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## Special Report / Viewpoint

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# Quill: 10 Years After

by Robert D. Plattner

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### I. Introduction

This year marks the tenth anniversary of the U.S. Supreme Court's decision in *Quill v. North Dakota*.<sup>1</sup> The Court in *Quill*, unwilling to overrule *National Bellas Hess*<sup>2</sup> in toto, held that the Commerce Clause of the U.S. Constitution prohibits a state from imposing use tax collection obligations on an out-of-state vendor whose only connections with the state are the distribution of catalogs in the state via U.S. mail and the delivery of goods to customers in the state by common carrier. Such vendors, the Court ruled, lack the substantial nexus with the state required by the Commerce Clause.

The *Quill* Court did, however, depart from its decision in *Bellas Hess* in one significant respect. In *Bellas Hess*, the Court made no attempt to distinguish Commerce Clause from Due Process Clause concerns. In *Quill*, the Court enunciated differing nexus requirements for the Due Process and Commerce Clauses, and concluded that the typical mail-order vendor, while lacking Commerce Clause nexus, does have the necessary "minimum contacts" with those states in which it distributes catalogs and delivers goods to satisfy the Due Process Clause. This distinction, which had no discernible basis in prior case law, appeared to be drawn by the Court in order to facilitate a congressional solution to the state taxation of mail-order sales. Congress could certainly authorize state action barred by the Commerce Clause; its power to do so with respect to state action barred by the Due Process Clause was less clear. By eliminating the Due Process Clause as a concern, *Quill* cleared the way for Congress to act.

Subject to substantial criticism at the time it was issued, it is safe to say that the stature of the *Quill* decision has not improved with age. Indeed, *Quill* was initially defensible, if at all, as a practical, political compromise that paved the way for a congressional resolution. Now, 10 years later, there is still no congressional response. Instead, there is continued debate over the shape of federal legislation, with the states, because of *Quill*, negotiating from a weak bargaining position vis à vis

powerful segments of the business community. Indeed, *Quill* has emboldened the business community to pursue an extremely aggressive position on the issue of business activity tax nexus in the context of these negotiations. Further, *Quill* stands as troublesome precedent on outstanding issues regarding Commerce Clause nexus. In short, the *Quill* decision qualifies as a blunder of major proportions by the Court.

This article asserts that the seeds of the *Quill* disaster were sown in *National Bellas Hess*, not because of its result but because of its flawed conceptual underpinnings, which were perpetuated by the Court in *Quill*. It then offers an alternative conceptual framework in which to address and rule on the issues faced by the Court in *Bellas Hess* and *Quill*, and plays out the likely consequences that would follow. These consequences, it is argued, would lead to sensible solutions to the use tax collection issue and other tax nexus issues that now linger on a decade after *Quill*.

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Finally, the article takes the position that the states should push the Supreme Court to reexamine *Quill* by bringing a new test case that seeks to change not only the outcome in *Quill* but also the framework of Supreme Court decisionmaking in state tax nexus cases. While it may be naive to think that the Court would abandon *Quill*, it is hard to believe that the Supreme Court is satisfied with the anachronistic, illogical state of constitutional doctrine embodied in *Quill*. Perhaps, given another opportunity to do better, the Court would seize on it.

### II. The Historical Backdrop

#### A. Commerce Clause

##### 1. Early History

The Commerce Clause states that "Congress shall have power to . . . regulate commerce with foreign nations, and among the several states, and with the Indian Tribes."<sup>3</sup> It was adopted by the Founders without much controversy. The experience of the young nation under the Articles of Confederation had made clear the need for national economic unity, achievable only by giving the power to regulate commerce to the federal government. Nonetheless, while the Commerce Clause explicitly vests in Congress the power to regulate commerce among the states, it is silent as to what role the states

<sup>1</sup> 504 U.S. 298 (1992).

<sup>2</sup> *National Bellas Hess v. Illinois*, 386 U.S. 753 (1967).

<sup>3</sup> U.S. Const. Article I, section 8, cl.3.

may play regarding interstate commerce carried on within its borders where Congress has not acted to preempt the field.

One possible interpretation of the Commerce Clause is that it prohibits all state regulation or taxation of interstate commerce. A second is that the states may act unless specifically prohibited or preempted by Congress. The third, and ultimately prevailing interpretation, is that the states' power to act lies somewhere between these two extremes, as developed by case law in light of the competing goals of the Commerce Clause and state regulatory and fiscal concerns. Under this interpretation, the negative or dormant Commerce Clause, by its own force, empowers the Court to place limits on state authority. (For a good history of Commerce clause jurisprudence, see Pomp and Oldman, *State and Local Taxation*, Fourth Edition, Vol. 1, pages 1-1 to 1-15.)

## 2. State Tax Cases

For much of the period preceding the Court's decision in *Complete Auto Transit*,<sup>4</sup> the prevailing interpretation of the negative Commerce Clause in state tax cases held that "pure" interstate commerce could not be taxed by a state. A state could, however, levy a tax on a local aspect of that interstate commerce if it could identify one.<sup>5</sup> Cases decided under this conceptual framework tended to ignore economic realities and instead rely on formalistic, artificial distinctions. The result was a body of law that the Court itself described as leaving much room for controversy and confusion and offering little in the way of guidance to the states.<sup>6</sup> *National Bellas Hess*, decided 10 years before *Complete Auto Transit*, was a product of this period.

*Complete Auto Transit*, decided in 1977, represented a critical event in Commerce Clause jurisprudence in two respects. First, quite intentionally, the Court in *Complete Auto* overturned decades of prior case law, specifically disavowed the long-held notion that states cannot directly tax "pure" interstate commerce, and held that it would no longer focus on the formal language of state tax statutes but instead would consider their practical effects in judging Commerce Clause claims.

Second, *without intention*, the Court in *Complete Auto* included *dicta* that quickly gained stature as the "four-part test" under which state taxing statutes are judged to determine their constitutionality under the Commerce Clause. As stated in *Complete Auto*, a state tax will survive a Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.

## 3. State Regulation Cases

In cases challenging state regulatory action, the Court adopted a different approach. At its most candid, the Court engaged in a two-part test. First, the Court examined whether the state regulation acted evenhandedly to pursue a legitimate local public purpose (akin to the "discrimination test" of *Complete Auto*). If this first test was met, the Court undertook a balancing test, weighing the nature of the local interest and whether less-burdensome alternatives were available against the extent of the burden imposed on interstate commerce. For example, in *Southern Pacific*, the Court struck down an

<sup>4</sup> *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

<sup>5</sup> See, e.g., *Ficklen v. Shelby County*, 145 U.S. 1 (1892); *Robbins v. Shelby County*, 120 U.S. 489 (1897).

<sup>6</sup> See, *Northwestern States Portland Cement v. Minnesota*, 358 U.S. at 457 (1959).

Arizona statute limiting the length of passenger and freight trains, holding:

Examination of all relevant factors makes it plain that the state interest here asserted is outweighed by the interest of the nation in an adequate, economical and efficient railway transportation service.<sup>7</sup>

## B. Due Process Clause

Since early in the 20th century, the Supreme Court has invoked the Due Process Clause as well as the Commerce Clause to invalidate state tax measures. Despite the fact that some distinguished Supreme Court Justices — including Holmes, Brandeis, Stone and Black — have questioned the basis for this constitutional doctrine,<sup>8</sup> it is now firmly ensconced in the Court's jurisprudence.

For example, in *Union Refrigerator*<sup>9</sup> the Court held that the Due Process Clause prohibited ad valorem taxation by an owner's state of domicile of tangible personal property permanently located in some other state. In *Standard Oil v. Peck*,<sup>10</sup> 342 U.S. 382, the Court ruled that Ohio violated the Due Process Clause by seeking to tax 100 percent of the value of tangible personal property that was subject to tax on an apportioned basis by other states.

In *Norfolk Western Railway*,<sup>11</sup> the Court, in striking down an apportionment formula utilized in the property taxation of rolling railroad stock, summarized its existing Due Process Clause jurisprudence in state tax cases as follows:

The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due. A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders." *Nashville, C. & St. L. R. Co. v. Browning*, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State. *Fargo v. Hart*, 193 U.S. 490, 499-500 (1904).<sup>12</sup>

In short, at the time *Bellas Hess* was decided, the Court's due process doctrine in state tax cases required that a state tax be rationally related to values connected with the taxing state.

In addition, in keeping with traditional jurisdictional due process concerns, the Court's body of case law held that a state could not assert its tax authority unless there was a threshold level of connection (minimum contacts) between the state and the person, property, or activity over which it sought to impose jurisdiction.<sup>13</sup>

<sup>7</sup> *Southern Pacific Co v. Arizona*, 325 U.S. 761, 781 (1945); see also, *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662 (1981).

<sup>8</sup> See, e.g., *Central R. Co. v. Pennsylvania*, 370 U.S. 607 (1961).

<sup>9</sup> *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194 (1905).

<sup>10</sup> *Standard Oil v. Peck*, 342 U.S. 382 (1952).

<sup>11</sup> *Norfolk Western Railway Co. v. Missouri*, 390 U.S. 317 (1968).

<sup>12</sup> *Ibid.*, at 325.

<sup>13</sup> *Miller Bros. v. Maryland*, 347 U.S. 340 (1954); see also *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

### III. National Bellas Hess

In *National Bellas Hess*, the Court for the first time confronted the issue of constitutional nexus in the context of a typical mail-order vendor. By this time, as noted, the potential implications of both the Commerce Clause and the Due Process Clause in state tax cases were well-established. The Court, however, had never articulated any clear distinction in the application of the two clauses.

It saw no need to do so in *Bellas Hess* either. Indeed, Justice Stewart begins his opinion in *Bellas Hess* by stating:

National argues that the liabilities which Illinois has thus imposed violate the Due Process Clause of the Fourteenth Amendment and create an unconstitutional burden upon interstate commerce. These two claims are closely related. For the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a State's compliance with the requirements of due process in this area are similar. As to the former, 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 (citing *Freeman v. Hewitt*, 319 U.S. 249, 253). 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 that state has given anything for which it can ask return (citing *Wisconsin v. J.C. Penney*, 311 U.S. 435, 444)." The same principles have been held applicable in determining the power of a State to impose the burdens of collecting use taxes upon interstate sales. Here, too, the Constitution requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax" (citing *Miller Bros. v. Maryland*, 347 U.S. 340, 344-345). (Citations omitted.)<sup>14</sup>

With this by way of background, Stewart goes on to address the matter at hand. The key paragraph of the decision reads:

We need not rest on the broad foundation of all that was said in the *Miller Bros.* opinion, for here there was neither local advertising nor local household deliveries, upon which the dissenters in *Miller Bros.* so largely relied. Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government."<sup>15</sup>

<sup>14</sup> *Bellas Hess*, at 756.

<sup>15</sup> *Bellas Hess*, at 759.

There's a lot going on in this paragraph, the foundation on which 35 years of Commerce Clause nexus jurisprudence has since been built. A close examination reveals a muddled mix of Commerce Clause and Due Process Clause concepts, including "minimum contacts," "pure" interstate commerce, the balancing of competing state and national economic interests, and the principle that a state tax must be rationally related to values connected with the taxing state. All appear to play a role in the Court's decision.

Justice Stewart does not simply tally the connections of *Bellas Hess* (the Company) with Illinois before concluding that the state lacks the requisite nexus to impose its tax authority. Rather, after examining the Company's connections with Illinois, Stewart apparently excludes from consideration those connections that constitute "pure" interstate commerce before applying the minimum contacts test ("it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved").<sup>16</sup>

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The Court's decision to exclude these connections in determining nexus was based on existing Commerce Clause doctrine, which, as discussed previously, treated certain activities as "purely" interstate in character and therefore beyond the tax reach of the states. Incorporating this concept into the "minimum contacts" test, Stewart discounts the presence in Illinois of hundreds of thousands of catalogs and millions of dollars worth of goods to which the Company held title prior to delivery.

As noted, the concept of "pure" interstate commerce beyond reach by the states was later repudiated by the Court in *Complete Auto Transit*, undermining the continuing vitality of *Bellas Hess*.<sup>17</sup>

The paragraph then goes on to engage in a balancing test, common in Commerce Clause state regulation cases but not in state tax cases. Stewart balances the state interest (collecting use tax on mail-order sales) against the burden imposed on national economic interests (potential compliance burdens in thousands of sales tax jurisdictions), and finds for the national interest.

That result makes some sense. But the decision of the Court is not couched in these terms. Instead, the Court employs this balancing test as an interim step in reaching the conclusion, on which the decision rests, that Illinois lacks sufficient nexus to impose its use tax collection statute.

This decisionmaking framework makes no sense at all. Determining the existence or lack of sufficient minimum contacts (nexus) does not require, or even allow for, the balancing of competing interests. The contacts either exist or they do not.

Finally, it appears that Stewart's "no nexus" finding is also influenced by his sentiment, as expressed in that same paragraph, that mail-order vendors do not get much in the way of

<sup>16</sup> *Bellas Hess*, at 759.

<sup>17</sup> The majority in *Quill* erroneously concludes that *Complete Auto* did not undercut the holding in *Bellas Hess*, at 311-312.

governmental services from the jurisdictions into which they sell. Stewart also incorporates this “interim” finding into his final determination of whether or not nexus exists. Yet again, Stewart has taken into account factors other than the presence or absence of minimum contacts in determining nexus.

#### IV. Quill

Decided in 1992, exactly 25 years after *Bellas Hess*, the *Quill* case afforded the Supreme Court a clear opportunity to put its Commerce Clause nexus doctrine on solid footing. Instead, the Court compounded the errors of *Bellas Hess*.

### ***The ‘bright line’ test reaffirmed in Quill (better characterized as a safe harbor) is artificial through and through.***

The majority in *Quill* correctly recognizes that a state tax may meet due process “minimum contacts” standards and yet fail to pass constitutional muster “because of its burdening effect upon [interstate] commerce.”<sup>18</sup> The Court goes awry, however, just as it did in *Bellas Hess*, by attempting to resolve in terms of nexus the issue of the burdening effect of use tax collection obligations on interstate commerce. As a result, the Court is forced to create a Commerce Clause concept of “substantial nexus” that is separate and apart from Due Process Clause nexus. Though not expressly stated by the Court, the determination of “substantial nexus” appears to require the consideration of the same mix of factors mentioned by Justice Stewart in *Bellas Hess*. That is, Commerce Clause nexus is not just about sufficient “minimum contacts,” but also about balancing state interests against interstate burdens and the extent of state services provided in relationship to the burdens imposed.

A key goal of the Court’s tortured nexus logic is to preserve the “bright line” test established in *Bellas Hess*, to which the Court assigns great value.<sup>19</sup> As to the shortcomings of that test, the Court concedes only that such test may appear “artificial at its edges.”<sup>20</sup> In truth, the “bright line” test reaffirmed in *Quill* (better characterized as a safe harbor) is artificial through and through. A determination of “substantial nexus,” as that concept is portrayed by the Court, should entail an analysis of competing benefits and burdens. The Court’s “bright line” test cannot serve as a plausible substitute for such determinations.<sup>21</sup>

<sup>18</sup> At 305-306, quoting *International Harvester Co. v. Department of Treasury*, 333 U.S. 340, 353 (1944).

<sup>19</sup> At 315-318.

<sup>20</sup> At 315.

<sup>21</sup> Take, for example, XYZ Co., a mail-order vendor that distributes a million catalogs in State A and sells \$5 million in merchandise delivered into State A. State A has a single state sales and use tax rate and base, and exempts remote vendors with less than \$1 million in annual sales. Despite the modest administrative burden imposed by State A on XYZ Co. and XYZ’s extensive economic activity and physical presence (the catalogs and goods to which it holds title until delivered) in State A, XYZ has no nexus in State A. In contrast, PQR Co. sells \$100,000 of goods annually in State B, which has 50 local sales tax jurisdictions, each with its own base and rate. PQR Co. solicits sales through the use of a single independent contractor who travels throughout the state approximately 10 days each year. Despite the substantial administrative burden imposed by State B’s sales and use tax and PQR’s modest contacts with State B, PQR is not protected by the Court’s bright-line test.

Moreover, by affirming the *Bellas Hess* “bright line” test in particular, the *Quill* court incorporates into an already artificial exercise the discredited pre-*Complete Auto* concept that the presence of catalogs and goods of a vendor in a state does not count toward the physical presence of the vendor in the state because these items are in “pure” interstate commerce. As a consequence, the test, even on its own terms, fails to determine physical presence in a rational manner.

The *Quill* Court would have done far better to view the decision in *Bellas Hess* as based on the balancing of competing national and state interests, an exercise obviously undertaken by Stewart in that decision and explicitly used by the Court in state regulation cases. It could then have used the same decisionmaking framework to decide *Quill* as it saw fit without creating a two-headed nexus monster.

While state tax statutes as a rule have not been subject to the candid balancing test used in regulatory cases, that is because the “burden to interstate commerce” side of the equation in tax cases is usually the tax liability itself, and the Court is generally unwilling to rule that some amount of tax is “too much” tax. *Commonwealth Edison*<sup>22</sup> is a good example. When, however, the issue is the administrative burden imposed by a taxing statute, as in *Bellas Hess* and *Quill*, the use of a balancing test is both appropriate and desirable.

#### V. A New Framework

##### A. Overview

Under the new framework suggested by this article, the *Complete Auto Transit* four-part test would still exist.<sup>23</sup> The presence or absence of Commerce Clause nexus would be determined on the same basis as Due Process Clause nexus. In addition, a fifth Commerce Clause challenge would be available to taxpayers, one that is already available in state regulation cases — that is, that the nature and extent of the burden imposed on interstate commerce by a state tax measure outweighs the state interests furthered by the measure.

Were a state use tax collection statute to come before the Court under this new framework, any nexus challenge would be determined under Due Process Clause standards. As held in *Quill*, a mail-order vendor’s contacts with a state are generally sufficient to meet due process concerns. Thus, the state would likely prevail on this issue.

The taxpayer’s remaining constitutional challenge would be determined under the test used in regulatory cases, in which the nature of the local interest and the availability of less-burdensome alternatives are weighed against the extent of the burden imposed on interstate commerce. This test poses the real constitutional issue before the Court in *Bellas Hess* and *Quill* (one sign that the new framework works — it asks the right question), and is the issue that should be put before the Court in this straightforward manner in an attempt to overturn *Quill*.

##### B. Sales and Use Taxes

What would be the outcome of a challenge to a use tax collection statute under the new framework? It depends. Any state use tax collection statute under challenge must be

<sup>22</sup> *Commonwealth Edison v. Montana*, 453 U.S. 609 (1981).

<sup>23</sup> Other aspects of the *Complete Auto Transit* four-part test may also require rethinking, but that is a subject for another discussion.

evaluated on its own specific merits. For example, a "test case" statute that sought to minimize the burdens on interstate commerce might include some or all of the following provisions:

- a single statewide sales and use tax base;
- local tax rates that could be determined by the ZIP code of the customer from software provided free of charge by the state;
- an exemption for vendors with sales under a threshold amount; and
- a freeze on the imposition of the statute if challenged legally until a court of final jurisdiction ruled it constitutional.

The Court should rule only on the constitutionality of the specific statute under challenge, weighing the burden on interstate commerce imposed by the statute against the state's interests in preserving its revenue base and maintaining a level playing field between remote sellers and "Main Street" retailers. The Court might uphold a use tax collection statute along the lines described above while rejecting a more burdensome one — an entirely appropriate result. In doing so, the Court would provide guidance to the states and create an impetus for them to simplify their sales and use tax statutes in order to pass constitutional muster.

### C. Business Activity Taxes

Constitutional challenges to business activity taxes currently treated as nexus challenges would also be appropriately reviewed under the new framework. These challenges would likely fail in light of current due process "minimum contacts" jurisprudence and the generally more modest burdens imposed on taxpayers in the administration of business activity taxes. The business community could then turn to Congress, as it did when the Court ruled in favor of the states in *Northwestern States Portland Cement*<sup>24</sup> and Congress responded in less than a year with Public Law 86-272. Were this to occur, the states would at least begin the legislative negotiation process in Congress on a more competitive footing than at present. As *Quill* and its aftermath have demonstrated, Congress is far more likely to respond promptly to the perceived needs of the business community than those of the states.

### VI. Conclusion

Commerce Clause nexus jurisprudence is in desperate need of rethinking. The states, in addition to their efforts to obtain federal legislation responsive to *Quill*, should mount a test case that seeks not only to overturn the result in *Quill* but also to overhaul current Commerce Clause nexus jurisprudence. ☆

<sup>24</sup> *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).