internet Tax Freedom Act § 1004(3), 47 U.S.C. § 151 (1998). On that date, nine states imposed Internet access charge taxes. The current proposal recommends removing all such taxes. See ADVISORY COMM'N ON ELEC. COMMERCE, supra note 5, at 20, which recommended removing even this grandfather clause for existing taxes on Internet access, making all such taxes illegal. However, because of questions in the way the majority vote was generated, the proposals in this report are just that; they are not considered findings or recommendations. Whether they will be submitted to Congress in their current format is unknown.

9. See ADVISORY COMM'N ON ELEC. COMMERCE, supra note 5, at 20. The ACEC majority voted to extend the current moratorium for five more years.

President Clinton signed in October 1998. The moratorium applies solely to new taxes, and does not at all limit the states' current taxing power, which reaches most Internet sales.

Contemporary sales and use tax jurisprudence has resulted in the development of a substantial nexus requirement before a state can impose a sales or use tax, or can impose responsibility for collecting those taxes. Substantial nexus has been defined as the physical presence of a taxpayer in a state, a concept that is as easily applied to an on-line world as it was in the off-line world in which it was developed. This Note will show that, under current sales tax jurisprudence, the states that impose a sales tax already have the power and the means to collect sales tax (or enforce its collection) on the vast majority of taxable Internet transactions. Through a consistent application of the physical presence standard for substantial nexus, and the adoption of creative and helpful tax simplification measures, the states can ensure that they capture much of the sales tax revenues that may currently be evading collection, and may even increase their sales tax collections.

Part I of this Note discusses sales and use taxes generally, the rationale of the Act with the comment: "[W]e cannot allow 30,000 state and local tax jurisdictions to stifle the Internet, nor can we allow the erosion of the revenue that state and local governments need to fight crime and invest in education." President William J. Clinton, Statement of the President (Oct. 21, 1998) <http://www.house.gov/cox/nettax/clinton.html>.

All states with sales taxes impose that tax on sales of tangible personal property, either over the counter or over the Internet, and the actual taxability of these items is not in dispute. See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 756 (1967), together with Quill Corp. v. North Dakota, 504 U.S. 298 (1992), which set forth the constitutionally based requirement of the physical presence of the seller in the state before taxation is proper.

For purposes of this Note, imposition will also include the collection responsibility imposed on the seller, and the term "tax" will apply interchangeably to the tax and the obligation; however, the tax itself is not imposed on the seller, but the obligation to collect it and remit to the state is. See Quill, 504 U.S. at 307.

Unless otherwise indicated, sales tax will also include use tax. While the two are not the same, I use sales tax here to simplify the text.

To wit, California Assemblywomen Migden and Aroner plan to introduce, in February 2000, a bill to enforce collection of sales tax on Internet sales using current (Quill) standards of physical presence: "[O]ur legislation simply clarifies what should be current practice." BNA DAILY TAX REPORT, Jan. 27, 2000, at 3.

Some contemporary philosophy holds that information, from the Internet or any other source, should not be taxed; it is important to clarify at the outset that this discussion focuses not on the Internet as such, but rather on the sale of otherwise taxable personal property over the Internet, and would in no way effect the taxability of items that might otherwise be exempt from tax, such as information.

This Note does not specifically address local sales or use taxes. Thirty-three states currently allow local jurisdictions to assess sales taxes. These taxes are generally structured....
constitutional and judicial restrictions on the imposition of these taxes, and the impact of the ITFA. Part II suggests that Congress codify the Supreme Court’s ruling in Quill, which requires physical presence in a state before a state is allowed to impose a sales tax collection obligation, and examines some of the tax simplification measures proposed to facilitate tax collection in the electronic world. Part III highlights the similarities in taxability between a traditional mail-order seller and an Internet seller through a hypothetical company that engages in both mail-order and e-commerce sales. This simplified example shows that states are not placed at a disadvantage when attempting to collect sales tax on Internet sales versus mail-order sales.

I. THE DEVELOPMENT OF CONTEMPORARY SALES TAX JURISPRUDENCE AND THE IMPACT OF THE IFTA

A. Sales and Use Taxes Generally

A sales tax is a tax on the retail sale of specified property or services. The tax is expressed as a percentage of the retail cost of the property or service. In the traditional “consumer levy” tax jurisdiction, the buyer pays the tax at the time of the sale, and the

similarly to the state tax, and in all but five states, Alabama, Alaska, Arizona, Colorado, and Louisiana, the local taxes are collected and remitted by the state. In these instances, the state is merely a conduit, and proper collection of the local, as well as the state, tax continues to rest with the seller. Nonetheless, these local taxes can account for significant revenues, and they certainly account for the vast majority of taxing jurisdictions and are only disregarded here for ease of discussion. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶ 19.02.

The primary focus of this Note is on tangible personal property for sale over the Internet. I do not here address the complicated issue of the sale and transmission over the Internet of intangible property, or tangible property in electronic format, such as music or software, because the application of the physical presence test should also apply to the seller in these situations. The medium of transfer should not necessarily change the taxability. However, note the recent proposal by the ACEC to permanently ban taxation of items delivered electronically. See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 26.

22. In most cases, only tangible personal property is subject to tax. In some cases, what is commonly perceived as intangible personal property is subject to sales tax as tangible personal property. For example, computer software is sometimes considered tangible and therefore taxable. Real property is usually not subject to sales tax, but may be subject to a transfer tax. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶¶ 13.01, 13.05.
23. | 12.05.
seller collects and remits the tax as an agent for the taxing jurisdiction. All states that impose a sales tax, and many local jurisdictions, also impose a complementary use tax. The use tax is an "ingenious legal device that was developed to safeguard state sales tax" by imposing tax on "the privilege of using, consuming, distributing or storing tangible personal property after it is brought into the State from without the State." The use tax is designed to capture sales tax revenue that would otherwise be lost, since the sales transaction, which is ordinarily the point of collection, occurred out-of-state. The use rates are generally the same as the sales tax rates, and the payment of a sales tax to an out-of-state vendor will usually qualify as a credit towards the use tax. This credit mechanism is designed to prevent double taxation of the same item.

Most states require the consumer to self-assess the use tax, since the only collection agent (the seller) in the transaction does not have a taxable, physical presence in the reporting state. However, if the seller has the requisite taxable nexus in the consumer's home state, the state can impose a sales tax collection obligation on the seller, thus guaranteeing the collection of the tax. The obligation is imposed in return for the seller having purposefully availed itself of and benefited from the taxing state's laws and market.

The use tax is theoretically effective when applied to sales of tangible personal property, but cannot ordinarily be enforced as a complementary tax against services purchased out-of-state but


27. States' authority to levy these taxes is derived from the 10th Amendment of the U.S. Constitution, which states that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the states respectively, or to the people." U.S. CONST. amend. X.


29. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶ 16.01.

30. See id. ¶ 16.11[3] and the discussion therein about state use tax rates that were higher than the same state's sales tax rates, designed to encourage local purchases over out-of-state purchases. Such laws are consistently struck down as repugnant to the Commerce Clause.

31. Id. ¶ 16.03.

32. Id.

33. Id.


performed in state. As a practical matter, however, use taxes are often totally avoided unless a collection burden is imposed on the seller. This is especially true for individual consumers, as opposed to business consumers, since unlike individuals, many business consumers undergo regular use tax audits and have use tax self-assessment procedures in place to ensure proper compliance. Generally, the individual consumers are the cause of the states’ concern in the context of e-commerce.

B. Composition of the Tax Base: What Items Are Taxable, and How Is the Tax Collected?

Sales tax is usually imposed on sales of tangible personal property, which has historically been sold over the counter to the buyer. The base is further expanded, in some states, to include certain intangible personal property, such as software. Due to the basic nature of this transaction, sales tax collection is a minor burden on the one location, one jurisdiction retail seller. In some states, the sales tax base was expanded to include certain services, which were usually taxed at the same rate as sales of tangible personal property. Again, since the tax is collected at the time of payment, and usually at the point of service, collection is not overly burdensome to the vendor.

Because they are independent taxing jurisdictions, the states may not all tax the same items, and each state will likely have a tax rate that differs from its neighbor’s rate on the same item. This inconsistency is compounded when the local taxing jurisdictions are included, many of which have their own collection and compliance

36. See Cline & Neubig, supra note 34, at 5.
37. See National Governor’s Association, Streamlined Sales Tax System for the 21st Century (visited Feb. 11, 2000) <http://www.nga.org/internet/Proposal.asp> (indicating up to 500 sales tax returns and potential audits per annum for multistate sellers).
38. This has practical motivations as well; many businesses buy items exempt as a sale for resale or under another exemption certificate, such as for incorporation into real property, and so many of the business-to-business sales are exempt from sales tax. See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 20. Individual consumers, on the other hand, generally buy for self-consumption, which is subject to sales or use tax. The focus of this Note, like the focus of the states’ concerns, is on individual consumers.
39. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, § 15.01.
40. In Illinois, for instance, computer software is a taxable tangible good—if it’s sold as prepackaged or canned software; custom designed software remains an intangible and is exempt. 35 ILL. COMP. STAT. SEC. 120/2-25 (West 1986); 86 ILL. ADM. CODE 130.1935.
41. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, § 15.01.
42. See Cline & Neubig, supra note 34, at 8.
requirements, which brings the total number of independent taxing jurisdictions in America to almost 7,500.\(^{43}\) A multi-state seller\(^{44}\) of various products with a physical presence in many states is thus faced with myriad tax bases,\(^{45}\) rates, and collection schemes. These factors are by no means all inclusive and only highlight the complexities faced by multi-state sellers.\(^{46}\) Generally, the sellers feel the tax collection is overly burdensome; they often do not have the current tax rate and base information, they do not have the resources to properly track sales and comply with the filing requirements,\(^{47}\) and they like the competitive advantage that not having to collect tax gives them.\(^{48}\) The states, of course, want the sellers to collect and remit the tax, thereby ensuring collection and simplifying (the states' own) tax administration. In part because the burden is not on them, and despite the confusion and subsequent lack of compliance\(^{49}\) that results from this checkerboard-taxation, states have been extremely hesitant to apply uniform rules to the sales tax structure.

Historically, this multi-jurisdictional collection obligation was a problem faced only by those sellers who were "unlucky" enough to have sales in more than one state. However, with relatively clear sales tax nexus rules, based on physical presence, the seller could effectively plan for, or around, the tax collection obligation. Yet, with the evolution of the Internet, a small retailer could become a multi-state seller literally overnight.\(^{50}\) Imposing a tax collection obligation

\(^{43}\) See Doug Sheppard, Representatives of Cities, Software Publishers Square Off on Internet Taxation, STATE TAX NOTES, Oct. 12, 1998, at 5 (estimating that the number could be as high as 30,000, and later adding that "further research has shown that the 30,000 figure may be understated").

\(^{44}\) The seller in question has often been a mail-order seller that sells to buyers in many different jurisdictions. The focus has more often than not turned to the Internet seller.

\(^{45}\) Some items are generally taxable, but could be exempt, or subject to a lower rate, based on the status of the buyer, or the use of the item, or whether it is sold during a "tax holiday," when otherwise taxable items are exempt for sales tax to spur buying in a locality. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, \textsection 10.01.

\(^{46}\) To add insult to injury, if a seller does not collect tax where it should, due either to ignorance or mistake, the seller is liable to the state for the tax. See id. In some states, a buyer who does not wish to be taxed must provide an exemption certificate to the seller. How such a certificate is to be transmitted to the seller with the speed of cyberspace, accepted in good faith and verified by the seller is unknown.

\(^{47}\) There are software products to help track these filing differences, and to assist in compliance. However, the issue is fairness to the taxpayers; just because compliance is possible does not mean it is easy or fair.

\(^{48}\) See ERNST & YOUNG, supra note 2 (indicating that no sales tax was the motivation for 12% of on-line shoppers to snub the regular brick-and-mortar stores).

\(^{49}\) See Cline & Neubig, supra note 34, at 8 (detailing taxpayer's lack of compliance).

\(^{50}\) See USA TODAY, Oct. 26, 1999, at 15A (IBM e-business advertisement heralding the creation of an interactive, sales-capable Web site in hours, at a cost of $39.95 a month).
on such a seller, with a nexus standard of something other than physical presence, could mean the retailer must collect up to 7,500 different sales taxes. Under such a compliance burden, the very instrument that made this seller a success could quickly become the instrument of its destruction.

The use of the Internet changes only the magnitude of sales transactions; it does not change their basic taxable nature. In the typical Internet sales transaction the buyer locates the seller's Web site and completes a purchase. The seller may not know the address of the buyer, further complicating the computation and collection of sales tax. However, in most cases the sale is one of tangible personal property, delivered by mail, so a ship-to address is required. With the buyer's address, the seller attempts to determine if it has nexus with the taxing jurisdiction, and if so, the correct tax rate to collect. If the seller has nexus with the state and fails to collect the tax due from the buyer, the seller becomes responsible for the tax. Before tax can be properly calculated and collected, the seller must determine such things as the status of the buyer (taxable, tax-exempt, or tax-exempt for certain purchases), and the taxability of the property, including how the property will be used. With Internet selling, this information will often be unavailable.

Thus, like their traditional mail-order competitors, Internet retailers must understand and apply the sales tax laws of many different jurisdictions. In addition, Internet retailers also face the added challenge of selling to unknown buyers over the Internet, which could substantially and rapidly expand the jurisdictions in which they do business. Fortunately, the current physical presence standard allows them to determine conclusively where they are subject to tax. Because of this physical presence standard, selling over the Internet is not quite the tax minefield it might otherwise be.

51. Could the sale of software (taxable if transmitted via tapes or other tangible personal property) over the Internet be exempt, since no tangible personal property changes hands? The idea is considered in ADVISORY COMM'N ON ELEC. COMMERCE, supra note 5, at 21.

52. The buyer may also be a repeat buyer who has access to sellers' proprietary inventory software to facilitate orders; if the seller retains title to this software, even if it is lent free of charge, does that equate to physical presence in the buyer's state? Probably not. See Quill Corp. v. North Dakota, 504 U.S. 298, 315 (1992) (discussing the location in North Dakota of Quill's floppy disks).

53. This again refers to the sale of digitized items for delivery entirely on-line, which may not require a bill-to or a ship-to address, based on the form of payment and delivery.

54. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶ 13.11.
C. Constitutional and Judicial Limits on State Taxing Powers

The first barrier to state taxation of out-of-state sellers is the United States Constitution. Under the Constitution, states may not tax out-of-state sellers unless the imposition of the tax meets the Due Process Clause requirement of minimum contacts and the Commerce Clause requirement of physical presence. The United States Supreme Court has stated that the Constitution requires the existence of some minimum contact (nexus) and some level of purposeful availment of the state’s benefits and protections by the taxpayer before the Due Process Clause will be satisfied and taxation can occur.

1. Due Process Clause Generally

The Due Process Clause ensures fundamental fairness in the operations of the state governments towards its citizens. One must not be deprived of “life, liberty, or property,” including tax dollars, without due process of law. Due Process has been interpreted in this context as requiring that a taxpayer have at least some minimum contact with a jurisdiction, “such that the maintenance of a suit [or, in this case a tax] does not offend the ‘traditional notions of fair play and substantial justice.’” The Due Process analysis centers on whether a taxpayer’s connections with the jurisdiction are sufficient to give notice that it may be haled into court, or subject to a tax, in that jurisdiction. For present purposes, the Due Process Clause requires that a seller meet minimum thresholds of activity (which need not equate to physical presence) with a state before that state

55. See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753 (1967) (holding that an Illinois use tax statute violated the Fourteenth Amendment’s Due Process Clause and created an unconstitutional burden on interstate commerce). The Court imposed the minimum contact requirement in the context of Due Process.
56. See id.
57. The Due Process Clauses of the United States Constitution (Fifth and Fourteenth Amendments) state: “No person shall . . . be deprived of life, liberty, or property, without due process of law.” U.S. CONST. amend. V. “Nor shall any State deprive any person of life, liberty, or property, without due process of law . . . .” U.S. CONST. amend. XIV.
58. Id.
59. See International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945). The Court found that due process requires that a defendant have minimum contacts with the jurisdiction. The taxpayer’s activities were systematic, continuous and resulted in a large amount of business from within the state, thereby justifying taxation in the state.
60. See Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985). The Court held that if one purposefully engages in significant economic activities in the state, he “manifestly [avails] himself of the privilege of conducting business there,” and “because his activities are subject to the ‘benefits and protections’ of the forum’s laws it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well.” Id.
can impose a tax on the seller, or an obligation to collect that tax from in-state buyers.\textsuperscript{61} However, even if a taxpayer exceeds the Due Process limitation, it must also exceed the physical presence requirement of the Commerce Clause before taxation can occur.

2. Commerce Clause Generally

The Commerce Clause is an express grant of power to Congress to regulate commerce among the states.\textsuperscript{62} The Commerce Clause is more restrictive than the Due Process Clause, in that it requires more than a minimal connection with the taxing state before taxation can occur.\textsuperscript{63} The Commerce Clause requires that a taxpayer establish a "substantial nexus," defined as physical presence with a state, before the state can impose a tax.\textsuperscript{64} However, the Commerce Clause has a negative implication, the so-called "dormant Commerce Clause," which prohibits a state from taxing if the tax has the effect of restraining interstate business.\textsuperscript{65} The dormant Commerce Clause allows Congress to prevent the states from imposing taxes that are restrictive of interstate commerce. It also allows Congress to require minimum standards, such as physical presence in the state, before taxation can occur.\textsuperscript{66} Congress could eliminate (or expand upon) the judicially created physical presence test; but the minimum connection required by the Due Process Clause, by contrast, can only be changed by an amendment to the Constitution.\textsuperscript{67} Thus, while Congress may not grant the states the right to tax without at least the minimal connection required by the Due Process Clause, the Commerce

\textsuperscript{61} See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753 (1967). However, it was not until the Court's ruling in \textit{Quill Corp. v. North Dakota}, 504 U.S. 298 (1992), that the distinction between Due Process (minimum connection) and Commerce Clause (physical presence) nexus in this context was established.

\textsuperscript{62} U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States . . .").

\textsuperscript{63} See \textit{Quill}, 504 U.S. at 312.

\textsuperscript{64} \textit{Id.}

\textsuperscript{65} \textit{Id.} at 309. Under the Articles of Confederation, the states levied taxes that operated as competitive trade barriers between the states. The competition resulted in a lack of conformity that hindered interstate and international trade. See \textit{1 RICHARD POMP & OLIVER OLDMAN, STATE & LOCAL TAXATION} ¶ 1-1.5 (3d ed. 2000). The Commerce Clause, with its negative sweep, was designed to rectify this situation. See Julie M. Buechler, \textit{Virtual Reality: Quill's Physical Presence Requirement Obsolete When Cogitating Use Tax Collection in Cyberspace}, 74 N.D. L. REV. 479 (1998) (outlining the development of the dormant Commerce Clause).

\textsuperscript{66} See Christina R. Edson, \textit{Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce}, 49 TAX LAW. 893, 937 (1996) (stating that the Commerce Clause protects national economic interests by prohibiting state restrictions, such as a sales tax, on interstate commerce).

\textsuperscript{67} \textit{Id.} at 940.
Clause gives Congress the ability to legislate a more or less restrictive requirement than physical presence. In part because Congress has not legislated in the sales tax arena under the Commerce Clause, the Supreme Court has stepped in to create a four-pronged test to determine if a state tax violates the Commerce Clause restrictions.

3. Judicial Interpretations

The Supreme Court held in *Complete Auto Transit v. Brady* that a tax imposed by a state must meet the following four-pronged test to withstand Commerce Clause scrutiny. The tax must (1) apply to a taxpayer with a "substantial" nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided to the taxpayer by the state. This is the test applied to a state's imposition of a tax on an out-of-state seller to determine if the tax will unduly restrict interstate commerce. To date, the majority of litigation arising out of the *Complete Auto Transit* test has focused on the definition of the substantial nexus requirement of prong one, leading to the creation of the physical presence requirement of *Quill*.

a. *National Bellas Hess, Inc. v. Department of Revenue of Illinois*

In 1967, the Supreme Court first applied the dual analysis of the Due Process Clause and the Commerce Clause to a tax imposed on an out-of-state mail-order seller, a form of interstate commerce very similar to an Internet seller. In *National Bellas Hess* ("Bellas Hess"), the Court struck down Illinois's attempt to impose a collection

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68. *Id.*

69. It has, however, done so in the state income tax arena: the Interstate Commerce Tax Act § 101, 15 U.S.C. § 381 (1959), commonly known as Public Law 86-272, limits the ability of the various states to impose income taxes on out-of-state sellers of tangible personal property.

70. *See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)* (setting forth the physical presence requirement as a prerequisite to the legitimate exercise of state power). The four-pronged test of *Complete Auto* still governs the validity of state taxes under the Commerce Clause today.

71. *Id.*

72. *Id.* at 279.

73. But note that the fourth prong of this test requires fair relation of the tax to services provided by the state to the taxpayer; imposing a collection obligation on a seller with minimal sales into a state, and no physical presence, would not seem to be fairly related to the benefits provided, and creating a nexus standard that does not require physical presence could run afoul of the *Complete Auto* test. *See Donald M. Griswold & Michael McLoughlin, Applying the Commerce Clause to Electronic Commerce, 17 STATE TAX NOTES 757 (1999).*

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

75. *See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753 (1967).*
obligation on Bellas Hess for the state’s tax on its sales into Illinois.\textsuperscript{76} Bellas Hess was a mail-order seller with sales to customers nationwide. Its principal place of business was Missouri, and it consistently sold goods into Illinois from its Missouri location.\textsuperscript{77}

Bellas Hess did not have a physical presence in Illinois; it did not maintain an office, employ agents or salespeople in Illinois, nor did it own property or have a telephone listing in Illinois.\textsuperscript{78} Bellas Hess personnel did not enter the state for maintenance, installation or other service on its products.\textsuperscript{79} The sole contact Bellas Hess had with Illinois was through the continual use of the United States mail. Catalogs were mailed into the state on a regular basis, and any orders for merchandise were sent from Illinois to Missouri, where they were accepted and filled from locations outside Illinois. All orders were shipped via common carrier or the United States post.\textsuperscript{80} Thus, Bellas Hess did actively solicit business in Illinois, but did not have a physical presence in Illinois.

The State of Illinois argued that Bellas Hess had established a minimal connection with Illinois, and should therefore be subject to the law that required the collection of Illinois’s tax.\textsuperscript{81} Under the relevant Illinois statute, any “retailer maintaining a place of business”\textsuperscript{82} in the state was required to collect the tax. That clause was further defined to include a retailer that was “engaging in soliciting orders within this State from users by means of catalogs . . . whether such orders are received or accepted within or without this state.”\textsuperscript{83} Illinois asserted that it had provided a market for Bellas Hess to exploit, and Bellas Hess therefore owed Illinois this collection duty.\textsuperscript{84}

In rejecting Illinois’s argument, the Court found a tension in the Commerce Clause between the free trade zone created by the federation of states and the need for merchants engaged in that free trade zone to pay their own way.\textsuperscript{85} In a later attempt to balance these

\textsuperscript{76} Id. at 760.
\textsuperscript{77} Id. at 754.
\textsuperscript{78} Id.
\textsuperscript{79} Id. at 754-55.
\textsuperscript{80} Id. at 755.
\textsuperscript{81} Id. at 754.
\textsuperscript{82} See 120 ILL. COMP. STAT. 439/2 (West 1965).
\textsuperscript{83} See National Bellas Hess, Inc., 386 U.S. at 755.
\textsuperscript{84} Illinois had provided something “for which it can ask [for something in] return.” Id. at 756.
\textsuperscript{85} Id. at 757.
conflicting provisions, the Court set forth the four-pronged test of *Complete Auto Transit*. 86

The Court found that the touchstone of Due Process was fairness, 87 requiring "some definite link, some minimum connection" between the state and Bellas Hess. 88 Taxability required something more than a simple exploitation of the market created by Illinois; it required that an out-of-state seller establish a physical presence within the taxing state in order to establish a sufficient taxing nexus. 89 The Court made note of the distinction between the taxpayer's physical presence in the state and a presence established solely by common carrier or United States mail. This distinction created a safe basis for companies to follow in planning expansion activities, which would re-appear in the Court's later reasoning 90 as a rationale for maintaining the bright-line 91 physical presence requirement for taxable nexus.

b. State of North Dakota v. Quill Corp.

Two generations of mail-order companies later, the Court again addressed the physical presence requirement in *State of North Dakota v. Quill Corp.* 92 In *Quill*, the Supreme Court declined to eliminate the bright-line physical presence test established in Bellas Hess and adhered to the rule that taxpayers had been relying on for twenty-five years: that physical presence with a state was required before taxation could occur. 93

The facts of *Quill* are similar to those of *Bellas Hess*. Quill was a mail-order seller of office supplies and equipment, 94 with no physical presence in North Dakota. 95 The state imposed a use tax collection

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88. Id. (quoting Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-45 (1954)).
89. See *National Bellas Hess, Inc.*, 386 U.S. at 759. It did not, at this stage, differentiate between the requirements of the Due Process Clause and the Commerce Clause, but revisited this issue in *Quill*.
90. See *Quill*, 504 U.S. 298.
91. However, see discussion herein on the not-so-bright line test the interpretation of physical presence has created.
92. 504 U.S. 298.
93. Id. at 312.
94. Id. at 302. Quill was the sixth largest vendor of office products in North Dakota, and sold over $1 million worth of goods to 3000 customers in North Dakota.
95. Id. But see id. at 315 n.8: Quill owned a few disks which buyers used to check inventory levels and prices at Quill's headquarters. The Court determined that although "title to 'a few
obligation on Quill, claiming that Quill was a "retailer maintaining a place of business" in North Dakota. The state acknowledged that Quill did not meet the physical presence requirement of Bellas Hess, but argued that it did have a significant economic presence in North Dakota, sufficient to require Quill to collect tax on items sold into North Dakota. The North Dakota Supreme Court agreed that Bellas Hess was obsolete, based on the changes in society and the mail-order industry since 1967. The Supreme Court responded by clarifying its prior ruling in Bellas Hess and refined the distinction between the Due Process and Commerce Clause requirements.

The Quill Court indicated that the Due Process analysis strayed from the physical presence requirement, speaking more to a minimal connection that seemed to embrace North Dakota's economic presence argument. The Due Process Clause did not require a physical presence before a state could impose its tax: "the requirements of due process are met irrespective of an [out-of-state seller's] lack of physical presence in the taxing State." Therefore, since Quill had directed its activities towards North Dakota with an intention to profit therefrom, under a pure Due Process analysis the tax was fairly imposed.

However, the Court decided while physical presence is not required under the Due Process Clause, it is still required under the Commerce Clause. In a vain attempt to prevent future confusion, the Court explicitly stated that "a[n out-of-state seller] whose only contact with the taxing State is by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause." The Court specifically upheld an important part of its ruling in Bellas Hess by emphasizing the "continuing vitality of Bellas Hess' sharp distinction

floppy diskettes'... might constitute some minimal nexus...[that] does not meet the 'substantial nexus' requirement of the Commerce Clause."

96. Id. at 302.
97. Id. at 303.
98. Id. Note the similarities between the rapid changes in the mail-order industry and changes in the Internet selling industry.
100. See Quill, 504 U.S. at 305.
101. Id. at 308.
102. It was not an easy decision, nor one that the Court was terribly pleased with. It was not the overpowering logic of the rule that persuaded the court to maintain it, but rather the following litany of reasons: 1) the administrative advantages of the physical presence rule; 2) the reliance on it by taxpayers and states; 3) stare decisis; 4) problems with the application of a different standard; and 5) the superior ability of Congress to fix what the Courts cannot. See id. at 318. The same concerns still plague Internet sellers.
103. See id. at 311.
between mail-order [sellers] with a physical presence in a taxing state" and those without such a physical presence. Thus, since Quill did not have the requisite physical presence, North Dakota's tax was unconstitutional as a restriction on interstate commerce and a violation of the dormant Commerce Clause.

The physical presence standard remains in force, and is the standard applied currently to all remote sellers, Internet sellers included. But defining exactly what qualifies as physical presence has proven to be a formidable task. The Court in Quill noted that a "few floppy diskettes" did not rise to the level of physical presence, but did not offer much beyond that. At its extremes, defining physical presence does not pose a problem. A company that is headquartered in a state, conducts all of its business in that state, and has all its property and sales activity in that state clearly has a physical presence in that state. It is just as easy to say that this company does not have a taxable presence in any other state.

But in the much more realistic penumbra, physical presence becomes far more amorphous, and the only clear rule to emerge from the foray thus far is that any physical connection, no matter how slight, could equate to physical presence. Physical presence is established with only a temporary physical presence in a state, and repeated trips by sales or service personnel into a state, even if unrelated to the company's sales into the state, can also constitute physical presence. The relevance is obvious; without a clear

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104. Id. (internal quotations omitted).
105. The Court revisited this in Trinova Corp. v. Michigan Dep't. of Treasury, 498 U.S. 358 (1991), where it reestablished that a state tax may be consistent with due process and yet unduly burden interstate commerce.
106. See Quill, 504 U.S. 298.
107. See TEXAS ALJ HEARING 37,473 (Apr. 1, 1999) (indicating that a modem and telecommunications equipment, along with an employee whose sole responsibility was to maintain the equipment, was sufficient to give a company taxable nexus in Texas). But see N.Y. DEPT OF TAX'N & FIN., TSB-A-00(1)S (Jan 21, 2000) (indicating that an out-of-state company's use of New York based independent contractors to accept orders and perform customer service over the phone did not create sales and use tax nexus).
110. See Tyson Foods, Inc. v. Department of Revenue, Ill. Ct. App., No. 1-98-1476 (2000), where an unstaffed office, rented solely for the purpose of registering the company under a regulatory trucking plan, was sufficient to give the taxpayer a taxable presence in Illinois for income tax purposes. However, note the recent recommendations of the ACEC that such
definition of what qualifies as physical presence, Internet sellers will have a difficult time determining where they are subject to tax.\textsuperscript{111} How the physical presence standard will be applied to Internet sellers with sales activity across the nation remains largely unanswered,\textsuperscript{112} but Congress did not fail to recognize its importance when it passed the ITFA.

D. The Internet Tax Freedom Act

The ITFA was signed into law by President Clinton on October 21, 1998 and is effective from October 1, 1998 to October 21, 2001.\textsuperscript{113} The ITFA imposes a moratorium against any new state and local tax liability on consumers or sellers of products sold over the Internet.\textsuperscript{114} The ITFA created the Advisory Commission on Electronic Commerce ("ACEC")\textsuperscript{115} which will recommend a sales tax structure regarding the Internet to Congress.\textsuperscript{116}

The ITFA does not restrict state and local authorities from collecting any non-discriminatory sales or Internet access taxes that were in place before October 21, 1998.\textsuperscript{117} Jurisdictions are permitted to impose tax on all e-business sales, provided that the tax rate is the same as that which would have been imposed had the transaction activity not create physical presence. See Advisory Comm’n on Elec. Commerce, supra note 5, at 22.

111. See Multistate Tax Comm’n, Nexus Guideline (Draft) for Application of a Taxing State’s Sales and Use Tax to a Remote Seller (Jan. 25, 1995) <http://www.webcom.com/software/issue/docs-htm/mtc-nxs2.html> (listing the activities that would give an out-of-state seller nexus with any given state under this proposal). See also the recommendations for nexus guidelines in Advisory Comm’n on Elec. Commerce, supra note 5, at 22.

112. Moreover, where the sale actually occurs is itself subject to interpretation. See Yancey et al., supra note 4, at 265 (listing fifteen possible locations of an Internet sale, including the location of the sales authorization center, credit authorization, and buyer’s accounts payable location).

113. See Internet Tax Freedom Act § 1102, 47 U.S.C. § 151 (1998). Recent indications are, however, that the termination date could be pushed back another five years. See Advisory Comm’n on Elec. Commerce, supra note 5, at 18.


115. See id. § 1004. The ACEC has nineteen members; three from the federal government, eight from state and local government, and eight from various industries. It met at various times over eighteen months and will submit its recommendations to Congress.

116. See id.; see also Advisory Comm’n on Elec. Commerce, supra note 5, at 11. However, the decisions recently announced by the ACEC are by no means unanimous. See, e.g., Comm’rs Joseph Guttentag et al., Statement Submitted to the Advisory Commission on Electronic Commerce, BNA Tax Core, Mar. 31, 2000 (suggesting that the Commission’s proposals are based on less than the supermajority count required by Congress).

117. See Internet Tax Freedom Act § 1004(2), 47 U.S.C. § 151 (1998); see also Advisory Comm’n on Elec. Commerce, supra note 5, at 18 (recommending invalidating all such access taxes).
been conducted in a traditional manner, such as by mail-order. States are therefore free to continue to impose their ordinary sales taxes on all taxable sales of tangible personal property over the Internet, just as if those sales were conducted via mail-order or over-the-counter. It is the difficulty with collection, rather than imposition, that causes the states such concern.

The ITFA also calls on the Clinton administration to demand that foreign governments keep the Internet free of all taxes and tariffs. The ACEC is charged with studying not only Internet sellers, but also all remote sellers—including mail-order sellers, so its recommendations on nexus will be far reaching. The ITFA indicates that nexus will still be determined based on traditional methods (physical presence), and the activities of Internet sellers will establish nexus in the same manner as other sellers. The ITFA addresses two situations in which an Internet seller can theoretically create nexus with a state: an in-state resident's ability to access a seller's Web site, and the presence of a seller's computer server in the state. Under the ITFA, states may not require an out-of-state seller to collect sales tax if "the sole ability to access a site on a remote seller's out-of-state computer server is considered a factor in determining a remote seller's tax collection obligation." Thus, the fact that a seller's Web site is accessible from within the state is itself insufficient to give the seller physical presence in that state.

The ITFA does not change the rules, however; it only prevents the creation of new ones. Accordingly, before the ITFA, any physical presence in a state was sufficient to create nexus, and under the ITFA the same holds true. Thus, if a remote seller's server must be an "out-of-state computer server" for taxation to be improper, the reverse seems true by implication. If an out-of-state server cannot create

118. Not to stop at that, some members of Congress wish to prohibit worldwide imposition of tax on Internet commerce (in the wake of allowing worldwide nuclear testing).
120. Indeed, to impose a different standard on Internet sellers vis-à-vis other remote sellers, based solely on the nature of the sales, would likely give rise to Equal Protection problems.
122. See id. A similar rule applies under the ITFA when a seller's Web site is hosted on an ISP's Web server.
123. See id.
124. See Carey R. Ramos & Curtis Carmack, Beware of Cyberspace Marauders: Internet Security Addressed, N.Y.L.J., Feb. 24, 1997, at S1. The Internet is a huge, multinational interconnected network of networks, which allows users to access Web sites from any connected computer terminal in the world. Most users access the Internet from Internet Service Providers ("ISPs"). The same ISPs may also provide Web site hosting for an Internet seller's Web site. This hosting is generally conducted via a computer server, which could be located in any state,
nexus, an in-state server seemingly can create nexus. Without a specific exemption,\textsuperscript{125} even if the seller's only physical presence in the state is its computer server, that will suffice as taxable presence for Commerce Clause nexus.\textsuperscript{126}

Under either the ITFA or the traditional physical presence standard, an Internet seller must know what will subject it to a tax collection responsibility in any given state. Clarity, more than anything else, is vital—and physical presence best provides that clarity.

II. AN ARGUMENT FOR STATE TAXATION OF E-BUSINESS BASED ON THE \textit{QUILL} STANDARD OF PHYSICAL PRESENCE

A. Congressional Acceptance of the Physical Presence Standard for E-Business

Sales tax nexus should continue to be based on the physical presence standard set forth in \textit{Quill}, and Congress should adopt a nationwide standard of sales tax imposition based on the taxpayer's physical presence in the taxing state.\textsuperscript{127} The physical presence standard has been the law for many years,\textsuperscript{128} and will remain so until Congress acts to change it. Physical presence works—and if it ain't broke, don't fix it. Taxpayers, mail-order and Internet alike, rely on it for "settled expectations"\textsuperscript{129} in tax planning and compliance, as do the states; any change in the standard would result in many taxpayers finding themselves taxable in far more states than they planned for.\textsuperscript{130}

and is essentially a computerized switchboard that handles the site and maintains connectivity. It is the location of this switchboard that is at issue.

125. Some states currently exempt such items from creating nexus, and the number may increase as the states realize the difficulty of avoiding such connection.

126. The easy way around this, of course, is to ensure that your server is located in your home state, where nexus is already established, or locate the server in a nontaxing state.


130. \textit{See} Douglas J. Derito & Carter Santros, \textit{State Taxation of Electronic Commerce}, CORP. BUS. TAX'N MONTHLY, Jan. 2000, at 18. To address all suggestions, let alone describe them with any detail, would fill tomes. They include an economic presence based nexus, which would change the physical presence standard to one of economic presence—company's sales into the state, even without any physical contact, would equate to taxable nexus; an agency-based nexus, which would give Internet sellers nexus anywhere that an agent of the seller, such as AOL, had the requisite physical presence; and Web site–based nexus, which would give a seller nexus anywhere its Web site could be accessed. Writ large, this last concept could subject an Internet seller to taxation in every jurisdiction in the world that has Internet access.
Congress should codify the *Quill* standard of physical presence, and include therein a *de minimis* exception for insignificant or accidental physical presence in a state that will not create taxable nexus.  

State taxes are a major cost of doing business in America, and tax planning is a vital practice of any multistate company. The physical presence standard provides taxpayers with an unchanging and easily verifiable guideline as to what will create taxable nexus, allowing them to plan their activities to maximize profitability. Under some other nexus standard, such as economic presence, such planning would be severely restricted, as taxability could occur without the taxpayer being cognizant of it or planning for it. With an economic presence standard, a taxpayer would not need to establish a physical presence in a state before imposition of a collection obligation would be constitutional; all that is theoretically required is a single sale into the state. What qualifies as sufficient economic presence is not clear, but a low threshold would cause sellers to be constantly concerned with sales levels into every state, further adding to the compliance burden. This standard first appeared (and was rejected) in the argument put forth by Illinois in *National Bellas Hess*, and repeated by North Dakota in *Quill*. How such a standard

132. *See* Cline & Neubig, *supra* note 34, at 18 (listing compliance costs as ranging between $1,200 and $6,800 per jurisdiction, per year). Compliance costs could equate to 18% of sales taxes collected.
133. It should be added that the physical presence standard is also something that foreign companies selling into the U.S. use to determine taxability. The problem of determining nexus is hard enough for a domestic company; a foreign company would be even less able to navigate the taxability maze with some other standard, and the nature of e-business means that it will cross international borders much more readily that other forms of commerce. Subjecting foreign entities that do not have even the slightest physical presence to a collection obligation could result in the company simply not selling to American buyers, a bad answer for the consumer. How the states would enforce such an obligation is a bit of a mystery as well.
134. The following states impose an economic nexus based collection obligation on out-of-state sellers: Alabama, Arizona, California, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Massachusetts, Minnesota, Mississippi, Missouri, Nebraska, Nevada, North Carolina, North Dakota, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, and Virginia. These laws, of course, are unenforceable. *See* COMMERCE CLEARING HOUSE, MULTISTATE SALES TAX GUIDE 2701 (1993).
135. *See* Buechler, *supra* note 65, at 499 (arguing for an economic presence test, that would "modernize" the current Commerce Clause physical presence test). Economic presence could be based on as little as a single sale into a state; this new test would "remove a competitive disadvantage for local merchants." *Id.* Sounds like the devil we know might be better than the one we don't know.
136. *See Quill*, 504 U.S. at 318. The North Dakota department of revenue made virtually the same argument, with the mail-order business, by showing that Quill was the sixth largest seller of office goods in North Dakota, with $6 million in sales, giving it economic presence without physical presence.
would simplify sales tax collection or compliance, from either the seller or the state’s perspective is unclear.137

Congress’s power to impose a physical presence requirement is undisputed.138 In reaffirming the physical presence standard of its Bellas Hess holding, the Quill Court expressly noted that Congress had the power to overrule Quill in an affirmative exercise of its Commerce Clause power.139 Congress has been successful in its imposition of a national standard before;140 in 1959, Congress enacted Public Law (PL) 86-272,141 which prohibits any state from imposing an income tax unless the taxpayer exceeds certain thresholds of activity in the state.142 The Supreme Court has interpreted PL 86-272 to be little more than a physical presence standard, with a de minimis exception and a focus on the taxpayer’s activity in the state.143 Under this Congressionally imposed standard, the mere physical presence of the taxpayer does not necessarily equate to a taxable presence.144 While this criteria applies to state income tax nexus, it could just as easily and successfully apply to state sales tax nexus.

Congress’ physical presence requirement for sales tax nexus should explicitly include the judicially recognized de minimis exception.145 This exception grants immunity from taxation if physical

137. Indeed, if it worked the states could be flooded with returns, remitting such small amounts that the costs to process each return could exceed the revenues generated therefrom.

138. Note that a majority of the commission members suggested a formal congressional solution to the nexus problem. This proposal would restrict states from imposing sales taxes on electronic merchants unless the seller had a substantial physical presence in the state under Quill. See ADVISORY COMM’N ON ELEC. COMMERCE, BUSINESS CAUCUS PROPOSAL (Mar. 20, 2000) <http://www.ecommercommission.org/document/202BusinessCaucusProposal.pdf>.

139. See Quill, 504 U.S. at 318-19. The Court noted that Congress is better qualified to address the Commerce Clause issue, and has the power to do so. Specifically, the Court stated that “in this situation, it may be that the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.” Id. (internal quotations omitted).

140. See Kathryn L. Moore, State and Local Taxation: When Will Congress Intervene?, 23 J. LEGIS. 171, 183 (1998) (discussing Congress’s attempts to date to pass sales tax bills and why they didn’t work out just the way they should have); see also Griswold & McLoughlin, supra note 73, at 763 (lamenting Congress’s repeated shunning of the Consumer and Main Street Protection Act (a.k.a., the Bumpers Bill), which would have allowed states, with certain restrictions, to impose use tax collection responsibility on out-of-state mail-order sellers).

141. The Interstate Commerce Tax Act § 101, 15 U.S.C. § 381 (1959) provides that a state may not impose a net income tax on any person if that person’s only business activities within such state involve the solicitation of orders approved and filled from outside of the state.

142. See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 19. The thresholds would be even further expanded under this proposal, which recommends the same nexus requirements for income tax as for sales tax.

143. See William Wrigley, Jr., Co. v. Wisconsin, 505 U.S. 214 (1992); any activity within a state that is not entirely ancillary to the solicitation of sales is sufficient to give the taxpayer nexus with that state under PL 86-272.

144. Id. at 225.

145. See National Governor’s Association, Leading Tax Experts Oppose Permanent
presence constitutes merely a trivial connection with the state. The Supreme Court has defined the exception as "de minimis . . . depends upon whether that activity establishes a nontrivial additional connection with the taxing State." The de minimis exception as applied to sales tax would except such physical presence in a state as a computer server or the presence of a corporate officer on unrelated business. Such a scheme would not tax out-of-state companies that have minimal physical presence in a state and cannot readily control sales into the state.

Physical presence with a de minimis exemption is the highest conceivable nexus standard that states would accept. Its adoption would reduce the number of taxpayers falling under the states' collection umbrella, by increasing the level of protected activities. On the other end of this spectrum is a standard that creates nexus based on Web site accessibility from within a state, which theoretically could allow every state to tax any and every company with a Web site. The inherent unfairness of this standard would

Exemption for Electronic Commerce (visited Feb. 11, 2000) <http://www.nga.org/internet/conRelease.asp> (quoting Charles McLure, an economist with the Hoover Institution at Stanford University: "It is extremely important to provide a de minimis rule or use other techniques to eliminate compliance burdens on small business.").

146. See Wrigley, 505 U.S. at 225.

147. By way of contrast, the economic presence test would; any activity in a state, including sales, could theoretically provide a basis for the state to impose a sales tax collection obligation. Thus, a small seller may shy away from selling into a state due to the added burden of compliance, while a large seller with the financial prowess to absorb such costs would not hesitate. Raising the barrier to enter a market via the Internet seems like killing the goose that's laying the golden eggs. See National Governor's Association, supra note 2 (regarding increased sales due to Internet activity).

148. See ADVISORY COMM'N ON ELEC. COMMERCE, supra note 5, at 17 (indicating that physical presence, while remaining the standard, should not be determined based on such things as the placement of digital data on an in-state server, performance of services in the state, or a contractual relationship with an in-state entity allowing customers to return goods bought over the Internet to the other party's physical location in the state). All of these elements could create physical presence, so the proposal actually decreases the number of taxpayers that have nexus in any given state.


150. Case law tends to indicate that such a standard could be feasible. See GTE New Media Services Inc. v. Ameritech Corp., 21 F. Supp. 2d 27 (D.D.C. 1998) (holding that a Web site was highly interactive and the quality and nature was significant enough for personal jurisdiction); see also Hasbro Inc. v. Clue Computing Inc., 994 F. Supp. 34 (D. Mass. 1997) (holding that an interactive Web site allowing residents of the forum to send e-mail to the defendant was sufficient for personal jurisdiction).
likely run afoul of other restraints on state tax, such as the Equal Protection Clause\textsuperscript{151} and the \textit{Complete Auto Transit} test.\textsuperscript{152}

\textbf{B. States Should Cooperate to Design a Simple, Efficient Tax Collection System That Does Not Prejudice E-Business}

Along with the physical presence requirement, Congress should encourage the state and the taxpayers to reduce the sales tax compliance burden, making it easier to collect and remit sales and use taxes.\textsuperscript{153} If the Internet must give rise to new state tax laws, then let those laws be tax simplification measures. States should increase tax collection efforts by increasing and directing their audit staff to focus on the fastest-growing portion of the escaping tax base: the in-state individual consumers.\textsuperscript{154} States could also remove the audit stick and fatten the carrot by negotiating with Internet sellers to voluntarily collect the tax even without the requisite physical presence, in exchange for a larger share of the proceeds.\textsuperscript{155} Since the primary objection to sales tax collection by sellers is un-reimbursed costs,\textsuperscript{156} making the administration easier will obviously reduce costs and increase taxpayer satisfaction and compliance.\textsuperscript{157} Centering the collection of both state and local taxes in one agency would not only reduce the burden on the seller by requiring only one return, but may also increase state efficiency.\textsuperscript{158}

The states are not blind to these concerns, and one proposal offers the following incentives: standardized administrative procedures; reduced costs of compliance, payment, and audits; eliminated rate and base monitoring and implementation; and eliminated costs of bad debts, audit liabilities, and negligence.

\textsuperscript{151} U.S. CONST. art. I, amend. XIV.
\textsuperscript{153} See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 26 (listing one of its recommendations that Congress “encourage state and local governments to work with and through the National Conference of Commissioners on Uniform State Laws in drafting a Uniform Sales and Use Tax Act that would simplify state and local sales and use taxation policies so as to” simplify collection efforts).
\textsuperscript{154} See Cline & Neubig, supra note 34, at 4 (indicating the level of sales tax lost due to individual consumers purchasing over the Internet).
\textsuperscript{155} See id. at 28 (listing vendor discounts that states currently offer for collection costs, ranging from zero to 3.3%).
\textsuperscript{156} See id. at 5.
\textsuperscript{157} None of the discussion about “federally un-funded mandates” imposed on the states has trickled over into the “state un-funded mandates” of sales tax collection imposed on sellers.
\textsuperscript{158} See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 17-18.
penalties. Nonetheless, even without these measures, as the following example shows, the advent of the Internet does not limit the states in their collection attempts, and it does not serve as a drain on state sales tax revenues.

III. MAIL-ORDER SELLERS V. INTERNET SELLERS—THE SAME RULES CAN APPLY IN PRACTICE

A. Porcupine the Mail-Order Seller

The same physical presence standard that applies to mail-order sellers can successfully apply to Internet sellers as well. The following example shows the viability of the congressional codification of *Quill* made in Part III. It shows that states really do not lose sales tax revenues due to e-business sales, and the *Quill* standard of physical presence, even without a *de minimis* standard, can easily and successfully accommodate Internet sellers.

To begin, imagine a hypothetical mail-order company, Porcupine, which has its only place of business in Dekalb, Illinois. Porcupine is a small mail-order seller of rare books to collectors in all fifty states. Porcupine solicits sales by sending out, semi-annually, a catalog that shows the various books for sale by Porcupine, including the edition, publisher, copyright date, condition, and other information.

To facilitate orders and allow for customer ease, Porcupine provides repeat buyers with access to its inventory database via Porcupine's Web site, which allows the exchange of information over the Internet, but does not allow buyers to purchase Porcupine's books

159. See National Governor's Association, supra note 37.

160. The physical presence standard is what is applied currently, and note the conclusion of the National Conference of State Legislatures' analysis of 1999 revenues, that the states are "generally in good to excellent fiscal condition." NAT'L CONFERENCE OF STATE LEGISLATURES, STATE FISCAL OUTLOOK FOR 2000, Jan. 5, 2000. This report indicates that twenty states "will exceed initial revenue expectations" and "29 states and the District of Columbia anticipate that revenue collections will be on target with estimates." Essentially, forty-nine of the fifty states lost nothing due to e-commerce; many increased tax revenues.

161. See Cline & Neubig, supra note 3, at 10 (stating that the sales tax dollars "lost" by the states are grossly overstated, and the uncollected sales tax revenues in 1998 did not exceed $170 million); see also Austan Goolsbee & Jonathan Zittrain, *Evaluating the Costs and Benefits of Taxing Internet Commerce*, 5 NAT'L TAX J. 1 (1999) (suggesting that the total uncollected taxes resulting from Internet sales will be less than 2% of all sales tax revenue in 2003).

162. The *de minimis* standard, however, would certainly make nexus determinations easier.

163. Imagine also that Congress has codified the *Quill* standard of physical presence without an explicit exemption for *de minimis* activities in the forum state. Thus, the example will assume that even the slightest physical presence is sufficient for sales tax nexus.
on-line. A server located in California maintains the Web site. All employees live and work exclusively in Illinois, with the exception of certain buyers, who travel to a number of different states to attend used book sales. When a recipient of Porcupine’s catalog wants a particular book, they call Porcupine’s toll-free number to place their order. The order is shipped to the buyer via common carrier or the U.S. mail. If the buyer wants later services for his purchase, such as re-conditioning, he must send the book back to Porcupine’s office in Illinois. None of Porcupine’s re-conditioners travel out-of-state and all services on the rare books are performed in Illinois.

Using these facts, five different scenarios will highlight the application of the Quill standard of physical presence to mail-order sellers, as well as reveal some of the difficulties in calculating and collecting the tax that these and all remote sellers face. The five sales are to residents of Illinois, Missouri, California, and Louisiana. Similar hypotheticals will also highlight the ease with which the states, using the same Quill physical presence standard, can continue to capture the sales tax on e-commerce sales to in-state buyers.

The first buyer, Polly, located in Illinois, has a ship-to address in Dekalb, Illinois, the same city as Porcupine’s offices and warehouse. Under Illinois law, all sales by Porcupine to Illinois buyers are subject to Illinois sales tax at the rate of six and one-quarter percent of the retail purchase price, based on Porcupine’s Dekalb location. Illinois is what is referred to as an “order acceptance point” state, meaning that the proper sales tax rate to be charged by the seller is based not on where the item is being shipped to, but rather where the order was accepted. Thus, if the second buyer,

164. Assuming rare books are taxable at all; some states may allow for exemptions for items such as antiques, or the books may qualify as educational materials, also exempt in many states. See 35 ILL. COMP. STAT. §120/2 (West 1986) (exempting certain educational materials).

165. This becomes important in the discussion of taxable buyers as well; even if the books are ordinarily taxable, they may be exempt if sold for educational purposes, even if bought by a private school that is itself taxable under IRS rules. See I.R.C. § 501 (1996). The myriad rules only muddy the waters more.

166. Even this is not so clear. Illinois is a home rule state, allowing each taxable jurisdiction (including school, utility and “entertainment” jurisdictions) to impose their own sales taxes on sales of tangible personal property, increasing the base rate to as much as 9.75%. The determination of the correct rate is based on the order acceptance point. Tax rate depends on where the order is filled from, as opposed to where it is shipped. Thus, a warehouse in Chicago would mean a seller must collect the highest tax rate in the state for all sales, regardless of where in the state they are shipped. See Kenneth H. Silverberg & Mark M. Foster, The Internet Tax Freedom Act: Will It Be a Success or a Failure?, J. MULTISTATE TAX’N 4 (1999).

167. See 35 ILL COMP. STAT. § 120/2 (West 1986) (imposing the tax on the sale of property).

168. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶ 14.02.
Hot Rodder, lives in Chicago, where the applicable rate is eight and three-quarters percent.\textsuperscript{169} Porcupine will still only charge tax at six and one-quarter percent, since the order is accepted in Dekalb, and not in Chicago.\textsuperscript{170}

Even considering all the complexity and intricacies of Illinois's sales tax scheme,\textsuperscript{171} it is relatively easy for Porcupine to navigate these sales tax waters so long as it remains solely within Illinois.\textsuperscript{172} However, like all multistate sellers, Porcupine's sales and use tax problems do not end in its home state. Porcupine sends its buyers out of Illinois to various locations, including Missouri, to buy rare books for Porcupine's inventory.\textsuperscript{173} Porcupine buys much of its inventory from Missouri sellers,\textsuperscript{174} and occasionally sells books to Missouri residents. The third buyer, Tom, is from Missouri. Tom calls Porcupine's toll-free number and places his order, which is shipped via U.S. mail to his home address in Missouri. Should Porcupine charge sales tax on this sale? If so, at what rate?

Illinois's rate is improper, even considering the order acceptance point theory, since this is a sale of goods in interstate rather than intrastate commerce. While Illinois is free to tax goods sold to Illinois buyers, it may not tax goods sold to Missouri buyers. So the rate, if any, must be the Missouri rate—but can Missouri require that Porcupine collect and remit the sales tax? To do so, Missouri must show that Porcupine has exceeded the Due Process requirement of minimal connection and the Commerce Clause requirement of physical presence in Missouri. Since Porcupine does not have any property in Missouri, does not have a sales office, and does not actively solicit sales there, Porcupine would seem to have no physical

\textsuperscript{169} See 35 ILL. COMP. STAT. § 3-27-010 (West 1986) (imposing the Chicago sales tax on sales of property taxable in Illinois).

\textsuperscript{170} However, if the order were filled from a warehouse in Chicago, the proper rate would be Chicago's higher rate, regardless of where in the state the order is accepted, or where it is shipped.

\textsuperscript{171} See Cline & Neubig, supra note 34, at 1 (calling state and local governments "masters of complexity in designing sales tax systems").

\textsuperscript{172} Imagine, though, how difficult it would be for an out-of-state seller that has no physical presence in Illinois, and thus is not collecting the tax, when it discovers that it is now over the economic presence threshold and must begin collecting the tax.

\textsuperscript{173} Suppose Porcupine buys 15\% of its inventory from Missouri; while that is a significant amount, under the pure physical presence analysis, even buying one book in Missouri via an in-state buyer would be sufficient for physical presence.

\textsuperscript{174} These purchases would likely be exempt from sales tax as sales for resale, assuming Porcupine gives the booksellers the appropriate exemption documentation. The sales tax rests solely on the end user, and is only imposed once, so a purchase of goods to be resold is usually exempt from sales tax. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, § 12.01.
presence in Missouri, and would thus not be required to collect Missouri’s sales or use tax.

This, however, is incorrect; Porcupine does have physical presence in Missouri, and can be required to collect Missouri’s sales tax on sales to Missouri buyers. The presence of Porcupine’s buyers in Missouri is sufficient to create physical presence under the Quill standard. This is so regardless of the level of sales volume directed towards Missouri, be it one sale or one hundred percent of Porcupine’s revenues; once created, physical presence is an indelible mark. Tom should thus be charged the price of the book, plus 4.225 percent, the applicable Missouri state use tax rate.

The fourth buyer, Casy, lives in California, the state where Porcupine has its computer server. Porcupine does not send buyers into California, and has no trace of physical presence there, other than the computer server. Like the other buyers, Casy calls in her order to Dekalb, which is filled in Illinois and shipped to her California home via U.S. mail. Under the basic Quill standard requiring a physical presence, and the interpretation of the ITFA discussed above, Porcupine has taxable nexus with California, due to its server in the state, even though it has no other physical presence in the state. The presence of the server equates to a taxable physical presence, and Porcupine must collect California tax on the sale to Casy.

The fifth buyer is Huck, who recently made his home in Louisiana. Huck’s order is billed without any sales tax included, because Porcupine does not have nexus with Louisiana. Porcupine has no property in Louisiana, does not send its buyers into Louisiana, and maintains no inventory there. Porcupine may have exceeded the minimum connection required by the Due Process Clause by

176. On an annual basis, anyway. It is doubtful that Missouri could continue to impose the tax collection obligation on Porcupine in the year following Porcupine’s last incidence of physical presence, even if it continued to sell into Missouri.
177. See § 144.610.1, R.S.MO. (1995). Missouri sales tax rate is 4.225% and consists of a general sales and use tax of 4%, a wildlife conservation tax of .125%, and a soil and water conservation and park tax of .10%.
178. Assume Porcupine owns the server itself in this case. Note the nexus definition in the ACEC’s recent proposal that indicates the maintenance of digital information on a server not owned by the taxpayer will not equate to physical presence. See ADVISORY COMM’N ON ELEC. COMMERCE, supra note 5, at 20.
179. Again, this is assuming the state does not specifically exempt such items from creating nexus.
180. 1993 CAL. STAT. §§ 6051, 6051.2.
directing its activities towards Louisiana, perhaps even by advertising there, but it has not exceeded the stricter Commerce Clause nexus standard requiring physical presence. Louisiana has no basis under *Quill* to impose a tax on Porcupine, and if the state wants the tax owed on the book purchased by Huck it must collect the tax directly from Huck himself. Louisiana of course may do so with no constitutional worries, pursuant to its use tax act, as this is now an in-state use of the book. However, as mentioned above, most states do not aggressively pursue consumer use tax liabilities, probably due to the cost of such enforcement, preferring to place that burden on the out-of-state (and out of voting power) sellers.

There are three states where Porcupine has taxable nexus, based on varying degrees of physical presence. In Illinois, Porcupine has a clear physical presence and must collect the Illinois sales tax, based on the order acceptance point, for all sales to Illinois residents. Porcupine must also collect the statewide tax for all sales to Missouri residents, due to the physical presence created by Porcupine’s buyers in the state. For all sales with a ship-to address in California, Porcupine must collect tax, based on the physical presence created by the location of Porcupine's computer server in California. In Louisiana, Porcupine has no collection responsibility since it has no physical presence there. Louisiana must pursue the in-state buyer to collect any tax owed. All of the states addressed have the ability to ensure the collection of the sales tax on sales to in-state residents; Illinois, Missouri, and California can impose the collection and remittance duty on Porcupine, and Louisiana can collect the tax directly from its own citizens. The same, of course, is true for all other states in which Porcupine may do business.

**B. Old Wine in a New Bottle—Porcupine Becomes an Internet Seller**

So what aspect of the sales tax should change if Porcupine begins selling over the Internet? Absolutely nothing. Suppose that Porcupine decides that to compete with other rare booksellers, it

181. See *Quill*, 504 U.S. at 302.
183. The initiation of some or all of the simplification measures discussed in Part III may make the collection duty in this case far less burdensome.
184. Of course, so could Illinois, Missouri, and California, but it's far easier for those states to impose this duty on Porcupine.
185. Clearly, the states that do not impose sales tax would not be interested.
must become fully integrated with the Internet and must allow potential buyers to complete sales entirely in cyberspace, via Porcupine’s Web site, www.pokeme.com. Accordingly, Porcupine upgrades its Web site to allow for the placement and shipment of an order entirely over the Internet. Porcupine continues to solicit sales via the traditional means, i.e. the catalogs continue to be sent out semi-annually, and the toll-free number remains fully operational, but all five buyers switch to Internet ordering for their next purchase. By taking each of the five scenarios in turn, it is evident that none of the states lose tax revenues because of the Internet sales,\(^{186}\) and the Internet may in fact help the states increase their sales tax collections.

When Porcupine receives Polly’s order, over the Internet, it will contain her payment information and her ship-to address in Dekalb, Illinois. With this ship-to address, Porcupine is able to determine whether and at what rate to collect tax. Since the ship-to address will show Illinois, Porcupine knows it must collect six and one-quarter percent on the sales price of the book. The same is true when Hot Rodder’s order comes in, showing his ship-to address as Chicago, Illinois. Porcupine again knows to charge the six and one-quarter percent rate on the sale to Hot Rodder.\(^{187}\) Porcupine’s Internet presence does not change the nature of its physical presence in Illinois, and neither does it change the nature of its collection duty.

Tom, the Missouri resident, also places his next order over the Internet. Porcupine refers to the ship-to address to determine the taxability of the sale, and based on the Missouri address knows that it must impose a Missouri tax on the sale to Tom. Again, Porcupine’s business did not change by the introduction of its Web site; the buyers still visit book sales in Missouri, and this still gives Porcupine physical presence in Missouri. The fact that the order is received via the Internet, rather than over the telephone or by mail, does not change the taxable nature of the sale. This is so regardless of the level of sales Porcupine makes into Missouri; if Porcupine’s Web site is a big

\(^{186}\) Again, it must be noted that this example assumes the sale of tangible personal property that must be physically delivered somewhere; the invention of digitized music or software that can be sold and downloaded over the Internet without a ship-to address admittedly causes some problems. While a bill-to address may still be required, and credit card payments have billing addresses, the advent of cyber cash, which could be completely untraceable, can cause significant complications.

\(^{187}\) Note that if Porcupine’s offices were in Chicago, the opposite would be true; Polly would be charged 8\(\frac{1}{2}\)% sales tax, no matter that she lives in an area that charges only 6\(\frac{1}{2}\)% and that she may never visit Chicago and never enjoy any of the benefits that Chicago visits upon its citizens due to its sales tax collections.
hit with Missourians and sales multiply by 500 percent, Porcupine must still collect and remit to Missouri the tax on all books shipped to Missouri, notwithstanding that the buyer’s activities remain the same or may even decrease. However, if the buyers stopped traveling to Missouri, and Porcupine severed its physical connection with Missouri, Porcupine would no longer have the requisite physical presence, and could cease collection and remittance of Missouri tax.

Considering Casy, the California buyer, here too nothing has changed in the nature of the sales transaction. Casy’s ship-to address remains the same regardless of how she places her order, so Porcupine knows that it must collect tax on the sale.\textsuperscript{188} Porcupine maintains its computer server in California, and barring a specific state exemption, under the \textit{Quill} standard and the ITFA the presence of a computer server in the state is sufficient to create physical presence. This is an obvious example of physical presence that should qualify as \textit{de minimis} under the proposed Congressional standard, but even without such a \textit{de minimis} exemption, the physical presence standard at least allows for effective planning and collection by Porcupine. On all sales to Casy or any other California resident, Porcupine must collect the California tax. If Porcupine determined that the compliance costs in California were too great to justify the level of sales into California, it could move its server, or stop selling to California customers, or seek to reduce its costs some other way; but it would know it had physical presence and could plan around it.

Finally, Huck from Louisiana also orders over the Internet. When his order is received, Porcupine goes through the same analysis; refers to the ship-to address, and based on that determines if it has a collection responsibility for Louisiana tax. Since nothing has changed for Porcupine vis-à-vis Louisiana, nothing should change in the taxability of sales to Louisiana residents. Porcupine still does not have taxable presence in Louisiana, and Huck will continue to be individually responsible to Louisiana for the tax owed on his purchase.\textsuperscript{189} Again, the same is true regardless of the level of sales

\textsuperscript{188} The state may collect from Porcupine the tax due on sales into the state if Porcupine has physical presence, regardless of whether the buyer paid the tax to Porcupine. Since in this case Porcupine bears both the collection and payment obligations, the incentive to collect when nexus exists is great.

\textsuperscript{189} Note that under either a Web site-based standard or the agency standard for nexus Porcupine would have a collection responsibility in all of Louisiana. The Web site is clearly accessible from Louisiana, and if the company that maintains the server and the connection agent has nexus with Louisiana, so too would Porcupine, under the agency nexus standard.
volume that is actually sold to Louisiana residents; Porcupine does not have physical presence and need not collect the Louisiana tax.

Louisiana also serves to illustrate the complexities that could arise if any standard other than physical presence is used to create sales tax nexus. Louisiana allows local jurisdictions, in addition to the state, to impose and collect their own tax on sales of tangible personal property into the local jurisdictions.190 These jurisdictions also have their own administration of the local tax, which means that an out-of-state seller with physical presence in the various local jurisdictions would be required to collect the local tax and remit it by filing multiple local returns, as well as the state return.191 With the complex questions that determine taxability, this could easily become a mammoth task for the unsuspecting seller if nexus could be created by something other than a physical presence. At the very least, a small seller can control its exposure to the extent that it knows where it has even the slightest physical presence. However, Porcupine may be willing to voluntarily collect and remit the tax—for a small fee, of course. Louisiana may also decide that the purchase of advertising time on Porcupine’s Web site, directed towards Louisiana residents and informing them of their tax payment responsibility, is money well spent.

From this example it is easy to see that while the advent of the Internet and the increase of e-commerce will change the face and magnitude of sales taxation and collection, the states will not be crippled in their collection efforts. The new economy does not destroy the old, and selling over the Internet does not change some of the basic aspects of Porcupine’s business. Buyers will still comb the market for the best value, leaving a trail of taxability behind them as they go. Porcupine’s inventory warehouses in various states, necessary for the immediate delivery that the Internet promises, will continue to create a physical presence in those states. Retail outlets, which many Internet sellers use to supplement their Internet sales (or vise versa), clearly create physical presence in a state,192 as does the location of a seller’s delivery vehicles. Increased sales notwithstanding, the states are not soon to be deprived of all means or basis

190. See 2 HELLERSTEIN & HELLERSTEIN, supra note 5, ¶ 13.03.
191. Id. What is not so clear is if the seller has physical presence in one locality, does that give it nexus with all localities in the state? See Yelverton’s, Inc. v. Jefferson, Alabama, 23 Ala. 1961702 (1999) (addressing a similar issue in Alabama, finding that nexus in one locality does not equate to nexus in another).
192. This is assuming the retail outlets are in the same corporate entity as the Internet seller.
for collecting their sales taxes, and they really should consider booming Internet sales a boon for their collection departments. Physical presence is not only a workable standard for determining sales tax nexus with Internet sellers; it is the best standard.

CONCLUSION

The rapidly expanding use of the Internet has caused increased congressional and taxpayer scrutiny of the patchwork of rules that current state sales taxation represents, but it need not cause broad, sweeping changes in the way state sales tax is administered or collected. The physical presence standard works and it can continue to work; if it ain’t broke, don’t fix it. Congress should adopt the Quill physical presence standard as the basic level of nexus required by an out-of-state seller before a state can impose a tax collection obligation. The standard should include a de minimis exception to allow for minimal or incidental physical presence in a state, and allow for accidental or temporary physical presence. It should be designed to allow out-of-state sellers to plan their activities in such a way as to be able to predict and maximize the value of their state tax exposure. The current judicial standard of a mandatory significant physical presence for state tax nexus, set out by the Supreme Court in Quill, provides a solid, workable basis for the development of a Congressional standard of sales tax nexus.

Such a standard would provide confidence and guidance to Internet sellers, as well as other out-of-state sellers, about what activities will create a taxable presence in a state. This assurance will allow for managed growth without stifling competition or discriminating against smaller taxpayers. The standard would also provide the states with a bright-line test to determine taxability, allowing for targeted auditing and enforcement activities and perhaps leading to increased returns on audit costs. Cooperation among and between the states and taxpayers will allow for the development of universal and fair collection and compliance requirements, encourage the development of a uniform tax base, and lead to increased tax revenues due to increased compliance.

The ITFA provides the opportunity to present the physical presence standard to Congress, and the need for a uniform, bright-line standard that encourages economic growth via the Internet could not be greater. Congress should take this opportunity to impose a nationwide standard of physical presence in a state before taxation
can occur. The Internet does not present an insurmountable obstacle or one calling for drastic changes in the sales tax arena; rather, it is a vehicle for creating ease and simplification in an area that is much in need of a little of both.