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GEOFFREY SIDESTEPS QUILL: CONSTITUTIONAL NEXUS, INTANGIBLE PROPERTY AND THE STATE TAXATION OF INCOME

Michael T. Fatale*

I. INTRODUCTION

In 1959, in Northwestern States Portland Cement Co. v. Minnesota, the United States Supreme Court addressed the “need for clearing up the tangled underbrush of past cases” with reference to the taxing power of the States” under the Commerce and the Due Process Clauses of the United States Constitution. Thirty-five years later, after the Court’s most recent pronouncements on the subject—most notably in Quill Corp. v. North Dakota—the need still exists. Quill held that a state may not impose a use tax collection obligation on a vendor unless that vendor is physically present in the taxing state. However, Quill left unanswered whether a state can tax the income of a corporation which is not physically present in the state where the income is derived from intangible property owned by the corporation and used within the state. In the recent case of

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This Article represents the opinions and legal conclusions of its author and not necessarily those of the Massachusetts Department of Revenue.

2. Id. (quoting Wisconsin v J.C. Penney Co., 311 U.S. 435, 445 (1940)).
4. See id. at 1907.
5. See Petition for Certiorari at 9, Geoffrey, Inc. v. South Carolina Dep’t of Revenue and Taxation, 114 S. Ct. 550 (1993) (No. 93-520) [hereinafter Geoffrey Cert. Brief] (noting that Quill left open the Geoffrey question as to “whether a state may impose an income tax on a taxpayer with no physical presence in the state”); see also 1 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 6.08 (Supp. 1994) [hereinafter HELLERSTEIN & HELLERSTEIN]; Lee A. Sheppard, Geoffrey: The Commerce Clause In the Information Age, 6 STATE TAX NOTES 35, 37 (1993).
Geoffrey, Inc. v. South Carolina Tax Commission, the South Carolina Supreme Court concluded that a state could apply its income tax to a corporation under these circumstances. The vitality of the analysis in that decision is the focus of this Article.

II. BACKGROUND

Portland Cement involved a state’s attempt to tax the net income of the interstate operations of a foreign corporation. The Supreme Court ruled that a state could tax this income, provided the tax “is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support [the tax].”


8. Certiorari was requested in Geoffrey, but was denied. 114 S. Ct. 550. While the denial of certiorari has no legal significance per se, see Wisconsin Dept. of Revenue v. Wrigley, 112 S. Ct. 2447, 2452-53 (1992), at least one commentator has concluded that the determination implicitly broadens the states’ taxing powers. See Marlis L. Carson, Supreme Court Denies Certiorari in Geoffrey, 5 STATE TAX NOTES 1352, 1352 (1993); see also Jeffrey S. Peters, Income Tax Nexus: Are Physical Contacts Required? Geoffrey, Inc. Sets Stage, STATE TAX REV., Sept. 27, 1993, at 6-7 (predicting this result); Semes, supra note 6, at 1302 (discussing the potential impact of the case). Commentators have split on the correctness of Geoffrey, often, apparently, consistent with whether they typically represent private or public interests. See, e.g., Geoffrey Filing Tops the State Tax Advisory Board’s Agenda, STATE TAX REV., Nov. 21, 1993, at 6-10 [hereinafter CCH Board Comments] (quoting comments both pro and contra, made by various members of the CCH State Tax Advisory Board); Peters, supra at 6-9 (contra); Semes, supra note 6, at 1297-1302 (contra); Gordon W. Stewart, The Geoffrey Decision’s Constitutional Problems, 5 STATE TAX NOTES 420, 420-23 (1993) (contra).

9. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452 (1959). Portland Cement was a significant development in the Court’s Commerce Clause jurisprudence, since the Court explicitly recognized for the first time outside the context of state property tax that an exclusively interstate business can be subject to the states’ taxing powers. See WALTER HELLERSTEIN, Federal Constitutional Limitations on State Taxation, in 2 STATE & LOCAL TAX PORTFOLIO SERIES ¶ 815.4 (1991 & Supp. 1993). The dominant theme of Portland Cement, which was subsequently expanded upon by the Court, was that “it is axiomatic that the founders did not intend to immunize such [interstate] commerce from carrying its fair share of the costs of state government in return for the benefits it derives within the State.” See HELLERSTEIN, supra at 1224 (quoting Portland Cement, 358 U.S. at 461-62); see also Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1912 n.5 (1992) (“Under our current Commerce Clause jurisprudence, "with certain restrictions, interstate commerce may be required to pay its fair share of state taxes."”) (quoting D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988)).

While Portland Cement expressly applied only to taxes levied on a corporation’s net income, the Court later, in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), stan-
response to *Portland Cement*, corporations with multi-state income began isolating individual activities in newly-formed subsidiaries and locating those activities in such a way as to avoid the taxing “nexus” of individual states.\(^\text{10}\)

After *Portland Cement*, the Supreme Court continued to revisit the constitutional nexus requirements applicable to state taxation of multi-state businesses. In this regard, one of the more significant decisions was *National Bellas Hess, Inc. v. Department of Revenue*.\(^\text{11}\) In *Bellas Hess*, the Court determined that a state could not impose a use tax collection obligation on a vendor where the vendor’s only contacts with the taxing state were by mail or common carrier.\(^\text{12}\) This ruling, like that in *Portland Cement*, had a significant, commercial impact: it created an incentive for a consumer to purchase goods from an out-of-state entity, since these purchases could be made without the corresponding payment of sales or use tax.\(^\text{13}\) This incentive,

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10. See Eugene F. Corrigan, *Interstate Corporate Income Taxation—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423, 429 (1976). The facts in *Geoffrey* reveal one example of this type of tax planning. The corporate-taxpayer in *Geoffrey* was specifically incorporated in Delaware—which does not tax corporations that merely maintain and manage intangible property—to minimize state tax. See infra note 142. Credit card companies also typically engage in a similar type of tax evasion. See generally infra notes 228-31 and accompanying text.


12. See id. at 758. A use tax applies to property which is used, consumed or stored in a state if that state would subject the in-state purchase of the same property to sales tax. The rationale for the use tax was explained by the Supreme Court in *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954):

> Taxation of sales or purchases and taxation of use or possession of purchases are complementary and related . . . . The former, a fiscal measure of considerable importance, has the effect of increasing the cost to the consumer of acquiring supplies in the taxing state. The use tax . . . usually appears as a support to the sales tax . . . [to protect] the state’s revenues by taking away from inhabitants the advantages of resort to untaxed out-of-state purchases.

Id. at 343.

13. In theory, the purchaser in these transactions remains directly liable for his or her state’s use tax. However, as a practical matter, there is very little tax compliance in these instances, and very little capacity or incentive for the taxing state to track what most times will be a de minimis tax payment. Therefore, there is an incentive for a state to register the out-of-state vendors which make sales in the state and to collect the use tax from them. See id. (“The collection of the use tax from inhabitants is a difficult administrative problem, and if out-of-state vendors can be compelled to collect it and remit it to the taxing state, it simplifies administration.”) Throughout this Article the term “use tax” refers to the use tax collection obligation which is imposed by the various states upon vendors—and not to the pri-
in turn, contributed to the dramatic growth of the mail order business.\textsuperscript{14}

In \textit{Quill}, the Court re-affirmed \textit{Bellas Hess}, which had come to be widely criticized as inconsistent with the practical realities of the commercial world.\textsuperscript{15} In addition, the Court sought to clarify, once again, the Due Process and Commerce Clause restrictions upon states seeking to tax multi-state businesses. In this regard, the Court distinguished between the Due Process Clause and the Commerce Clause—something it noted it had not always clearly done\textsuperscript{16}—and analyzed the requirements under each. In so doing, the Court made clear that there are two constitutional nexus requirements, one under each clause. The Due Process nexus requirement is less onerous, and approximates the “minimum contacts” analysis utilized in the context of adjudicative jurisdiction.\textsuperscript{17} The Commerce Clause nexus requirement is more stringent and necessitates that there be “substantial nexus.”\textsuperscript{18} At least in the context of a use tax, the substantial nexus test requires that the vendor be physically present in the taxing state.\textsuperscript{19}

While \textit{Quill} resolved a number of questions, it did not address the issue faced by the South Carolina Supreme Court in \textit{Geoffrey}—whether the mere ownership and use of intangible property within a taxing state can create nexus. The specific question in \textit{Geoffrey} was whether a state has nexus with a corporation for income tax purposes where that corporation licenses intangible property into the state and derives income from its use therein.\textsuperscript{20} \textit{Geoffrey} held

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\item 16. \textit{Quill}, 112 S. Ct. at 1916.
\item 17. See id. at 1909-11.
\item 18. See id. at 1911-16.
\item 19. See id. at 1914, 1916.
\item 20. See Geoffrey, Inc. v. South Carolina Tax Comm’n, 437 S.E.2d 13 (S.C.), cert. denied, 114 S. Ct. 550 (1993). \textit{Geoffrey} involved a Delaware holding company licensing the
\end{itemize}
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that there is taxing nexus under these circumstances. In so holding, *Geoffrey* relied on two doctrines which have been referenced favorably by the Supreme Court: the business situs rule, which applies to intangible property, and the economic benefits test. The business situs rule, referenced in various cases, including *Wheeling Steel Corp. v. Fox*, 22 states generally that an item of intangible property acquires a taxable situs in a state when it is used in that state in a local business. The economic benefits test, often quoted, most times from *Wisconsin v. J.C. Penney*, 24 states that "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, [and] to benefits which it has conferred . . . ." 25

This Article evaluates the correctness of the analysis utilized by *Geoffrey*. It proceeds in four sections. Part III analyzes *Quill* and, in particular, the Court's articulation of the physical presence test. This section determines that it is unclear whether the physical presence test applies outside the area of use tax. However—whether or not it does—*Quill* seems to permit a finding of constitutional nexus based upon the ownership and use of intangible property within a taxing state. Part IV examines the analysis set forth in *Geoffrey*. In particular, this section evaluates *Geoffrey* in light of *Quill*, and focuses on the business situs rule and economic benefits test. This section con-
cludes that, while Quill calls into question whether the economic benefits test supports Geoffrey, that case also suggests that Geoffrey reaches the right result under the business situs rule. Part V evaluates whether a rule which posits constitutional nexus based upon the business situs of intangible property is supported by the line of analysis used by the Supreme Court in Quill. This section concludes that the approach used by Quill does support the use of the business situs rule. Finally, the Article summarizes its salient conclusions.

III. Quill Corp. v. North Dakota

A. The Opinion

1. The Facts and the Prior Case History

In Quill, the state of North Dakota sought to apply its use tax statute to an out-of-state mail order company with no outlets or sales representatives present in the state. In Bellas Hess, the Supreme Court had held that a statute similar to North Dakota’s violated the Due Process Clause and unconstitutionally burdened interstate commerce. Notably, the Court in Bellas Hess ruled that a “seller whose only connection with customers in the State is by common carrier or the United States mail” lacks the minimum contacts with the state necessary to uphold the tax.

Quill, a Delaware corporation, maintained offices and warehouses in Illinois, California, and Georgia. None of its employees worked or lived in North Dakota and Quill did not own any significant tangible property in that state. Quill predominantly sells office equipment and supplies. In addition, it solicits business through catalogs, flyers, and telephone calls, and advertises in periodicals throughout the country. At the time of the Court’s decision, Quill’s annual

27. See id.; Bellas Hess, 386 U.S. at 758.
29. Quill, 112 S. Ct. at 1907.
30. Id. at 1907-08. At trial, North Dakota argued that Quill’s unconditional 90-day guarantee to its customers caused it to retain title to the goods for ninety days after delivery to its customers. Id. at 1907 n.1. The trial court disagreed, holding that title passed when customer received the merchandise. Id. The North Dakota Supreme Court adopted this ruling as correct and noted that Quill licensed a computer software program to some of its North Dakota customers enabling them to check Quill’s current inventories and prices and allowing them to place orders directly. Id.
31. Id. at 1907.
32. Id.
national sales exceeded $200,000,000—with its 3,000 North Dakota customers generating almost $1,000,000 in sales.33 These latter sales made Quill the sixth largest office supplies vendor in North Dakota.34 Merchandise was delivered to the North Dakota customers by mail or common carrier from locations outside the state.35

North Dakota brought an action for declaratory judgment seeking a determination that Quill was required to collect and remit the applicable state use tax.36 It argued that the statute defined a “retailer” as “every person who engages in a regular or systematic solicitation of a consumer market in this state.”37 The statute further defined “regular or systematic solicitation” to mean three or more advertisements within a 12-month period.38 Quill contested the state’s action, claiming that North Dakota was without the power to compel it to collect a use tax from its North Dakota customers.39

The trial court, finding the case indistinguishable from Bellas Hess, agreed with Quill.40 However, the North Dakota Supreme Court concluded that “wholesale changes” in both the economy and the law made it inappropriate to follow Bellas Hess” in the contemporary realm.41 The North Dakota Supreme Court cited the astounding growth of the mail order business “from a relatively inconsequential market niche” in 1967 to a ‘goliath’ with annual sales that reached “the staggering figure of $183.3 billion in 1989” as the predominant economic change.42 Moreover, it noted that computer technology had greatly assisted compliance with a “welter of complicated obligations” imposed by both state and local taxing authorities.43

33. Id. at 1907-08.
34. Id. at 1908.
35. Id.
36. Id.
37. Id. (alteration in original) (quoting N.D. CENT. CODE § 57-402-01(6) (Supp. 1991)).
38. Id. (citing N.D. ADMIN. CODE § 81-04.1-01-03.1 (1988)).
39. Id.
40. Id. Specifically, the trial court found that “because the state had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no ‘nexus to allow the state to define the retailer in the manner it choose.” Id. (quoting App. to Petition for Certiorari at A41).
41. Id. (quoting State v. Quill Corp., 470 N.W.2d 203, 213 (N.D. 1991)).
42. Id. (quoting Quill, 470 N.W.2d at 208-09).
43. Quill, 470 N.W.2d at 215 (quoting National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 759-60 (1967)).
In addition to the changes in the economy, the North Dakota Supreme Court focused on the changes in the "legal landscape." With respect to the Commerce Clause, it concluded that *Complete Auto Transit v. Brady* and its progeny indicated that the physical presence nexus suggested in *Bellas Hess* was no longer required. Similarly, with respect to the Due Process Clause, the North Dakota court determined that the requisite "minimum contacts" do not require physical presence. The court concluded that the due process requirement of minimum contacts was encompassed within the *Complete Auto* test and that the relevant inquiry was whether "the state has provided some protection, opportunity, or benefit for which it can expect a return." The North Dakota Supreme Court found that this test was satisfied in *Quill* because North Dakota had created an "economic climate that foster[ed] demand for" Quill's products, maintained a legal infrastructure that protected the market, and disposed of over twenty tons of catalogs that Quill mailed into the state every year.

In reviewing the situation in *Quill*, the United States Supreme Court began with a brief analysis of the Commerce and Due Process Clauses. It noted that its holding in *Bellas Hess* had relied on both of these "closely related" clauses. The Court admitted that it has not always been clear in distinguishing between the two clauses, but that they are fundamentally different in that they reflect different constitutional concerns. In this regard, the Court noted that "Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce," yet it "does not similarly have the power to authorize violations of the Due Pro-
cess Clause.”

Also, it noted that, as in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue,* the imposition of a state tax may pass muster under the Due Process Clause, but nonetheless violate the Commerce Clause. The Court proceeded to address the Due Process Clause and Commerce Clause, separately, at greater length.

### 2. The Due Process Clause

The Court stated that the Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” and that the “income attributed to the State for tax purposes must be rationally related to “values connected with the taxing state.”” It noted that *Quill* was concerned with the former of these two requirements. As to this first requirement, the Court stated that prior to *Bellas Hess* it had found the necessary minimum connection in a number of cases pertaining to a use tax—all involving some sort of physical presence within the taxing state, such as the placement of sales personnel in the state or the operation of local retail stores. The “furthest extension” of these cases, the Court stated, was *Scripto, Inc. v Carson,* where the Court found physical presence and upheld a use tax, even though independent contractors solicited all of the in-state customers. It then noted that *Bellas Hess* suggested that physical presence

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52. Id.
54. *Quill,* 112 S. Ct. at 1909.
57. Id. at 1910.
58. Id. With respect to the examples given, the Court quoted the statement in *Bellas Hess* that the exercise of taxing power was justified because the seller’s local activities were “plainly accorded the protection and services of the taxing State.” Id. (quoting *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753, 757 (1967)).
59. 362 U.S. 207 (1960)
60. *Quill,* 112 S. Ct. at 1910. Like *Bellas Hess, Quill* harmonized *Scripto* with its physical presence requirement even though, under agency principles, the corporation in question in *Scripto* was not physically present in the taxing state. See *Bellas Hess,* 386 U.S. at 760, 764 (Fortas, J., dissenting) (arguing, inter alia, that the corporation in *Bellas Hess* should have been taxable just like that in *Scripto,* since in each case the vendor had “no office or place of business in the State, and had no property or employees there”). In *Scripto,* there were ten independent contractors who worked part-time on the corporation’s behalf. *Scripto,* 362 U.S. at 211. Commentators have suggested that *Scripto* signaled a movement by the Court to an
was necessary—not simply sufficient—for jurisdiction under the Due Process Clause. Indeed, Bellas Hess intentionally refrained from blurring the "sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as a part of a general interstate business." After evaluating Bellas Hess, the Court acknowledged that its due process jurisdiction evolved substantially after that case, particularly in the area of "judicial jurisdiction." As the Court stated almost fifty years ago in International Shoe Co. v. Washington, the relevant test for jurisdiction is whether the defendant's contacts with the jurisdiction are "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" Applying this principle, the Court noted that a foreign corporation's purposeful availment of the forum state's economy can subject it to the state's jurisdiction, even if the corporation is not physically present in the state. Similar logic, the Court concluded, justifies impos-

62. See id. (quoting Bellas Hess, 386 U.S. at 758).
63. Id. The primary statement in Bellas Hess concerning due process was taken from J.C. Penney. See Bellas Hess, 386 U.S. at 756 ("And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.'") (quoting Wisconsin v. J.C. Penney, Co., 311 U.S. 435, 444 (1940)). For a discussion of J.C. Penney, see infra note 177.
64. 326 U.S. 310 (1945)
65. International Shoe, 326 U.S. at 316 (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)). The Court stated that the inquiry is whether the defendant's contacts with the forum state make it reasonable to compel the defendant to defend the suit in that forum. Quill, 112 S. Ct. at 1910.
66. Quill, 112 S. Ct. at 1910. In this regard, the Court quoted from Burger King Corp. v. Rudzewicz: "Jurisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum state. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' towards residents of another State, we
ing a collection duty on a mail-order corporation that continuously solicits business within the state.67 Such a corporation, the Court stated, clearly has "'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.'"68 Based upon this reasoning, the Court concluded that, "to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of a duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process."69 In light of this conclusion, the Court noted, "[i]n this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts are more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State."70

3. The Commerce Clause
   a. The Historical Analysis

After evaluating the Due Process Clause, the Court proceeded to the Commerce Clause.71 It began by noting that the Commerce Clause does not expressly prohibit state actions that interfere with interstate commerce, but rather merely authorizes Congress to "regulate Commerce with foreign Nations, and among the several States."72 However, the Commerce Clause also contains a judicially-created negative or "dormant" aspect.73 The Court proceeded to review the substantial evolution of the dormant Commerce Clause, with respect to limitations imposed upon state taxing powers. It traced this evolution beginning with the rule prohibiting direct rather than indirect taxation of interstate commerce; the later adoption of a "multiple taxation doctrine"—which focused on whether a state's tax affected interstate commerce through a risk of multiple taxation; and the subsequent return to the direct-indirect approach.74 The Court noted that,

67. Id. at 1910-11 (quoting Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985)).
68. Id. (quoting Shaffer v. Heitner, 433 U.S. 186, 218 (1977) (Stevens, J., concurring)).
69. Id. at 1911.
70. Id.
71. Id.
72. Id. (quoting U.S. CONST. art. I, § 8, cl. 3).
73. Id.
74. Id. The return to the direct-indirect approach came in Freeman v. Hewit, 329 U.S.
after returning to the direct-indirect approach in _Freeman v. Hewit_, it reapplied this approach in _Spector Motor Service, Inc. v. O'Connor_ to strike down a tax on the "privilege of doing interstate business." Over twenty-five years later, however, the Court renounced the _Freeman-Spector_ approach in _Complete Auto Transit, Inc. v. Brady_, as "attaching constitutional significance to a semantic difference." _Complete Auto_ expressly overruled _Spector_ because, under _Spector_, a differently denominated tax with the same result would not have been unconstitutional.

The Court concluded that the four-part test articulated in _Complete Auto_ governs the constitutionality of state taxes with respect to the Commerce Clause. Under the _Complete Auto_ test the Court:

will sustain a tax against a Commerce Clause challenge so long as the 'tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.'

_Bellas Hess_ was handed down after _Freeman_ and _Spector_, but before _Complete Auto_. While the Court noted that there is language in _Complete Auto_ which emphasizes the importance of looking beyond "the formal language of the tax statute [to] its practical effect," it stated that _Complete Auto_ did not render _Bellas Hess_ obsolete. According to the Court, _Complete Auto_ rejected the "formal distinction between 'direct' and 'indirect' taxes . . . [which] allowed the validity of [a tax] to hinge on 'legal terminology,' 'draftsmanship

249 (1946), where the Court invalidated Indiana's gross receipts tax on a particular transaction because applying it would "impose[s] a direct tax on interstate sales." _Quill_, 112 S. Ct. at 1911 (quoting _Freeman_, 329 U.S. at 256) (alteration in original).

75. 329 U.S. 249 (1946).
77. _Quill_, 112 S. Ct. at 1912.
79. _Complete Auto_, 430 U.S. at 285; _Quill_, 112 S. Ct. at 1911-12.
80. _Quill_, 112 S. Ct. at 1912; _Complete Auto_, 430 U.S. at 281.
81. _Quill_, 112 S. Ct. at 1912.
82. _Quill_, 112 S. Ct. at 1912 (alteration in original) (quoting _Complete Auto_, 430 U.S. at 279). The Court also noted that under its "current Commerce Clause jurisprudence, 'with certain restrictions, interstate commerce may be required to pay its fair share of state taxes.'" _Id._ at 1912 n.5 (quoting _D.H. Holmes Co. v. McNamara_, 486 U.S. 24, 31 (1988)).
83. _Id._ at 1912 (alteration in original) (quoting _Complete Auto_, 430 U.S. at 279).
84. _Id._
and phraseology." Because *Bellas Hess* did not rely on the classification of taxes, it did not necessarily fall under the analysis in *Complete Auto*.

Although conceding that its current Commerce Clause jurisprudence might not bring about the same result if the issue were one of first impression, the Court found that *Bellas Hess* was not inconsistent with *Complete Auto* and its recent cases. Relating *Bellas Hess* to *Complete Auto*’s four-part test, the Court stated that “*Bellas Hess* concerns the first [part of the test] and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.” This explains why the Court cited *Bellas Hess* in *National Geographic Society v. California Board of Equalization*, just three weeks after *Complete Auto*, and why the Court has continued to cite the case with approval ever since.

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85.  *Id.* (quoting *Complete Auto*, 430 U.S. at 281).
86.  *Id.* The Court’s placement of *Bellas Hess* within its historical review of its Commerce Clause jurisprudence is not satisfying. For example, while *Bellas Hess* is arguably not inconsistent with *Complete Auto*—as *Quill* concludes—the Court’s Commerce Clause analysis in *Bellas Hess* did rely primarily on Freeman v. Hewit, 329 U.S. 249 (1946), a case which *Quill* critiques. See *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967) (“As to the [Commerce Clause], the Court has held that ‘State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.’”) (quoting *Freeman*, 329 U.S. at 253). It is noteworthy that four of the nine Supreme Court Justices who decided *Quill* disagreed with the *Bellas Hess* Commerce Clause analysis. See *Quill*, 112 S. Ct. at 1923 (Scalia, J., concurring in part, dissenting in part) (noting he would not “revisit the merits” of the Commerce Clause holding of *Bellas Hess*); *id.* at 1916-22 (White, J., concurring in part, dissenting in part); see also Rothfeld, *supra* note 15 at 1414-19 (arguing that the *Bellas Hess* Commerce Clause holding was based upon an unsound doctrinal underpinning).
87.  *Quill*, 112 S. Ct. at 1912.
88.  *Id.*
90.  *Quill*, 112 S. Ct. at 1912-13. The Court stated that in *National Geographic Soc’y*, it “affirmed the continuing vitality of *Bellas Hess*’ ‘sharp distinction . . . between mail-order sellers with [a physical presence in the taxing] State and those . . . who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.’” *Id.* at 1912 (alteration in original) (quoting *National Geographic Soc’y*, 430 U.S. at 559). The Court also noted Goldberg v. Sweet, where it expressed “‘doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call.’” *Id.* at 1912 (quoting Goldberg v. Sweet, 488 U.S. 252, 263 (1989)). Finally, the Court cited D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33 (1988); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981); and Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 437 (1980). See *Quill*, 112 S. Ct. at 1912-13.
b. An Evaluation of the Current Rule

After placing *Bellas Hess* within the framework of its Commerce Clause cases, the Court proceeded to evaluate the argument that the nexus requirement imposed by the Commerce Clause is identical to that imposed by the Due Process Clause, and does not require physical presence in the taxing state. The Court rejected this argument. It noted that the two requirements are distinct, and are motivated by different constitutional concerns. Specifically, due process regulates the integral fairness of government action. Thus, according to the Court, the core of the due process nexus analysis requires an inquiry as to whether a person’s connections with a state are strong and substantial enough to support the government’s exercise of power over him. For this reason, the Court stated, it has often identified “notice” or “fair warning” as the cornerstone of due process analysis.

On the other hand, the Commerce Clause’s nexus requirement is concerned less with fairness for the individual defendant than for the national economic effect of state regulation. According to the Court, the *Complete Auto* four-part test adequately reflects the Commerce Clause’s concerns for the nation’s economy. For example, the second and third parts, requiring fair apportionment and a non-discriminatory purpose, prohibit taxes that unfairly shift the tax burden onto interstate commerce. Moreover, the first and fourth prongs—requiring substantial nexus with the state and a relationship between a proposed tax and a state’s services—limit the state’s tax reach and ensures that a tax does not unduly burden interstate commerce. Thus, the Court stated, because Commerce Clause nexus is

91. *See Quill*, 112 S. Ct. at 1913.
92. *See id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *See id.; see also* text accompanying note 82.
100. *Id.* The Court used North Dakota’s use tax to illustrate how a state’s taxation policy might unduly burden interstate commerce. The North Dakota law imposed a collection duty on every vendor who advertises in the state three times in a single year. *Id.* at 1913 n.6; *see supra* text accompanying notes 36-38. Thus, the Court surmised that—absent the *Bellas Hess* rule—a publisher who included a subscription card in three issues of its magazine, a vendor
concerned with limiting state burdens on interstate commerce, not notice to a corporation, such corporation can have due process "minimum contacts" with a taxing state, but lack the substantial nexus required by the Commerce Clause.101

The United States Supreme Court noted that the North Dakota Supreme Court had concluded that its recent Commerce Clause decisions signalled a "‘retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach.’"102 While the Supreme Court agreed with this analysis, it disagreed with the conclusion that the evolving case law effectively overruled Bellas Hess.103 In this regard, the Court noted that all of the cases cited by the North Dakota court—unlike Bellas Hess—concerned taxpayers who were physically present in the taxing state.104 Moreover, the Court stated—although its Commerce Clause jurisprudence now prefers a flexible balancing test—it has not rejected all established “bright-line” tests.105 The Court stated, “[a]lthough we have not, in our review of other types of taxes, articulated the same physical-presence requirement that Bellas Hess established for sales and use taxes, that silence does not imply repudiation of the Bellas Hess rule.”106

The Court went on to evaluate the utility of the Bellas Hess

whose radio announcements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty.” Quill, 112 S. Ct. at 1913 n.6. More significantly the nation’s other 6,000-plus taxing jurisdictions could impose a similar tax obligation. Id.

101. Id. at 1913-14. The Court conceded that it has sometimes stated that the “Complete Auto test, while responsive to Commerce Clause dictates, encompasses as well . . . Due Process requirement[s].” Id. at 1914 n.7 (alteration in original) (quoting Trinova Corp. v. Michigan Dep’t of Treasury, 498 U.S. 358, 373 (1991)). However, it noted that, although such comments suggest that every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause, it does not follow that the converse is also true. Id. (citing Tyler Pipe Indus., Inc. v. Washington State Dep’t of Revenue, 483 U.S. 232 (1987)).

102. Id. at 1914 (quoting State v. Quill Corp., 470 N.W.2d 203, 214 (N.D. 1991)). The Court noted the North Dakota court’s citation of Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975), and Tyler Pipe, 483 U.S. 232. See Quill, 112 S. Ct. at 1914.

103. Quill, 112 S. Ct. at 1914.

104. Id.

105. Id.

106. Id. The Court repeated substantially this same statement later in its opinion. See infra note 122. This statement seems to undercut, to a certain extent, the claim of commentators who argue that the Quill physical presence test is the operative Commerce Clause test outside the area of use tax.
bright line rule.\textsuperscript{107} It noted that, while the \textit{Spector} rule "served no purpose within [its] Commerce Clause jurisprudence, but stood 'only as a trap for the unwary draftsman,'"\textsuperscript{108} \textit{Bellas Hess} comports with the intent of the dormant Commerce Clause.\textsuperscript{109} According to the Court, \textit{Bellas Hess} creates a discrete realm of commercial activity that is free from interstate taxation, "a safe harbor for vendors 'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.'"\textsuperscript{110}

The Court conceded that, like other bright-line tests, the \textit{Bellas Hess} rule appears "artificial at its edges," because factual distinctions such as the presence of a small sales force, plant, or office in the state may be determinative of the state's power to tax.\textsuperscript{111} However, the Court found that the benefits of a clear rule outweighed its artificiality.\textsuperscript{112} Moreover, the Court noted that a bright line sales and use tax rule solidifies settled expectations and therefore encourages investment by businesses and individuals.\textsuperscript{113} As evidence of this tenet, the court cited the \textit{Bellas Hess} rule as the likely cause of the dramatic

\begin{footnotes}
\item[107] \textit{Quill}, 112 S. Ct. at 1914.
\item[108] Id. (quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).
\item[109] Id.
\item[110] Id. (alteration in original). The Court concluded that \textit{Bellas Hess} exempts such vendors from state-imposed sales and use taxes. Id. Applying the facts of the case at bar, the Court noted that Quill had additional contacts with some of its North Dakota clients, since it licensed software to them. Id. at 1914 n.8; see supra note 30. The Court concluded that "[a]lthough title to 'a few floppy diskettes' present in a State might constitute some minimal nexus," in \textit{National Geographic Soc'y}, we expressly rejected a "'slightest presence" standard of constitutional nexus." \textit{Quill}, 112 S. Ct. at 1914 n.8 (citation omitted) (quoting \textit{National Geographic Soc'y v. California Bd. of Equalization}, 430 U.S. 551, 556 (1977)).
\item[111] Notwithstanding the Court's rejection of the "slightest presence" test in \textit{National Geographic Soc'y}, that case upheld a use tax on a California corporation potentially in an amount exceeding $180,000—based upon the presence in the state of two offices each with between two to four persons. \textit{See National Geographic Soc'y}, 430 U.S. at 555 nn.2, 3. Moreover, the offices were engaged in soliciting advertisements and did not generally make sales. \textit{See id.} at 552.
\item[112] \textit{Quill}, 112 S. Ct. at 1914.
\item[113] Id. at 1915. The benefits of a firm rule include clear boundaries as to when a state may legitimately impose a duty to collect sales and use tax, and the reduction of litigation concerning those taxes. The Court cited to \textit{Portland Cement} for the proposition that such guidance is important in the area of state taxes. \textit{Id.}; see also \textit{Northwestern States Portland Cement Co. v. Minnesota}, 358 U.S. 450, 457 (1959).
\item[114] \textit{Quill}, 112 S. Ct. at 1915. The Court noted that Congress had previously followed a similar approach. \textit{Id.} at 1915 n.9 (citing Pub. L. 86-272, 73 Stat. 555 (codified at 15 U.S.C. § 381 (1988))). Public Law 86-272 applies to the sale of tangible personal property and prevents a state from imposing a net income tax on a person whose "'only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled . . . outside the State.'" \textit{Id.} (alteration in original) (quoting 15 U.S.C. § 381 (1988)).
\end{footnotes}
growth of the mail-order industry over the last twenty-five years.\footnote{114}

The Court stated that, notwithstanding the benefits of bright-line rules, it has sometimes replaced these rules with balancing tests.\footnote{115} The Court gave as an example, \textit{Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission},\footnote{116} where it rejected a bright-line test previously articulated in \textit{Public Utilities Commission v. Attleboro Steam & Electric Co.}\footnote{117} In \textit{Arkansas Electric}, the Court rejected \textit{Attleboro}'s mechanical test, finding it to be "anachronistic," and further noted that—because it had "rarely relied on the test"—rejecting the test would upset "no strong reliance interests."\footnote{118} In contrast, the rule in \textit{Bellas Hess} was not formalistic,\footnote{119} was frequently relied upon by the Court in the twenty-five years after \textit{Bellas Hess},\footnote{120} and "has engendered substantial reliance[,] the basic framework of a sizeable industry."\footnote{121} In the interest of order and stability—the bases for \textit{stare decisis}—the Court therefore expressed a desire to follow settled precedent.\footnote{122}

In concluding its discussion of the Commerce Clause, the Court

\begin{itemize}
\item \footnote{114} \textit{Id.} at 1915. By discussing the prior reliance of taxpayers in the context of its discussion of the benefits of the \textit{Quill} bright-line physical presence rule, the Court suggests that the arguments in favor of creating such a rule outside the area of use tax are weak. \textit{See generally infra} notes 123-27 and accompanying text.
\item \footnote{115} \textit{Quill,} 112 S. Ct. at 1915.
\item \footnote{116} 461 U.S. 375 (1983), \textit{cited in Quill,} 112 S. Ct. at 1915.
\item \footnote{117} 273 U.S. 83 (1927), \textit{cited in Quill,} 112 S. Ct. at 1915.
\item \footnote{118} \textit{Quill,} 112 S. Ct. at 1915 (quoting \textit{Arkansas Electric,} 461 U.S. at 391). The \textit{Attleboro} mechanical test "distinguished between state regulation of \textit{wholesale} sales of electricity, which was constitutional as an 'indirect' regulation of interstate commerce, and state regulation of \textit{retail} sales of electricity, which was unconstitutional as a 'direct regulation' of commerce." \textit{Id.} at 1915. The Court stated that this test was "'anachronistic' because it relied on formal distinctions between 'direct' and 'indirect' regulation (and on the regulatory counterparts of [its] \textit{Freeman} line of cases)." \textit{Id.; see supra} notes 74-80 and accompanying text.
\item \footnote{119} \textit{Quill,} 112 S. Ct. at 1915. The Court's rationale was that the rule was consistent with its contemporary Commerce Clause approach, as articulated in \textit{Complete Auto. Id; see also supra} text accompanying notes 81-86.
\item \footnote{120} \textit{Quill,} 112 S. Ct. at 1915-16. For this proposition, the Court cited several of its prior cases, which it had cited earlier in \textit{Quill. See supra} note 90.
\item \footnote{121} \textit{Quill,} 112 S. Ct. at 1916.
\item \footnote{122} \textit{Id.} (quoting \textit{Runyon v. McCrary,} 427 U.S. 160, 190-91 (1976) (Stevens, J., concurring)). The Court also substantially repeated a statement which it had made previously in the opinion that, "although in our cases subsequent to \textit{Bellas Hess} and concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule that \textit{Bellas Hess} established in the area of sales and use taxes." \textit{Id.; see supra} note 106 and accompanying text. The Court noted that, "[t]he contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of \textit{stare decisis} indicate that the \textit{Bellas Hess} rule remains good law." \textit{Quill,} 112 S. Ct. at 1916 (emphasis in original).
\end{itemize}
noted that its analysis was made easier by the fact that Congress ultimately retained the power—and was in fact more competent—to resolve the issues addressed. The Court observed that Congress had considered many bills which would have overruled Bellas Hess. It reasoned that Congress may have decided not to act because Bellas Hess held that the Due Process Clause, as well as the Commerce Clause, mandated the Bellas Hess result—suggesting that Bellas Hess could not be legislatively overruled. The Court noted that, subsequent to Quill, this would no longer be the case. It stated that, if it were “convinced that Bellas Hess was inconsistent with our Commerce Clause jurisprudence, ‘this very fact [might] give us pause and counsel[ ] withholding our hand, at least for now.’”

123. Quill, 112 S. Ct. at 1916. The Court noted that if it overruled Bellas Hess it could create “thorny questions concerning the retroactive application of those taxes” which could “trigger substantial unanticipated liability for mail order houses.” Id. at 1916 n.10. It stated that Congress, rather than the Court, is in a better position to allocate such burdens. Id. An attorney who represented Quill in the action has stated that it was on this retroactivity question that the case was decided:

You know why we won Quill? Because the Attorney General [of North Dakota] stood before the Court and when Justice O’Connor asked “What do you intend to do about past liability,” said “We’re going to collect every nickel that we’re entitled to.” There went the Quill case down the tube.

See CCH Board Comments, supra note 8, at 7 (quoting comments of Jim Peters).

124. Quill, 112 S. Ct. at 1916 & n.11.

125. Id. at 1916.

126. Id.

127. Id. (alteration in original) (quoting Commonwealth Edison Co. v. Montana, 483 U.S. 609, 637 (1981)). Justices Scalia, Kennedy and Thomas concurred in Quill’s Commerce Clause analysis, but on the basis of stare decisis and deference to Congress:

I also agree that the Commerce Clause holding of Bellas Hess should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of stare decisis. Congress has the final say over regulation of interstate commerce, and it can change the rule of Bellas Hess by simply saying so. We have long recognized that the doctrine of stare decisis has “special force” where “Congress remains free to alter what we have done.” Moreover, the demands of the doctrine are “at their acme . . . where reliance interests are involved.” As the Court notes, “the Bellas Hess rule has engendered substantial reliance and has become part of the basic framework of a sizeable industry.”

Id. at 1923 (Scalia, J., concurring in part, dissenting in part) (citations omitted). The fact that the five-Justice majority also relied heavily on this point suggests that the Court may not quickly revisit its Quill interpretation of Commerce Clause nexus. See supra notes 122-26 and accompanying text; see also CCH Board Comments, supra note 8, at 6 (quoting comments of Alice Davis). This, in turn, explains why certiorari in Geoffrey may have been denied. See id.; see also Walter Hellerstein, Supreme Court Says No State Use Tax Imposed on Mail Order Sellers . . . For Now, 77 J. Tax’N 120, 123-24 (1992) (stating that the Court’s opinion in Quill may have been intended, as a practical matter, to elicit action by Congress).
B. Analysis

Quill does not clearly resolve whether the Commerce Clause "substantial nexus" test requires a corporation to be physically present for taxing purposes where the tax is not a use tax. On the one hand, the Court makes clear that a physical presence requirement is not inconsistent with its current jurisprudence and is a "bright-line" that, as such, has certain advantages. Moreover, the Court observes that Bellas Hess, which was renowned for the physical presence requirement, was cited in numerous cases through the years, including cases which did not pertain to a use tax.

On the other hand, the Court specifies that it never adopted a physical presence requirement outside the realm of use tax and that, generally, it has grown to disfavor bright-line rules. Moreover, it states that, if the Bellas Hess physical presence issue arose for the first time today, the result might not be the same. Together these statements suggest that the Court would be reluctant to formally extend the physical presence test outside the area of use tax—particularly because the Court would like to defer to Congress in this area of law.

For a historical analysis which argues that the Court should refrain from an activist approach under the dormant Commerce Clause, see Tyler Pipe, Inc. v. Washington State Dep't of Revenue, 483 U.S. 232, 260-65 (1987) (Scalia, J., concurring in part, dissenting in part).

128. The general counsel of the Multistate Tax Commission has reached this same conclusion. See, e.g., Alan H. Friedman, Second Supplemental Report of Hearing Officer Regarding Proposed Adoption of Multistate Tax Commission Regulation IV.18.(j) (publishing), April 14, 1993, at 22-29; see also Hellerstein, supra note 127, at 124 (arguing that one plausible interpretation of Quill—but not the only one—is that the physical presence rule applies only to the mail order industry).

129. See supra text accompanying notes 83-86 and 102-22.

130. See supra text accompanying notes 111-114. But see supra note 114.

131. See supra notes 90, 120 and accompanying text (referencing, inter alia, Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) and Commonwealth Edison v. Montana, 453 U.S. 609 (1981)). Mobil Oil involved an income tax, see infra note 164, and Montana involved a coal severance tax. This point has been argued by persons who oppose the result in Geoffrey. See, e.g., Stewart, supra note 8, at 422 (noting that, prior to Quill, the Supreme Court had cited Bellas Hess as authority for a number of income and other tax cases).

132. The Court made this statement twice. See supra notes 106, 122 and accompanying text.

133. See generally supra notes 102-22 and accompanying text.

134. See supra text accompanying note 87.

135. See supra notes 122-27 and accompanying text. Another important consideration in Quill was the reliance by taxpayers on the Bellas Hess rule. See supra notes 114-27 and
However, even assuming that the physical presence rule articulated in *Quill* does apply to an income tax, that decision suggests that this rule would—notwithstanding its literal language—permit the state taxation of income based solely upon the situs of intangible property. Significantly, this question was before the Court in *Quill*, since licensed software had formed a basis for the North Dakota Supreme Court decision which the Court reviewed. In response, the Court stated, within the context of its Commerce Clause analysis, that, while “a few floppy diskettes present in a State might constitute some minimal nexus,” the property in question did not create nexus with North Dakota because the Court—as stated in *National Geographic*—does not recognize a “slightest presence standard of constitutional nexus.” This implies that if the intangible property used within North Dakota in *Quill* were more significant, the admitted “nexus” with that state would have surpassed the required constitutional threshold. Perhaps this inference is unintended, and is the result of the Court’s quick, footnoted disposition of this issue. However, it is noteworthy that, in at least one other instance expressly approved by *Quill*—the accompanies text; see also Hellerstein & Hellerstein, supra note 5, ¶ 6.08[1] (stating that “in passing on corporate income and franchise taxes, the [Supreme] Court may not be faced with the same clear-cut expectation and stare decisis considerations that substantially influenced the decision in the *Quill* case”).

136. See *Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1907 n.1 (1992). In this footnote, the Court cited to the following analysis by the North Dakota Supreme Court:

*Quill* has a further connection with North Dakota which supports a finding of nexus. *Quill* licenses to some of its North Dakota customers a computer software program, *Quill Service Link* ["QSL"], which permits customers direct computer access to *Quill*’s computer. This allows customers to check *Quill*’s available inventory, confirm current price, and order merchandise directly by computer. Customers with QSL can also communicate with *Quill* and others customers through an electronic “bulletin board.”

*Quill* retains all rights in QSL through the license agreement. *Quill* also retains the right to terminate the license “forthwith without prior notice and without cause,” and upon termination the customer must “immediately return Software, and copies thereof and the user documentation to *Quill*.” The explicit terms of the licensing agreement belie *Quill*’s assertion that it merely sells the software—lock, stock and barrel—to the customer. Through its licensing agreement, *Quill* clearly retains rights to property situated in North Dakota, providing further nexus with the State.


137. See supra note 110. The Court’s reference to floppy disks in *Quill* referred to just four floppy disks present in North Dakota. Telephone Interview with Alan H. Friedman (Feb. 8, 1994). Mr. Friedman was appointed Special Assistant North Dakota Attorney General in connection with *Quill*.
prior case of *Scripto, Inc. v. Carson*—the Court has determined that the physical presence requirement was met, where the corporation in question was not physically present in fact.\(^{138}\) Thus, it seems that *Quill* leaves open the possibility that the use of intangible property within a state may create taxing nexus.\(^{139}\)

IV. *GEOFFREY, INC. v. SOUTH CAROLINA TAX COMMISSION*

A. The Opinion

1. The Facts

Geoffrey, a wholly-owned subsidiary of Toys R Us, Inc., was a Delaware corporation with its principal offices in that state.\(^{140}\) Geoffrey did not maintain employees in South Carolina, nor did it own any tangible property there.\(^{141}\) In 1984, Toys R Us, Inc. granted Geoffrey ownership of several trademarks and trade names, including the valuable trade name, "Toys R Us."\(^{142}\) Later that year, Toys

\(^{138}\) *Quill*, 112 S. Ct. at 1910; see also *supra* note 60. The Court's analysis in other cases with respect to the unitary business principle similarly suggests that a corporation may be subject to a state's income-based tax, even where that corporation is not physically present in such state. See *infra* note 146.

\(^{139}\) See generally *infra* notes 209-15 and accompanying text.


\(^{141}\) *Id.*

\(^{142}\) *Id.* Geoffrey would not be taxed on its income in Delaware because that state provides for tax-free treatment for corporations whose activities within the state "are confined to the maintenance and management of their intangible investments," such as trademarks. See *Del. Code Ann.* tit. 30, § 1902(b)(8) (Supp. 1992). Toys R Us, Inc. freely acknowledged in its petition to the United States Supreme Court seeking certiorari for *Geoffrey* that it selected Delaware as the incorporation state for its licensing subsidiary because the incorporation in that state would minimize taxes:

By holding the trademarks in Geoffrey, and having Geoffrey license the trademarks for a royalty to [Toys R Us, Inc.], its affiliates, and unrelated parties, [Toys R Us, Inc.] could reduce its state tax liability without any offsetting increase in Geoffrey's tax liability if (1) Geoffrey were located in a state that did not tax its income, and (2) [Toys R Us, Inc.] operated in a state that measured its tax liability without combining its income with that of its affiliates, such as Geoffrey. . . .

In light of these potential state tax savings, when [Toys R Us, Inc.] created Geoffrey in January 1984, it chose to establish it in Delaware. *Geoffrey* Cert. Brief, *supra* note 5 at 4. Tax practitioners suggest this type of tax manipulation. See Ira H. Rosen, *Use of a Delaware Holding Company to Save State Income Taxes*, 20 TAX ADVISER 180 (1989); see also Mark J. Christopher & Barbara J. Janaszek, *Limitations on State Income Taxation of Interstate Business After Wrigley and Quill*, 11 J. ST. TAX'N 9, 20 (1993) (noting Geoffrey to be illustrative of a specific type of tax planning). For an analysis of the principle that permits the states to measure the income tax liability of a corporation by combining the income of that corporation with its affiliates (i.e., taxation using the unitary business principle), see *infra* note 146.
R Us, Inc. and Geoffrey entered into a license agreement ("the Agreement"), allowing Toys R Us, Inc. to use the trade name Toys R Us, as well as other trademarks and trade names in South Carolina and forty-four other states. The Agreement also gave Toys R Us, Inc. a right to use Geoffrey's "merchandising skills, techniques, and 'know-how' in connection with marketing, promotion, advertising, and sale of products covered by the Agreement."

In return for the licenses granted by the Agreement, Geoffrey received a royalty calculated as a percentage of the pertinent net sales. Pursuant to the Agreement, Toys R Us, Inc. reported its aggregate sales to Geoffrey on a monthly basis, and paid the royalty annually from its account in Pennsylvania to Geoffrey's New York account. Toys R Us, Inc. began paying royalties to Geoffrey...
based upon its South Carolina sales in 1985, the year it began conducting business in the state.\footnote{147} In 1986 and 1987, Toys R Us, Inc. deducted the royalty payments from its South Carolina taxable income.\footnote{148} While the South Carolina Tax Commission first contested this deduction, it later allowed Toys R Us, Inc. the deduction and required Geoffrey to pay South Carolina income tax on the royalty income.\footnote{149} Geoffrey contested this determination, partly claiming that it lacked the required state nexus for South Carolina to tax its royalty income.\footnote{150}

As a threshold matter, the South Carolina Supreme Court noted that the state’s corporate income tax statute reached the income in question.\footnote{151} The Court then went on to consider whether, notwith-
standing this fact, the Due Process Clause or the Commerce Clause barred the imposition of the tax. 152

2. The Due Process Clause

Geoffrey began its due process analysis by stating the applicable two requirements set forth in Quill: (1) that there be "'some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax,'" and (2) that the "'income attributed to the state for tax purposes must be rationally related to values connected with the taxing State.'"153 As to the former "minimum connections" requirement, the South Carolina Supreme Court noted that, under Quill, this requirement can be satisfied even where a corporation that is not physically present in the state purposefully directs its activity into the state's economic marketplace.154

Geoffrey argued that, because it had no South Carolina stores when it entered into the Agreement with Toys R Us, Inc., it did not purposefully direct business activity into South Carolina and that its parent company's unilateral expansion into the state could not create the requisite minimum connection.155 The South Carolina court declined to characterize Geoffrey's contact as unwilling or the unilateral product of an independent party.156 It noted that Geoffrey's business was the ownership, licensing, and management of intellectual property, and that by licensing its trademarks and trade names for use by Toys R Us, Inc. in many states, Geoffrey consciously and intentional-

152. Id. at 15-19.
153. Id. at 16 (quoting Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1909-10 (1992)).
154. Id. (citing Quill, 112 S. Ct. at 1909-10).
155. Id. In its subsequent petition submitted to the Supreme Court seeking certiorari for Geoffrey, the taxpayer analogized its situation to that in Asahi Metal Industries Co., Ltd. v. Superior Court, 480 U.S. 102 (1987). See Geoffrey Cert. Brief, supra note 5, at 15-17. In that case, a plurality decision, the Court stated that "a defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum State." Asahi, 480 U.S. at 112. By way of analogy, Geoffrey argued that, "by licensing [Toys R Us, Inc.] to use its trademarks, Geoffrey was merely releasing its intangible 'product' into the stream of commerce" and that "whether that 'product' would find its way into South Carolina was wholly within the control of [Toys R Us, Inc.]." Geoffrey Cert. Brief, supra note 5, at 16-17.
156. Geoffrey, 437 S.E.2d at 16.
ly sought the economic benefit of contact with those states. Additionally, Geoffrey could have prohibited the use of its intangible property in South Carolina as it did in other states, and therefore controlled its contact with South Carolina. The court held that "by licensing intangibles for use in South Carolina and receiving income in exchange for their use, Geoffrey has the 'minimum connection' with this State that is required by due process." The court also concluded that Geoffrey's ownership of intangible property in South Carolina—that is, an account receivable on the books of Toys R Us, Inc. generated by South Carolina sales and a Toys R Us franchise located within that state—satisfied the minimum connection test. In reaching this conclusion, the court relied pri-

157. Id. The court added that, "Geoffrey has been aware of, consented to, and benefitted from [Toys R Us, Inc. ']s use of Geoffrey's intangibles in South Carolina." Id.

158. Id.; see supra note 143 and accompanying text. The Agreement also required Toys R Us, Inc. to submit samples of products and advertising to Geoffrey for its approval, which approval could not be unreasonably withheld. See Final Supplemental Reply Brief of Appellant at 2, Geoffrey v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C. 1993) (No. 92-569) [hereinafter Geoffrey Brief] (citing section 6.3 of the Agreement). In addition, the Agreement provided that, in the event of any infringement of Geoffrey's trademarks or symbols, Geoffrey had the right to bring suit in South Carolina to protect this property. See Brief in Opposition to Petition for a Writ of Certiorari, Geoffrey, Inc. v. South Carolina Dept. of Revenue and Taxation, 114 S. Ct. 550 (1993) (No. 93-520), reprinted in 5 STATE TAX NOTES 1251, 1252 (1993). Geoffrey argued that this latter right was of little practical utility. See Geoffrey Brief, supra at 4; see also Geoffrey Brief, supra note 5, at 3 n.4 (noting that all of Geoffrey's outstanding trademark suits at the time of its initial hearing in South Carolina were in federal court).

159. Geoffrey, 437 S.E.2d at 16. The court cited two New Mexico cases for this proposition: American Dairy Queen Corp. v. Taxation and Revenue Dep't, 605 P.2d 251 (N.M. 1979) and AAMCO Transmissions, Inc. v. Taxation and Revenue Dep't, 600 P.2d 841 (N.M. Ct. App.), cert. denied, 598 P.2d 1165 (N.M. 1979). The cases are discussed infra note 176.

In general, it is difficult to quarrel with the court's analysis of purposeful direction and minimum contacts, as discussed in this paragraph of the text. During the years in question, Toys R Us, Inc. was the world's largest retailer of children's toys. See Geoffrey Cert. Brief, supra note 5, at 2-3. Though the Agreement did not specifically reference sales to be made in South Carolina, clearly they were intended, as they were in forty-four other states (i.e., every state other than those which were expressly precluded by the Agreement). See supra note 143 and accompanying text. But see supra note 155 (discussing the taxpayer's argument).

160. Geoffrey, 437 S.E.2d at 16. The court quoted the definition of the term "franchise" from Black's Law Dictionary:

"In its simplest terms, a franchise is a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark. More broadly stated, a 'franchise' has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisee undertakes to assist the franchisee through advertising, promotion, and other advisory services."
marily on *Virginia v. Imperial Coal Sales Co., Inc.*,\(^{161}\) for the proposition that intangible property may have a taxable presence within a state.\(^{162}\) In addition, the court relied on *Mobil Oil Corp. v. Commissioner of Taxes*\(^{163}\) for the rule that intangible property may be taxed at more than one situs.\(^{164}\) Finally, *Geoffrey* also relied on *Wheeling Id.* at 16 n.2 (quoting *BLACK'S LAW DICTIONARY* 592 (5th ed. 1979)). The court further noted that *Geoffrey* did not contest the trial judge's finding that the Agreement created a franchise. Id. For a discussion on the difference between a franchise and a license, see 1 *LAWRENCE J. ECKSTROM, LICENSING IN FOREIGN & DOMESTIC OPERATIONS* § 1.02[3] (1988 & Supp. 1993).

161. 293 U.S. 15 (1934).

162. In *Imperial Coal*, the Supreme Court sustained, against a Due Process and Commerce Clause challenge, an ad valorem property or “capital” tax imposed upon money and accounts receivable (less accounts payable) located within the taxpayer-corporation's domicile state. *Id.* at 18-20. The Court concluded that this intangible property had a taxable situs within the state, since that was where the corporation's principal offices were located and where the proceeds of its accounts receivable were collected and deposited in the bank. *Id.* at 19-20. *Geoffrey* determined that, while *Imperial Coal* pertained to a property tax, it also applied to an income tax, since *Shaffer v. Carter*, 252 U.S. 37, 52 (1920), extends the authority to tax property to the income produced by that property. *See Geoffrey*, 437 S.E.2d at 17 n.3. It is noteworthy that, while this interpretation of *Shaffer* seems correct, *Shaffer* did not pertain to a situation involving intangible property. *See infra* note 233 and accompanying text.


164. *Geoffrey*, 437 S.E.2d at 17. In contrast to *Geoffrey*, *Mobil Oil* was concerned, not with a state's ability to levy a tax upon the corporation in question, but rather with the restrictions which apply to the state's legitimate taxing power. *See Allied-Signal, Inc. v. Director, Div. of Taxation*, 112 S. Ct. 2251, 2258 (1992) (noting these to be two distinct constitutional questions). In *Mobil Oil*, the taxpayer argued that the dividends received by a corporation which was physically present in Vermont could not be taxed by that state because such dividends were taxable only in the state from which they were derived (i.e., the state of their “business situs”) or, alternatively, the state in which the corporation maintained its commercial headquarters (i.e., the state of the corporation's commercial domicile). *Mobil Oil*, 445 U.S. at 436; *see infra* notes 192-96 and accompanying text (discussing the “business situs rule”) and *infra* note 196 (discussing the “commercial domicile rule”). The Court rejected this argument, stating the following language which was quoted in *Geoffrey*:

> Although a fictionalized situs for intangible property sometimes has been invoked to avoid multiple taxation of ownership, there is nothing talismanic about the concepts of “business situs” or “commercial domicile” that automatically renders those concepts applicable when taxation of income from intangibles is at issue. The Court has observed that the maxim *mobilia sequuntur personam*, upon which these fictions of situs are based, “states a rule without disclosing the reasons for it.” The Court also has recognized that “the reason for a single place of taxation no longer obtains” when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction. Even for property or franchise taxes, [multi-state] apportionment of intangible values is not unknown. Moreover, cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the [multi-state] apportionment principle prevails.
Steel Corp. v. Fox,165 for the proposition that intangible property "may acquire a situs for taxation other than at the domicile of the owner if they have become integral parts of some local business."166

The court also found that South Carolina had conferred benefits upon Geoffrey that were rationally related to the challenged tax, thus satisfying the second part of the Quill test.167 That is, the court noted that Geoffrey's source of income was the South Carolina customers of Toys R Us, Inc., not the paper Agreement which had been executed by the parties.168 The court stated:

That Geoffrey has received protection, benefits, and opportunities from South Carolina is manifested by the fact that it earns income in this state. That the tax is rationally related to these protections, benefits, and opportunities is evidenced by the fact that the State seeks to tax only that portion of Geoffrey's income generated within its borders.169

3. The Commerce Clause

Geoffrey proceeded to its Commerce Clause analysis, and began by re-stating the four-part test taken by Quill from Complete Auto.170 The court then evaluated Geoffrey's claim that it did not have

Mobil Oil, 445 U.S. at 445 (citations omitted), quoted in Geoffrey, 437 S.E.2d at 17.
165. 298 U.S. 193 (1936).
166. Geoffrey, 437 S.E.2d at 17. Wheeling Steel, which was not a nexus case per se, is discussed infra note 196.
167. Geoffrey, 437 S.E.2d at 17. To support this point, the court stated:

Very different considerations, both theoretical and practical, apply to the taxation of intangibles, that is, rights which are not related to physical things. Such rights are but relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts. The power of government over them and the protection which it gives them cannot be exerted through control of a physical thing. They can be made effective only through control and protection afforded to those persons whose relationships are the origin of the rights . . . . Obviously, as sources of actual or potential wealth—which is an appropriate measure of any tax imposed on ownership or its exercise—they cannot be dissociated from the persons from whose relationships they are derived.

Id. at 17-18 (alterations in original) (quoting Curry v. McCanless, 307 U.S. 357, 365-66 (1939)). Curry is discussed infra note 179.
168. Geoffrey, 427 S.E.2d at 18. The court also stated that "[b]y providing an orderly society in which Toys R Us conducts business, South Carolina has made it possible for Geoffrey to earn income pursuant to the royalty agreement." Id.
169. Id. (citations omitted).
170. A tax withstands a Commerce Clause challenge if it (1) is applied to an activity having a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not dis-
substantial nexus with South Carolina because it lacked a physical presence there. According to the South Carolina Supreme Court, Geoffrey's reliance upon the physical presence requirement was misplaced. It noted in a footnote that while Quill re-affirmed the physical presence requirement for sales and use taxes, that decision expressly noted that this requirement has not been extended to other types of taxes.

Geoffrey then stated that a person need not be physically present in a state for its income to be taxed by the state and that "[t]he presence of intangible property alone is sufficient to establish nexus." For the latter proposition, the court cited American Dairy Queen Corp. v. Taxation and Revenue Department, a New Mexico case which held that New Mexico could tax a franchisor which was not physically present in the state on license fees paid by unaffiliated, in-state franchisees. For supporting authority, the court cited International Harvester Co. v. Wisconsin Department of Taxation. Final-
ly, the court quoted *Curry v. McCanless*, for the proposition that "[a] taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business." The court held, that by licensing intangible

*J.C. Penney* determined that the tax was a corporate tax, notwithstanding its effect on the corporation's shareholders. *Id.* at 442. Given this determination, *J.C. Penney* did not involve a nexus question, since the corporation was doing business in—indeed was physically present in—Wisconsin. See supra text accompanying notes 25, 63 (quoting oft-repeated language from *J.C Penney*).

Three years later, in *International Harvester*, the Court revisited the due process question first addressed in *J.C. Penney*, this time after a determination by the Wisconsin Supreme Court that the tax in question was a shareholder tax—not a corporate tax—and therefore not allowable as a state corporate tax deduction. See *Int'l Harvester*, 322 U.S. at 438-39. The issue in *International Harvester* was whether Wisconsin could tax non-resident shareholders on dividends declared out-of-state, where the dividends were with respect to income derived in Wisconsin. See *Id.* at 439. The Court's analysis was two-pronged. First, notwithstanding the characterization by the Wisconsin Supreme Court, it reiterated its *J.C. Penney* view that the tax in question was a tax upon the corporation, and therefore generally re-incorporated its prior analysis. See *Id.* at 441. Second, as to the fact that the burden of the tax fell upon the corporation's shareholders, the Court stated:

The power to tax the corporation's earnings includes the power to postpone the tax until the distribution of those earnings, and to measure it by the amount distributed. In taxing such distributions, Wisconsin may impose the burden of the tax either upon the corporation or upon the stockholders who derive the ultimate benefit from the corporation's Wisconsin activities. Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers. *Id.* at 441-42 (citations omitted). *Geoffrey* relied upon the final sentence in this quote, taken out of its fact-specific context. See *Geoffrey*, 437 S.E.2d at 18; see also HELLERSTEIN & HELLERSTEIN, supra note 146, ¶ 6.09 n.76 (noting that this sentence reflects a broad interpretation of the rule permitting taxation of a non-resident's income); supra note 25 (noting the similarity of this sentence in *International Harvester* to commonly-invoked language in *J.C. Penney*).


179. *Geoffrey*, 437 S.E.2d at 18 (quoting *Curry*, 307 U.S. at 368). This quotation was dictum in *Curry*, which concerned a due process claim, since the taxes there were imposed upon intangible property which was not used in the taxpayer's business. See *Curry*, 307 U.S. at 368 (stating that "there are many circumstances in which more than one state may have jurisdiction to impose a tax and measure it by some or all of the taxpayer's intangibles"). In particular, *Curry* involved an attempt by two states to tax a distribution of stocks and bonds. *Id.* at 360-61. The assets were owned by a decedent who was a resident of one state, and held by a trustee who was a resident of the other. *Id.* The Court concluded that the intangibles could be taxed by both states, stating that:

When the taxpayer extends his activities with respect to his intangible property, so as to avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer
property for use in South Carolina, and by earning income from its use, Geoffrey acquired a substantial nexus with that state. 180

B. Analysis

To a certain extent, Geoffrey's two constitutional nexus analyses—under the Due Process Clause and the Commerce Clause—overlap. In resolving whether Geoffrey had minimum contacts with South Carolina as required for purposes of due process nexus, the court looked both to the fact that Geoffrey contemplated prospective business in South Carolina, 181 and the fact that its intangible property was located in that state. 182 Then, in resolving whether Geoffrey had substantial nexus with South Carolina for purposes of Commerce Clause nexus, the court again focused on the situs of the intangible property. 183 The difficulty with this latter approach is that Quill suggests that Commerce Clause nexus, or “substantial nexus,” requires physical presence—at least in the context of a use tax, and maybe otherwise. 184 However, in contrast to this, Geoffrey concluded that it is well-settled that physical presence is not required for the

there, the reason for a single place of taxation no longer obtains.

Id. at 367-68; see also supra note 164 (quoting similar language in the more recent case of Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)). Thus, Curry suggests that income derived from intangible property can be taxed to a person, even though that person is not physically located in the taxing state. See infra note 233 and accompanying text; see also Kathleen L. Roin, Note, Due Process Limits on State Estate Taxation: An Analogy to the State Corporate Income Tax, 94 YALE L.J. 1229, 1233 (1985) (stating that, notwithstanding Curry, “[o]f the forty-nine states that levy an estate tax, forty-eight have effectively declared that only the state of domicile may levy an estate tax”).

180. Geoffrey, 437 S.E.2d at 18. In a footnote, the court declined to further discuss the remaining requirements of the Commerce Clause. Id. at 18 n.5. It stated that Geoffrey failed to argue that the challenged tax was not fairly apportioned or that it discriminated against interstate commerce (i.e., prongs two and three of the Complete Auto test). Id. Moreover, it stated that its due process analysis of the benefits conferred upon Geoffrey, see supra notes 167-69 and accompanying text, applied with equal force to its Commerce Clause analysis and did not have to be repeated. Geoffrey, 437 S.E.2d at 18 n.5. Because the court addressed the first, “substantial nexus” requirement of the Complete Auto test, and the second and third requirements did not apply, the court suggests that it invoked its due process “benefits” analysis to satisfy the fourth requirement of Complete Auto—that the tax be fairly related to the services provided by the state. The literal language of this fourth requirement is similar to the second requirement under the Due Process Clause (i.e., that “the income attributed to the state for tax purposes must be rationally related to values connected with the taxing state”). See supra notes 167-69 and accompanying text.

181. See supra notes 155-69 and accompanying text.

182. See supra notes 160-66 and accompanying text.

183. See supra notes 174-80 and accompanying text.

184. See supra text accompanying notes 129-31.
purpose of an income tax, as opposed to a use tax.\textsuperscript{185}

In general, Geoffrey relies on two theories as to why Geoffrey’s intangible property acquired a legal situs in South Carolina: 1) because it was afforded the benefits, protection and opportunities of the state,\textsuperscript{186} and 2) because it was used in a local business there.\textsuperscript{187} Both theories are founded in due process analysis, but the former theory is broader, and could apply theoretically even where a corporation has no property interest or business within the taxing state. Thus, in the abstract, it seems less likely that an activity which merely meets with the economic benefits test—as opposed to a situation involving the presence of intangible property—would meet with the Supreme Court’s Commerce Clause requirement of substantial nexus. Indeed, Quill seems tacitly to reject the economic benefits test under its Commerce Clause analysis—at least in the context of a use tax.\textsuperscript{188} This is because the benefits bestowed by North Dakota in Quill were significant, and the economic benefits test was expressly relied upon by the North Dakota Supreme Court in upholding the use tax which the Supreme Court then struck down.\textsuperscript{189} In contrast, Quill

\textsuperscript{185} See supra text accompanying note 174.

\textsuperscript{186} See supra notes 174-80 and accompanying text.

\textsuperscript{187} See supra notes 160-66 and accompanying text and text accompanying note 180.

\textsuperscript{188} However, Quill used the economic benefits language in its due process analysis. See Quill Corp. v. North Dakota, 112 S.Ct 1904, 1910 (1992) ("Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State’s . . . jurisdiction even if it has no physical presence in the State.") (referencing Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985)). Moreover, the economic benefits test may have continuing application under the Commerce Clause outside the area of use tax. See Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251, 2258 (1992) ("We are guided by the basic principle that the State’s power to tax an individual’s or corporation’s activities is justified by the ‘protection, opportunities and benefits’ the State confers on those activities.") (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940)) (evaluating, generally, an income tax under both the Due Process and Commerce Clause); see generally infra note 215.

\textsuperscript{189} See State v. Quill Corp., 470 N.W.2d 203, 216-19 (N.D. 1991). Specifically, the court noted that the state created the economic climate which fostered demand for Quill’s products, and disposed of 24 tons of solid waste contributed annually to North Dakota’s landfills by Quill’s catalogs and fliers. Id. at 218-19. Moreover, the state courts provided the only means by which a mail order vendor could enforce its legal rights against a delinquent or fraudulent buyer. Id. at 218 (noting also that the state’s consumer protection and usury laws governing mail order sales created important consumer confidence with respect to such sales). The court noted several of the various articles by commentators who had argued in favor of finding nexus based upon a state’s provision of economic benefits, and quoted at length from Hartman, Collection of the Use Tax, supra note 15. Quill, 470 N.W.2d at 217-18; see also Hellerstein & Hellerstein, supra note 146, ¶ 6.08 (arguing in favor of an economic-based standard); Marcus, supra note 59, ¶ 310.6 (same).
evaluated, but did not resolve, the question of whether application of the business situs rule can create nexus. In this regard, the Court suggested that the mere ownership of intangible property within a state can satisfy the nexus requirement of the Commerce Clause—but only in the instance where this ownership interest is more than de minimis. In the following section, this Article evaluates whether the “business situs” of intangible property can justify a finding of nexus in a situation like Geoffrey, or otherwise.

V. THE BUSINESS SITUS RULE

A determination as to whether the use of intangible property within a state can supply nexus under the business situs rule must logically begin with the line of analysis used by the Supreme Court in Quill. This line of analysis focused primarily on prior Supreme Court precedent, reliance interests, and public policy. The use of this approach suggests that the business situs of intangible property can create constitutional taxing nexus.

A. Supreme Court Authority

The business situs rule dates back to five turn-of-the-century Supreme Court cases involving a due process challenge to an ad valorem tax. In each case the challenged tax pertained to notes or receivables “sitused” in the taxing state, which were derived from lending activity by an out-of-state individual or corporation. The

190. See supra notes 128-39 and accompanying text.
191. See generally supra notes 102-27 and accompanying text.
193. The corporate cases were Metropolitan and Liverpool. Four of the five cases—all but Bristol—involved an 1898 Louisiana statute, or its substantially similar predecessor. See Liverpool, 221 U.S. at 349-52. The Louisiana tax as applied to the corporations in Metropolitan and Liverpool resembled, conceptually, the capital stock tax applied to Geoffrey by South Carolina—though the South Carolina statute did not apply to the Geoffrey receivables. See supra note 150; see also Hellerstein & Hellerstein, supra note 146, ¶ 11.01 (referencing the fact that capital stock taxes are derived from property taxes). For a discussion of the different types of capital stock taxes, see Hartman, Federal Limitations, supra note 9.
persons taxed were not physically present in the taxing state, but the
taxes were upheld, in part because the receivables taxed derived from
a business located within the state. In a subsequent case, *Wheeling
Steel Corp. v. Fox*, the Court cited the five early business situs cases for the proposition that "chooses in action may acquire a
situs for taxation other than at the domicile of their owner if they
have become integral parts of some local business."

1. Income Tax: *New York ex rel. Whitney v. Graves*

The first Supreme Court case to apply the business situs doctrine
to state income tax was *New York ex rel. Whitney v. Graves.*
*Whitney* involved a due process challenge to a New York income tax,
which was applied to a Massachusetts resident not physically present
in New York. The tax was imposed with respect to the sale of a
right owned by the taxpayer which was derived from his seat on the

§ 11.1.

194. See Powell, *supra* note 192, at 106. *Liverpool* applied the prior four cases to its facts:

Tested by the criteria afforded by the authorities we have cited, Louisiana must be
deemed to have had jurisdiction to impose the tax. The credits would have had no existence save for permission of Louisiana; they issued from the business transacted under her sanction within her borders; the sums were payable by persons domiciled within the State, and there the rights of the creditor were to be enforced. If locality, in the sense of subjection to sovereign power, could be attributed to these credits, they could be localized there. If, as property, they could be deemed to be taxable at all, they could be taxed there.

*Liverpool,* 221 U.S. at 354-55.


196. *Id.* at 210 (quoting Farmer's Loan & Trust Co. v. Minnesota, 280 U.S. 204, 213 (1930)). *Geoffrey* relied upon this line in *Wheeling Steel.* See *supra* text accompanying note 166. While this characterization of the prior Supreme Court cases seems significant, there was no nexus question in *Wheeling Steel,* since the corporation in question was physically present in the taxing state. *Wheeling Steel* held that a state could impose an ad valorem property tax on accounts receivable and bank accounts, where the commercial headquarters of the corporation was located in-state but its business operations and state of incorporation were elsewhere. See *Wheeling Steel,* 298 U.S. at 211-15. The rationale for this holding was that the corporation's contracts were finalized by its executives at the in-state office. See *id.* at 212-13. The notion that a corporation's intangible property and the income derived therefrom is taxable by the state where the corporation's headquarters is located is often referred to as the "commercial domicile rule." This rule and its potential overlap with the business situs rule is discussed in *Hellerstein & Hellerstein, supra* note 146, ¶ 9.0312[2], [3].

197. 299 U.S. 366 (1937). See Recent Case, *Taxation—Jurisdiction to Tax Nonresident on Income from Sale of Right to Seat on Stock Exchange Located in State,* 50 Harv. L. Rev. 704 (1937). This work notes, perhaps prophetically, "[i]t is significant with regard to possible future limitations on jurisdiction to impose income taxes that the Court did not hesitate in placing an income tax case within an exception established by inheritance and property tax cases." *Id.* at 705.
New York Stock Exchange. The taxpayer disputed the tax and contended that the business situs rule did not apply to intangible property in a state where the owner neither lived nor transacted business. Whitney rejected the taxpayer’s arguments and broadly embraced the business situs rule in the context of income tax. The Court stated:

When we speak of a “business situs” of intangible property in the taxing State we are indulging in a metaphor. We express the idea of localization by virtue of the attributes of the intangible right in relation to the conduct of affairs at a particular place. The right may grow out of the actual transactions of a localized business or the right may be identified with a particular place because the exercise of the right is fixed exclusively or dominantly at that place. In the latter case the localization for the purpose of transacting business may constitute a business situs quite as clearly as the conduct of the business itself.

The analysis in Whitney suggests that the taxpayer was taxable in New York even though he transacted no business there. Thus, Whitney not only recognized the business situs rule as viable in the area of income tax, it seemingly broadened the rule in this context.

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198. In particular, the interest was the right to a percentage in a new membership on the Exchange which the taxpayer possessed by reason of his pre-existing membership. The right existed because the Exchange was increasing its membership and gave existing members a stake in this expansion. Whitney, 299 U.S. at 369.

199. Id. at 367, 372. The facts supported the taxpayer’s claim that he did not do business in New York. While the taxpayer and his partners accepted orders from customers in Boston for execution on the Exchange, they made none of the actual purchases and sales, but rather telegraphed other members of the Exchange who executed the orders in their own names for a reduced fee. Id. at 371. Moreover, neither the taxpayer, nor his partners, bought or sold securities on the Exchange for their own accounts. Id.

200. Id. at 372.

201. The Exchange interest in Whitney met the Court’s test because the “privilege of conducting the business of . . . buying and selling . . . securities on the floor of the Exchange [was] the dominant feature of the membership or ‘seat.’” Id. at 373. Moreover, this privilege was localized in New York since it could be exercised there, but nowhere else. Id. In addition, “[t]he nature of [the] right [was] not altered by the [taxpayer’s] failure to exercise it.” Id.

202. The Court’s prior business situs rulings in the area of property tax seemed to suggest that a tax could be applied to credits and other intangible property only where such property was incident to a regular and continuous business. See Powell, supra note 192, at 106; Recent Case, supra note 197, at 704-05. However, while Whitney determined that the mere presence of a right which was exercisable for the purpose of conducting business could confer nexus, the case suggests that not every such right would in fact do so. See Whitney, 299 U.S. at 372 (“Here, we are dealing with an intangible right of a peculiar nature. It embraces the privilege of a member to transact business on the Exchange as well as a valuable
Arguably, the business situs rule, recognized in the Court's five property cases and *Whitney*, is limited to the area of due process from which those cases arose, and has no application with respect to the Commerce Clause. Under this view, the "business situs" of intangible property might satisfy due process "minimum contacts," but not the substantial nexus required by the Commerce Clause. While this is possible, the analyses of the cases in question suggest broad approval of the pertinent taxes, and create no sense that an inquiry under the dormant Commerce Clause would have changed the results. Moreover, while *Whitney* was decided under the Due Process Clause, not the Commerce Clause, subsequent Supreme Court cases in this area have suggested that the analysis in *Whitney* applies under both clauses.

2. Use Tax: *Miller Brothers Co. v. Maryland*

*Miller Brothers Co. v. Maryland* involved an attempt by Maryland to assert its use tax against a Delaware store which sold merchandise to Maryland residents. While the store did advertise in Maryland through newspaper, radio and some direct mailings, it had...
no property or employees in Maryland, did not send agents into the state for purposes of making sales, and did not accept mail or telephone orders. Residents of Maryland made purchases at the store, which they either took away, or had delivered by common carrier or by means of the store’s truck. Taxing authorities in Maryland found the truck within the state, seized it, and used it as the basis to assert that state’s use tax against the store on all sales made to Maryland residents.

Miller Brothers was one of the Court’s seminal use tax cases. The Court invalidated the tax under the Due Process Clause because there was no requisite “minimum connection” between the state and the store. In its analysis, the Court considered all the possible bases upon which it could establish the necessary “minimum connection.”

As part of its analysis, the Court stated:

Of course, the situs of property may tax it [sic] regardless of the citizenship, domicile or residence of the owner, the most obvious illustration being a tax on realty laid by the state in which the realty is located. Also, the keeping of tangible or intangible personality within a state may give it a similar taxable situs there (sometimes called a business or commercial situs or domicile).

Although Miller Brothers stated that its analysis was based upon the Due Process Clause, and that it was therefore unnecessary to consider the taxpayer’s Commerce Clause claim, Bellas Hess subsequently applied the Miller Brothers analysis to both constitutional provisions. Bellas Hess’ use of Miller Brothers indicates that the

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206. See id. at 341-42, 345-46. The store’s newspaper and radio advertising in Maryland was indirect. See id. at 341-42; see also id. at 349-50. The store advertised using Delaware newspapers and radio stations, and the advertising reached, with the store’s notice, Maryland residents. See id. at 341-42.

207. Id. at 341-42.

208. Id. at 341.

209. See id. at 343 (“We are dealing with a relatively new and experimental form of taxation . . . . [I]t raises questions of great importance to particular taxpayers, to the course of commercial dealing among the states and as to appropriation by other states of tax resources properly belonging to the state where the event occurs.”).

210. Id. at 344-47. For a discussion of the result in Miller Brothers in light of the Court’s subsequent holdings, see Rosen & Bernstein, supra note 60, at 554-55.

211. Miller Bros., 347 U.S. at 344-46.

212. Id. at 345 (footnotes omitted). Miller Brothers relied upon Whitney, among other cases, for the proposition that intangible property can create a taxable situs. Id. at 354-55 n.13. For a discussion of the commercial domicile doctrine, see supra note 196.

213. Miller Bros., 347 U.S. at 347.

214. See supra note 204 and accompanying text. But see supra note 86 (questioning the
Bellas Hess-Quill physical presence rule is founded in principles which do not preclude a finding of nexus based upon intangible property. This is so because Miller Brothers suggests that intangible property used within a state can create taxing nexus.215

B. Reliance by the States

While Quill struggled to adhere to prior precedent,216 it appeared primarily concerned with maintaining respect for the reliance interests the Court created in the area of state taxation.217 Thus,
there is a question as to whether the Supreme Court’s prior pronouncements with respect to the business situs rule have engendered any significant reliance by the states. In this regard, it is clear that at least some of the states have evaluated the pertinent Supreme Court precedent and taken the position—dating back prior to Geoffrey—that the business situs of intangible property can create taxing nexus.218

Prior to Geoffrey, at least three states asserted nexus based upon the business situs of intangible property, in reliance upon a state court decision which approved this practice.219 For example, New Mexico, in reliance on three 1979 holdings by that state’s court of appeals, has asserted nexus as to franchisors with no physical presence in that state, based upon license fees paid by an in-state franchisee.220 New Mexico asserts nexus in these instances even if, unlike in Geoffrey, the franchisor and franchisee are unaffiliated.221 In addition, Hawaii, in reliance on a 1976 holding by that state’s supreme court, has asserted nexus as to businesses which license intangible rights for use within that state.222 Similarly, New Jersey, relying in part on a 1983

218. The following discussion does not purport to be an analysis of the precise level of reliance evidenced by the fifty states. This subject is one which is beyond the scope of this Article.

219. In Bellas Hess, the Supreme Court suggested that the opinion of the state courts is one factor in determining the justifiable reliance by the states. See National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 758-59 n.11 (1967) (observing that the Alabama Supreme Court reached a result similar to that reached in Bellas Hess). In light of Geoffrey, the South Carolina Department of Revenue and Taxation takes the position that intangible property which is present in South Carolina may give rise to nexus. See Information Letter #94-5, South Carolina St. Tax. Rep. (CCH) ¶ 340-028 (Feb. 22, 1994).

220. Telephone Interview with Dianne L. Rossbach, Tax Auditor, New Mexico Taxation and Revenue Department (Oct. 13, 1994). The three cases, American Dairy Queen, AAMCO, and Baskin Robbins, are discussed earlier. See supra note 176 and accompanying text. This taxing activity, which dates back at least to the early 1980’s deals with the state’s gross receipts tax. See GR Regulation 3(1):2, New Mexico St. Tax. Rep. (CCH) ¶ 65-376 (1993). The fact that this tax is not an income tax per se is not relevant to the constitutional analysis. See supra note 9. The state’s regulation on the subject gives the following example:

Y, a pie company of Cambridge, Massachusetts, grants to X, of Virden, New Mexico, the right to make pies according to their exclusive recipe and to operate Y Pie shops throughout New Mexico. The right to make the pies and operate the pie shops, whether granted for a “one-time” payment or for a continuing percentage of the proceeds of the shops, is a franchise. Therefore, the receipts of Y, from its granting of the franchises are subject to gross receipts tax.


holding by that state’s tax court, has asserted nexus based upon the 
business presence in that state of intangible property.\(^{223}\)

Other states have also reviewed the prevalent law and, based 
upon that law, asserted nexus using a business situs theory. For 
example, Minnesota has asserted nexus pursuant to 1987 legislation 
which provides that a person has nexus with that state—"without 
regard to physical presence"\(^{224}\)—where the taxpayer engages in 
"transactions with customers in [Minnesota] that involve intangible 
property and result in income flowing to the person from within this 
state . . . ."\(^{225}\) Moreover, North Carolina, has asserted nexus pursuant 
to a 1992 regulation that provides that a taxpayer is doing busi-
ness in North Carolina where it owns in that state, for the purpose of 
economic gain, "[t]rademarks, tradenames, franchise rights, computer 
programs, copyrights, patented processes, [or] licenses."\(^{226}\) Also,
Texas, has asserted nexus pursuant to a 1992 regulation that provides that a franchisor has nexus with that state if it enters into one or more contracts with a person in Texas granting a franchisee the right to engage in the sale of goods or services pursuant to a franchise plan where "the operation of [the franchisee's] business pursuant to such plan is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate." 227

Minnesota has used the provision referenced in the preceding paragraph, inter alia, to assert nexus against out-of-state credit card and lending companies whose only presence in Minnesota are the receivables due from Minnesota residents. 228 Other states have similarly asserted nexus against credit card and lending companies based upon these facts, including Tennessee, Indiana and West Virginia. 229 In these lending situations, the states may take the position that nexus exists under both a business situs and an economic presence or solicitation theory. 230 Moreover, in the instance of credit card companies,
the states may also take the position that the credit cards issued by the companies constitute a physical presence in the taxing state, since a credit card contract typically states that the credit card issued remains the property of the credit card issuer.\textsuperscript{231}

\textbf{C. Public Policy}

1. In General

At least since \textit{Shaffer v. Carter},\textsuperscript{232} it has been widely accepted that an individual's income may be taxed by the state in which it is earned.\textsuperscript{233} Consistent with this, it seems that constitutional nexus
was not an issue in the case of Whitney v. Graves—notwithstanding the individual's lack of physical presence within the taxing state—because the fact that the individual derived income from the state suggested to the Court that there was something upon which the state could constitutionally operate.234 While there should logically be limitations on this principle, which could come from the Court's Commerce Clause role as guardian of the structure of the national economy, it does not seem that any event—certainly not the Court's decision in Bellas Hess or the reasons therefore—has caused the principle to have any less force.235 Indeed, the Court has recently continued to stress the notion that "'[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business.'"236 Thus, the Court's recent cases evidence an intention—not to abandon previously established tax principles—but rather to determine the appropriate restrictions to be placed thereon.237 Given the above, it would seem inappropriate for the

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234. For a discussion of Whitney, see supra notes 197-202 and accompanying text. International Harvester, discussed supra note 177, provides a similar example. Cf. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (""'Taxable event,' 'jurisdiction to tax,' 'business situs,' 'extraterritoriality,' are all compendious ways of implying the impotence of state power because state power has nothing on which to operate."').

235. The mail order situation involved in Bellas Hess—and also, Quill—is conceptually distinct, since in that situation the state seeks to impose a "trustee" obligation on an out-of-state vendor to collect a tax which is ultimately owed by an in-state resident. See supra notes 12-13, 215.


237. See, e.g., Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251, 2258 (1992) (noting that a state's ability to levy a tax upon a corporation and the restrictions to be applied to this legitimate taxing power are two distinct constitutional concerns). In the recent case of Barclays Bank, the Court stated that, because it is difficult to determine the purely local activity of a multi-state business, the Court will permit the income tax methodology used by the various states to be somewhat arbitrary: The Due Process and Commerce Clauses... prevent States that impose an income-based tax on nonresidents from taxing [ing] value earned outside [the taxing State's] borders. But when a business enterprise operates in more than one taxing
Court to establish a rigid physical presence rule in the area of income tax, since this rule would unjustifiably cut back upon the policy evident in the Court's prior rulings, and would invite multi-state businesses to engage in tax manipulation. Moreover, this type of judicial "re-determination" seems especially inappropriate in light of Quill, since that case suggests that policy questions arising under the Commerce Clause are now to be resolved by Congress.

2. Specific Areas of Concern

Commentators who have objected to the potential widespread application of Geoffrey have expressed particular concern with respect to two specific fact situations. First, these commentators have expressed concern with the possible assertion of nexus based upon monies loaned to individuals who are located in the taxing state (i.e., the ownership of loan receivables sitused in such state). However, even prior to Geoffrey, several states asserted nexus as to credit card and lending companies under these circumstances. Moreover, while the commentators appear to be concerned with the assertion of nexus as to de minimis lending activity, a de minimis presence does not confer nexus.

Second, commentators have also objected to the possible assertion of nexus in the situation where a taxpayer not physically present...
in a state receives royalties from that state through the activities of a third party intermediary (for example, royalties which are paid to a book author, a television producer, or a person appearing in a commercial endorsement). However, it is unclear whether there is currently any state enforcement activity in these types of situations. Moreover, to be taxable, these situations would have to meet the threshold test under the Due Process Clause, that the taxpayer in question "purposefully direct" his or her activities towards the taxing state.

VI. CONCLUSION

It is unlikely that the Supreme Court will be quick to enter the fray regarding the question of whether the ownership and use of intangible property within a state confers constitutional taxing nexus for income tax purposes. This is because, while there are certainly important questions in this area to be resolved, the Court acknowledged in Quill that it is ill-suited for this type of problem resolution. However, in a situation like Geoffrey, where a corporation derives income from intangible property located in a state in which the corporation is not otherwise physically present, the analysis used in Quill supports a determination that there may be taxing nexus. This is because the Court has previously recognized a "business situs" doctrine which posits taxing nexus as to intangible property where that property is located and used within the taxing state. This doctrine dates back almost one hundred years, and has been extended by the Court to the area of income tax. Moreover, the states have generally relied upon the business situs doctrine and, under Quill,

244. See, e.g., Geoffrey Cert. Brief, supra note 5, at 9, 20 (citing each example); Quirk, supra note 240, at 960 (citing the example of an author and the commercial endorser); Stewart, supra note 8, at 421 (citing the example of the author)

245. See supra text accompanying notes 63-70; see also supra note 155 and accompanying text and note 159; The Center for State and Local Taxation Symposium Focuses on Taxation of Intangible Property, STATE TAX REV., Nov. 7, 1994, at 9 (arguing that Michael Jordan should not be expected to pay tax to California merely because his face appears on T-shirts in that state—absent a showing that Jordan has purposefully exploited the California market) (comments of Thomas H. Steele). There is a similar inquiry under the Commerce Clause, since it is the taxpayer's "activity" which must have substantial nexus with the taxing state. See supra text accompanying note 82.

246. See supra note 127.

247. See supra notes 123-27 and accompanying text.

248. See supra notes 192-215.

249. See id.
their reliance interest should be respected.250

While the business situs doctrine is consistent with the analysis used in Quill, it appears to conflict with the Quill physical presence requirement. However, this requirement was founded more than a half-century after the Court's recognition of the business situs rule—and in the area of use tax, not income tax.251 Moreover, the business situs doctrine was cited with approval in one of the Court's seminal use tax cases, Miller Brothers Co. v. Maryland, which the Court later applied to create the Quill physical presence requirement.252

Quill retained the physical presence rule in the area of use tax in large part because it engendered substantial reliance by mail order vendors and fostered the growth of the mail order business.253 Because the physical presence requirement has special application in the area of use tax, it may not apply outside that area.254 Alternatively, if the physical presence requirement does apply to the area of income tax, it seems that the business situs of intangible property can nonetheless meet this test.255 In this regard, the Court has previously indicated that the physical presence rule is not a rigid one.256 Moreover, as the Court has suggested, the application of a rigid physical presence test to intangible property makes no conceptual sense, since intangible property is, by definition, not physical.257

A rule which asserts constitutional nexus based upon the ownership and use of intangible property within a state would be consistent with public policy, since this policy—as recently articulated by the

250. See supra notes 216-31 and accompanying text.
251. See supra notes 204, 206-15 and accompanying text.
252. See id.
253. See supra notes 114-27 and accompanying text and supra note 135; see also Hellerstein, supra note 127, at 124 (stating that Quill may have established a physical presence standard only for the mail order industry).
254. See id. and supra note 215; see also supra note 204. Outside the area of use tax the assertion of nexus may not require that a taxpayer be "present" through the ownership of either tangible or intangible property. Thus, a taxpayer could be subject to income tax in a state by virtue of its exploitation of the economic market in that state. See supra notes 188-89 and note 230 and accompanying text.
255. See supra text accompanying notes 128-39.
256. See supra note 138 and accompanying text.
257. See, e.g., Wheeling Steel Corp. v. Fox, 298 U.S. 193, 209 (1936) ("When we deal with intangible property . . . we encounter the difficulty that by reason of the absence of physical characteristics they have no situs in the physical sense, but have the situs attributable to them in legal conception."); see also supra note 166 (quoting Curry v. McCanless, 307 U.S. 357, 365-66 (1939)).
Supreme Court—posits that multi-state businesses pay their fair share of state tax, even though this payment increases the cost of doing business. In contrast, without such a rule, an intangibles corporation, like the taxpayer in Geoffrey, can be created such that it pays no tax to many of the states in which it transacts business. Moreover, while commentators have criticized the potential application of Geoffrey, their concerns may be generally addressed under constitutional principles which are already outstanding.

Quill clarifies that Congress can determine the rules regarding taxing nexus, and suggests that the Court would prefer that this legislative body address these questions. However, since Congress has been reluctant to act in this area, the Court may ultimately be responsible for determining the nexus rules with respect to intangible property and income tax.