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## State and Local Taxation of Electronic Commerce: Reflections on the Emerging Issues

Walter Hellerstein

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## State and Local Taxation of Electronic Commerce: Reflections on the Emerging Issues

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### I. INTRODUCTION

When Ed Cohen honored me with the invitation to present the principal paper on state and local taxation of electronic commerce for this conference, I was pleased to accept, but with one caveat. Because most

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of my waking hours over the past year seem to have been consumed by the preparation of papers addressed to state taxation of electronic commerce,<sup>1</sup> I warned Ed that much of what I might have to say would not be new—at least to me.

But a funny thing happened on the way to this forum. When I set about my task to prepare yet another paper on state taxation of electronic commerce, fully expecting—in the finest academic tradition—to cannibalize my earlier writing, I found that there were, in fact, a number of significant issues on which I had barely touched in my previous efforts or that deserved considerably more attention than I had given them. More importantly, the intense debate that has been raging during the past year or so over state taxation of electronic commerce—particularly with regard to proposed legislative solutions to the problem—has raised additional issues that warrant consideration. Finally, since at least two of the distinguished commentators on my paper were acquainted with my earlier work,<sup>2</sup> I felt liberated from the obligation to repeat much of what I said before.<sup>3</sup>

In this paper, then, I have approached the topic of state taxation of electronic commerce in a somewhat less systematic and formal mode than in my earlier efforts, and more with an eye to some of the issues that have emerged in recent discussions of the subject.<sup>4</sup> Whether or not

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1. See Walter Hellerstein, *State Taxation of Electronic Commerce*, TAX L. REV. (forthcoming 1998); Walter Hellerstein, *Transaction Taxes and Electronic Commerce: Designing State Taxes That Work in an Interstate Environment*, 50 NAT'L TAX J. 593 (1997); Walter Hellerstein, *State Taxation of Electronic Commerce: Preliminary Thoughts on Model Uniform Legislation*, Paper prepared for a symposium on multijurisdictional taxation of electronic commerce at Harvard Law School (Apr. 5, 1997), in 12 STATE TAX NOTES 1315 (1997) [hereinafter *Preliminary Thoughts*]; Walter Hellerstein, *Telecommunications and Electronic Commerce Overview and Appraisal*, Paper prepared for Conference of Taxation and Telecommunications (Nov. 11-12, 1996), in 12 STATE TAX NOTES 519 (1997); REPORT NO. 1 OF THE DRAFTING COMMITTEE OF THE NATIONAL TAX ASSOCIATION'S COMMUNICATIONS AND ELECTRONIC COMMERCE TAX PROJECT (Nov. 1997), reprinted in 13 STATE TAX NOTES 1255 (1997) [hereinafter NTA ELECTRONIC COMMERCE REPORT]. I am Chairman of the Drafting Committee, whose other members are James Eads, Harley Duncan, Ellen Fishbein, Paull Mines, and Bruce Reid.

2. Professor Reuven Avi-Yonah was the panel moderator at the Harvard Law School symposium where I delivered one of my earlier papers. See *Preliminary Thoughts*, *supra* note 1. He also presented a paper on international taxation of electronic commerce at the New York University Law School Graduate Tax Faculty Symposium, at which I delivered another one of my earlier papers. See *State Taxation of Electronic Commerce*, *supra* note 1. Paull Mines was a commentator on my New York University Law School paper, and we have collaborated closely in the National Tax Association's Communications and Electronic Commerce Tax Project, where we are both members of the Drafting Committee. See NTA ELECTRONIC COMMERCE REPORT, *supra* note 1.

3. My liberation, I must confess, was tempered by some trepidation, because of my traditional training in the reinvent-the-wheel mode of scholarship that is all too familiar to law journal readers.

4. In particular, the dialogue that is certainly occurring in connection with the National Tax

the paper “moves the ball forward”—the precondition of its ascension into academic Elysium—I hope that it will contribute to the public dialogue regarding state taxation of electronic commerce.

## II. THE SCOPE OF THE SOLUTION TO THE ELECTRONIC COMMERCE PROBLEM

No one seems to have any trouble describing the “problem” of state taxation of electronic commerce. If massive amounts of economic activity will soon be conducted through electronic commerce by remote service providers engaged in nontraceable transactions from unidentifiable locations, it does not take a rocket scientist (or even a state tax lawyer) to appreciate the difficult questions raised by this eventuality. Which states, if any, will have jurisdiction to impose (or require collection of) taxes on the sales or income generated by such economic activity? To which states should the receipts or the income from such economic activity be assigned? And how will states administer, and taxpayers comply with, a taxing regime that attempts to capture the receipts or income from such economic activity?

While it may be easy enough to describe the “problem” of state taxation of electronic commerce, one of the key issues that has emerged from the discussions it has spawned is the scope of the solution to that problem. If we keep our sights narrowly focused on electronic commerce, and view the task as devising an approach that best accommodates our existing tax structure to this particular slice of economic activity, we may settle upon a solution that deals with electronic commerce and nothing else. Some of the early efforts to fashion a legislative solution to the electronic commerce problem have taken such a focused approach—in large part because they were responding to the particular problem at hand.<sup>5</sup>

Such narrow solutions to the electronic commerce problem, however, create problems of their own. A set of taxing provisions directed only at electronic commerce will produce a disparity between the tax treatment of electronic commerce and conventional commerce. More fundamentally, there may be problems raised by state taxation of electronic commerce that cannot be resolved satisfactorily without making

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Association's Communications and Electronic Commerce Tax Project, *see* NTA ELECTRONIC COMMERCE TAX REPORT, *supra* note 1, and that occurred at the seminar “Transaction Taxation: Telecommunications & Electronic Commerce” (jointly sponsored by the Institute for Professionals in Taxation and the National Tax Association (Feb. 2-3, 1998)), inspired a number of the topics addressed in this paper. This paper does, however, draw freely from my earlier work in the area. *See supra* note 1 and accompanying text.

5. *See Preliminary Thoughts*, *supra* note 1; NTA ELECTRONIC COMMERCE REPORT, *supra* note 1.

basic changes in the overall taxing regime. Consequently, in approaching the question of how to fix the tax system to accommodate electronic commerce, we must confront the question of whether that "fix" necessarily must extend beyond electronic commerce itself.

Consider, for example, the matter of sales and use taxation of electronic commerce. There is virtually universal agreement that there are serious difficulties with applying existing sales and use tax regimes to electronic commerce. Two of these difficulties—the nexus or jurisdictional issue and the double taxation or pyramiding issue—are illustrative.

### A. *Nexus*

There is widespread recognition that traditional nexus criteria are ill-suited to the creation of sensible and administrable rules for determining the taxability of taxpayers or transactions in electronic commerce. Traditional tax jurisdiction or "nexus" principles, after all, are rooted in concepts of territoriality, and the physical presence of the taxpayer in the state.<sup>6</sup> Indeed, although the U.S. Supreme Court has abandoned physical presence as the touchstone of Due Process Clause nexus,<sup>7</sup> it has retained the physical-presence standard, however grudgingly,<sup>8</sup> as a litmus test of Commerce Clause nexus,<sup>9</sup> at least in the context of sales and use tax taxes.<sup>10</sup> In any event, whether we are talking about traditional concepts of jurisdiction to tax based on physical presence or more "modern" concepts of jurisdiction to tax based on "economic" presence, we are still counting contacts—tangible or intangible.

But, such an approach makes little sense in cyberspace. The signal characteristic of cyberspace is the irrelevance of geographic borders. As

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6. See *Pennoyer v. Neff*, 95 U.S. 714 (1877) (holding that no state can exercise jurisdiction and authority over persons and property outside of its territory).

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

8. Despite its reaffirmation of the physical-presence standard of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), the Court was almost apologetic in its defense of the old rule. The Court acknowledged that its recent Commerce Clause decisions—like its modern Due Process Clause decisions—signalled a "retreat from the formalistic stringent physical presence test in favor of a more flexible substantive approach." *Quill*, 504 U.S. at 314. Moreover, the Court conceded that its "contemporary Commerce Clause jurisprudence might not dictate" the result reached in *Bellas Hess* "were the issue to arise for the first time today." *Id.* at 311. Furthermore, the Court recognized that, "[l]ike other bright-line tests, the *Bellas Hess* rule appears artificial at the edges" by drawing a constitutional line in the sand between commercial activity "purposefully directed" to a state through physical presence and economically equivalent commercial activity "purposefully directed" to a state through other means. *Id.* at 315.

9. See *Quill*, 504 U.S. at 309-19.

10. But see *Geoffrey, Inc. v. South Carolina State Tax Comm'n*, 437 S.E.2d 13, 18-19 (S.C.), cert. denied, 510 U.S. 992 (1993) (ruling that a state has jurisdiction to tax out-of-state taxpayer with no physical presence in the state on income earned from licensing trademarks to in-state licensee).

the co-directors of the Cyberspace Law Institute have declared, "[g]lobal computer-based communications cut across territorial borders, creating a new realm of human activity and undermining the feasibility—and legitimacy—of laws based on geographic boundaries."<sup>11</sup> This thought has not been lost on those seeking a solution to the problems raised by state taxation of electronic commerce. They recognize that "traditional concepts of nexus may not be entirely appropriate for electronic commerce and Internet related services,"<sup>12</sup> and that we need to "rethink nexus standards as they apply to the Internet and Internet-based transactions."<sup>13</sup>

Whatever may be the appropriate nexus standards for the Brave New World of electronic commerce, however, one cannot, as a practical matter, ignore the question whether those standards should be confined to electronic commerce. For example, suppose it were determined that a sensible sales and use tax regime for electronic commerce would require vendors to collect and remit sales or use taxes on sales of electronically-transmitted information and services to the states in which the customers received such information or services (at least in circumstances under which the vendor could reasonably identify such states). Accordingly, suppose it were further determined that creation of such a regime required the establishment of nexus over an out-of-state vendor in the states in which such information or services were received.<sup>14</sup>

But, if such a regime would make sense for electronic commerce, one might reasonably ask why it would not make equally good sense for

11. David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367 (1996).

12. Information Technology Association of America, *Straight Talk: Internet, Tax & Electronic Commerce: A White Paper on Taxation of Electronic Commerce and the Internet 10* (undated and unpublished manuscript) (on file with the *University of Miami Law Review*) [hereinafter ITAA White Paper].

13. Interactive Services Association, *Logging On to Cyberspace Tax Policy: An Interactive Services Association Task Force White Paper* (Dec. 1996), reprinted in 12 STATE TAX NOTES 209, 221 (1997) [hereinafter ISA White Paper]. The U.S. Treasury has made the same point in the context of U.S. income taxation of international transactions:

The concept of a U.S. trade or business was developed in the context of conventional types of commerce, which generally are conducted through identifiable physical locations. Electronic commerce, on the other hand, may be conducted without regard to national boundaries and may dissolve the link between an income producing activity and a specific location. From a certain perspective, electronic commerce doesn't seem to occur in any physical location but instead takes place in the nebulous world of "cyberspace." Persons engaged in electronic commerce could be located anywhere in the world and their customers will be ignorant of, or indifferent to, their location.

Department of the Treasury, Office of Tax Policy, *Selected Tax Policy Implications of Global Electronic Commerce*, in 97 TAX NOTES TODAY 90, 91 [hereinafter Treasury White Paper].

14. This part of the paper is not concerned with the merits of such a proposal or whether it could be implemented constitutionally. These questions, however, are addressed in Parts III and IV, *infra*.

non-electronic commerce. In other words, if an ideal sales and use tax regime is one in which vendors can be required to collect and remit the tax to the customer's state, is that any less true for the sale of tangible personal property by a mail-order vendor than it is for the sale of electronically-transmitted information or services by the electronic commerce vendor?

If the answer to that question is "no," then we suddenly find ourselves confronted not with the task of crafting a solution to the problem of electronic commerce, but rather with the broader task of determining the appropriate nexus rules for sales and use taxes generally, at least insofar as such taxes are applied to sales by remote vendors. While this may make perfect economic sense and appeal to "an academic desire for tidiness,"<sup>15</sup> it could create significant political impediments to solving the electronic tax problem. Whatever may be the political difficulties of fashioning a rational solution to the problem of electronic commerce, the political difficulties of establishing new nexus rules for all sales and use taxes may be even more daunting. One need only look to the seemingly interminable negotiations over the problem of requiring out-of-state mail-order vendors to collect use taxes on their sales to in-state purchasers<sup>16</sup>—not to mention the public outcry at the very suggestion that out-of-state vendors had agreed to collect such taxes<sup>17</sup>—to gauge the political hazards of attempting to forge a broader solution to the nexus problem.

But the alternative is clearly worse. If we confine our solution to electronic commerce, we violate one of the basic tenets of good tax policy—to which virtually all parties concerned with state taxation of electronic commerce adhere—namely, that there should be competitive equality between similarly situated economic actors. This means that those who provide goods or services in electronic commerce should be taxed no differently from those who provide goods or services in conventional commerce. As one "white paper" devoted to state and local taxation of on-line services declared, "businesses that provide services over the information highway . . . should not be subjected to different taxes from those that are imposed on businesses that provide competing services separate from the information highway . . . or from those imposed on the general business taxpayer."<sup>18</sup> Another such "white

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15. *Commissioner v. Duberstein*, 363 U.S. 278, 290 (1960).

16. See Carol Douglas, *Prospects Dim for Prompt Accord Between Direct Marketers and States*, in 13 *STATE TAX NOTES* 1235 (1997).

17. See David Cay Johnston, *Angry Customers Hinder Mail Order Tax Accord*, N.Y. TIMES, Nov. 7, 1997, at D1.

18. Information Highway State and Local Tax Study Group, *Supporting the Information Highway: A Framework for State and Local Taxation of Telecommunications and Information*

paper" also observed that "[i]ntangible products sold and delivered over the Internet should be treated the same way for tax purposes as products purchased off-line in the tangible world."<sup>19</sup>

Establishing one nexus regime for electronic commerce while maintaining another, more taxpayer-friendly regime for mail-order sellers involved in traditional commerce would fly in the face of these precepts. Thus, if a billing-address nexus regime were established for electronic commerce, but traditional mail-order sales continued to be governed by the bright-line, physical presence rule of *Quill*, there would be a tax-induced incentive to make traditional mail-order purchases rather than purchases using the Internet. There is no justification for tilting the playing field in that fashion, and any solution to the electronic commerce tax problem should be designed to avoid such competitive inequalities.

### B. *Pyramiding*

In theory, a retail sales tax, like those in force in forty-five states and the District of Columbia,<sup>20</sup> is a single-stage levy imposed on the final sale of goods or services to the consumer.<sup>21</sup> This essential feature of a retail sales tax is reflected in provisions that exclude intermediate transactions in the economic process from taxation. Such provisions are designed to avoid the pyramiding or double taxation that would result if both intermediate and final sales were subject to tax.

Every state, for example, excludes sales for resale from the retail sales tax base. Similarly, sales of ingredients or components of property produced for sale are typically excluded from the retail sales tax. Still other provisions reflect the broader view that costs of producing articles that will ultimately be sold should be excluded from the retail sales tax base, even though the costs cannot be tied directly to the purchase of the finished item or one of its component parts. Exclusions or exemptions for purchases of machinery and equipment used to produce tangible personal property for sale illustrates these sorts of provisions.

The pyramiding problem is particularly acute in the context of elec-

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*Services* (undated), reprinted in 9 STATE TAX NOTES 57, 61 (1995) [hereinafter SALT Study Group White Paper].

19. ITAA White Paper, *supra* note 12, at 10.

20. See 2 State Tax Guide (CCH) ¶ 60-100 (1997). Only Alaska, Delaware, Montana, New Hampshire, and Oregon fail to impose a general state sales and use tax. Currently, sales taxes are the most significant source of state tax revenue, yielding thirty-four percent of such revenue. See generally JOHN F. DUE & JOHN MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION (2d ed. 1994).

21. In this respect, the retail sales tax may be distinguished from a general sales or gross receipts tax, which is imposed on intermediate sales.



tronic commerce for two reasons. First, the states' separate taxation of related services (e.g., telecommunications, data processing, and information services) creates the risk that each separately-identified service will be taxed even if they are all part of a single economic process. Second, the sale-for-resale exemption is not as clearly refined with respect to the sale of services as it is with respect to the sale of tangible personal property. This is because states generally have less experience in taxing services and because services, by their very nature, are often more difficult to trace in space and in time than are items of tangible property. Consequently, while it is easy enough to follow steel used to manufacture a car from the foundry to the retail show room (and thus, to exempt it under a sale-for-resale exemption until the final sale of the car), it is difficult to follow the telecommunications service used to provide an information service purchased through an on-line service provider. Thus, courts are more likely to find the latter "consumed" rather than "resold" by the information or on-line service provider.

It is, therefore, understandable that many observers want lawmakers to address the pyramiding problem raised by the taxation of electronic commerce. The Information Technology Association of America urged that "[s]tate and local governments should take action to prevent double taxation."<sup>22</sup> Similarly, the Information Highway State and Local Tax Study Group—an ad hoc group of many of the nation's leading telecommunications, cable, and software companies—urged that "tax exemptions in the context of the sale of information highway services be designed and construed to ensure that only the final sale of a taxable information highway service can be subject to tax."<sup>23</sup>

The precise scope of this policy objective, however, is uncertain. Despite the theoretical premise that the retail sales tax is a single-stage levy on consumer expenditures, and despite the existence of statutory provisions that exclude intermediate purchases in the economic process from the retail sales tax, producers' purchases make up a healthy portion of most states' sales tax bases. Indeed, a nationwide study concluded that producers' share of the sales tax base averaged forty percent for forty-five states and the District of Columbia.<sup>24</sup> Typical taxable business purchases are those in which the business entity is deemed to be the ultimate consumer of the particular item purchased, even though the cost of the item will likely constitute a portion of the price of the product that the business sells. For example, transportation equipment, office furni-

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22. ITAA White Paper, *supra* note 12, at 12.

23. SALT Study Group White Paper, *supra* note 18, at 64.

24. See Raymond J. Ring, Jr., *The Proportion of Consumers' and Producers' Goods in the General Sales Tax*, 42 NAT'L TAX J. 167, 175 (1989).

ture, advertising catalogs, and supplies purchased by manufacturers and other businesses are usually taxable under state sales taxes. Yet, the cost of these items is likely to be reflected in the final cost of the products that the business sells. Consequently, these items are effectively subjected to a second tax, assuming the products sold by the business are taxable.

As noted above, the same problem exists in connection with electronic commerce. For example, if an on-line service provider purchases and pays tax on telecommunications services and, in turn, collects tax on the charges for the services it sells to its customers at a price that includes the value of the purchased telecommunications services, there will be double taxation in an economic sense. Yet, many state taxing regimes would treat the on-line service as the taxable consumer of the telecommunications service while imposing a tax on the full charge for the on-line service provider's services to its customer.

Accordingly, while avoiding double taxation of electronic commerce is a worthy and widely-shared objective, implementation of that objective, at least in the context of sales and use taxation, is complicated by the well-entrenched tradition of taxing many business inputs under state retail sales taxes. This once again raises the question as to the appropriate scope of the solution to the electronic commerce tax problem.<sup>25</sup> If eliminating taxation of business inputs makes sense for sales and use taxation for electronic commerce, which it plainly does, why does it not make equal sense for other forms of commerce?

The answer, once again, is that it does make sense, but that the political difficulties of achieving this broad objective—by a “radical restructuring of the sales tax itself” so that “all inputs and sales for resale [w]ould be exempt from sales taxation”<sup>26</sup>—may be greater than achieving it with respect to electronic commerce alone. Nevertheless, as suggested above, the alternative to the more sweeping reform may be worse than accomplishing the desired result through half-measures addressed solely to electronic commerce.

A separate solution to the pyramiding problem in the domain of electronic commerce would undermine the goal of achieving competitive equality between electronic commerce and conventional commerce. If only electronic commerce enjoyed a regime in which all business inputs were exempt from sales and use taxation, electronic commerce transactions would be favored over competing transactions in conventional commerce. There is no more justification for favoring electronic

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25. As in the case of nexus.

26. Matthew N. Murray, *Telecommunication Services and Electronic Commerce: Will Technology Break the Back of the Sales Tax?*, 12 STATE TAX NOTES 273, 279 (1997).

commerce over other forms of commerce than there is for subjecting it to more onerous tax burdens than those imposed on other forms of commerce.

### C. *Concluding Thoughts on the "Scope of the Solution" Issue*

The simple but important conclusion that emerges from this discussion is that the solution to the electronic commerce problem has implications extending far beyond electronic commerce alone. This raises the fundamental question whether, in seeking to solve the electronic commerce problem, we should also seek to resolve analogous problems raised by other forms of commerce, or whether we should keep our attention narrowly focused on the electronic commerce problem.

To some extent, we have no choice. We *must* deal with some of the problems that are closely related to electronic commerce in order not to make matters worse. For example, it would be ludicrous to create a nexus regime for electronic commerce that did not apply equally to mail-order sellers when they are engaged in economically-equivalent transactions. There simply is no reason to favor one form of commerce over another. Similarly, there is no good reason for providing more favorable resale exemptions for electronic commerce than for competing forms of economic activity.

The broader question, however, is whether we should stop there. Why not, as Charles McLure has suggested, use the electronic commerce issue as an opportunity to fix the sales tax generally?<sup>27</sup> In effect, the electronic commerce problem provides us with an opportunity to engage in a "radical restructuring of the sales tax itself."<sup>28</sup> There is much to be said for capitalizing on the intense interest in the electronic commerce problem as a vehicle for bringing greater rationality to the overall sales tax structure. Nevertheless, I believe that we must be cautious in pushing the "radical restructuring" agenda too far. While we do have an opportunity to achieve real changes in the sales and use tax that necessarily will extend beyond electronic commerce, it is important that we keep our finger on the pulse of political reality so that we do not end up sacrificing the opportunity for real reform on the altar of a utopian solution to problems raised by the sales tax as we know it today.

## III. STRUCTURING A SOLUTION TO THE ELECTRONIC COMMERCE PROBLEM

Any meaningful solution to the problems raised by state taxation of

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27. See Charles E. McLure, Jr., *Electronic Commerce and the Tax Assignment Problem: Preserving Sovereignty in a Digital World*, 14 STATE TAX NOTES 1169 (1998).

28. Murray, *supra* note 26, at 279.

electronic commerce must address the central questions of who is subject to tax (or tax collection responsibilities) and where the tax base is subject to tax. In addition, any such solution will be viable only if it is administrable, which means that uniformity and simplicity will be essential features of a sound tax regime for electronic commerce. This section of the paper considers how such a regime might be structured, and it addresses some of the issues that implementation of such a regime is likely to raise.

### A. *Nexus and Situsing Principles*

Any statutory solution<sup>29</sup> to the problems raised by state taxation of electronic commerce must tackle the nexus issue if it is going to be of much practical benefit to the industry and the states. The nexus issue is second to none in the consternation it has created in discussions of state taxation of electronic commerce and in its unsuitability to resolution under existing legal criteria. Moreover, without a solution to the nexus issue, sensible solutions to other critical issues (e.g., apportioning income and situsing sales) will be difficult, if not impossible. For example, it makes little sense to assign the sales, use, or income tax base to a state where the taxpayer is not taxable,<sup>30</sup> or to assign the sales or use tax base to a state in which the vendor cannot be required to collect the tax.<sup>31</sup>

As suggested above, traditional approaches to the nexus question appear doomed to failure in the context of taxation of electronic commerce. To ask about the "location" of electronic commerce—whether that location is defined in terms of physical contacts (e.g., the presence

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29. Because a statutory solution along the lines suggested below may not be entirely consistent with existing constitutional restraints on state taxation, *see* *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), or, in some instances, with the states' own constitutional limitations on state taxation, and because uniformity is not likely to be achieved without congressional legislation, I am assuming that the legislative proposals discussed below would be implemented by congressional legislation. The question of Congress' power to enact such legislation is considered in Part IV, *infra*.

30. I use the term "taxable" in the same way it is used in the Uniform Division of Income for Tax Purposes Act, which provides: "[A] taxpayer is taxable in another state if . . . that state has jurisdiction to subject the taxpayer to . . . tax regardless of whether, in fact, the state does or does not." 7A U.L.A. 331, § 3 (West Supp. 1997) [hereinafter UDITPA].

31. To be sure, when this problem does arise, a "throwback" or "throwaround" rule can provide a default regime for situsing sales as an antidote to this problem. *See infra* notes 37-43 and accompanying text. But, it is hardly desirable from the standpoint of policy or practice to design a system where the default rule plays a significant role. Insofar as it is possible, one ought to design the attribution rules appropriately in the first place, without having to resort to a default rule that effectively changes the normal attribution rule, in order to assure that the tax base is available for taxation by some jurisdiction. *See* Walter Hellerstein, *Construing the Uniform Division of Income for Tax Purposes Act: Reflections on the Illinois Supreme Court's Reading of the "Throwback" Rule*, 45 U. CHI. L. REV. 768 (1978).

of computer servers or leased telecommunications lines) or nonphysical contacts (e.g., the deemed presence of intangibles or electromagnetic impulses)—is to ask a question that is not worth answering. The reason is two-fold.

First, the location of those tangible or intangible contacts often will bear little relationship to the location of the essential economic activity that electronic commerce comprises—the production and consumption of information. Second, even if the location of those tangible and intangible contacts were relevant to the location of electronic commerce, the location of those contacts can be changed so easily (without affecting the underlying transaction in electronic commerce) that efforts to prevent tax avoidance by creative tax planning are likely to be futile. If the server's presence is relevant, Oregon (a state with no sales tax) will soon become the server capital of the world; if the presence of the electronic impulse is relevant, those impulses will be routed through nontaxable paths (assuming one can even trace the paths through which they are routed).

What we need instead is a fresh approach that essentially “reverse engineers” the nexus issue. The first question ought to be what kind of taxing regime will allow participants in electronic commerce to pay and collect taxes in an administratively feasible fashion to those states with a legitimate claim to the tax revenues. Once we answer that question, we can build our nexus rules (and also our tax sourcing or situsing rules) around such a regime.

#### 1. BILLING-ADDRESS NEXUS AND SITUSING REGIME

With regard to sales and use taxes imposed on transactions in electronic commerce, we need a regime in which vendors can be certain about their tax collection obligations and can comply with them at reasonable administrative costs. One way of achieving these objectives would be by establishing nexus over the out-of-state vendor in the state of the purchaser, defined by reference to the purchaser's billing address or other locational information furnished to the vendor by the purchaser (e.g., the area code and local exchange from which the purchaser accessed the seller's Web site).<sup>32</sup> The vendor who obtained such information in good faith would be able to rely on it in remitting the tax to the purchaser's state.<sup>33</sup>

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32. A wireless industry group has proposed that state sales and other transaction taxes imposed on mobile telecommunications be limited to charges that are billed to customers whose primary use of the mobile telecommunications services is within the taxing state. *Proposal for Uniform Sourcing for Mobile Telecommunications Taxes*, reprinted in 13 STATE TAX NOTES 717 (1997).

33. The statute implementing such a regime might read something like this:

The use of the purchaser's billing address (or some other convention for determining the purchaser's location) as establishing the state of the sale's situs (along with a nexus rule that creates jurisdiction over the out-of-state vendor in that state) is consistent with the underlying theory of a sales tax as a tax on personal consumption. Thus, Charles McLure has observed that "[s]tate sales taxes are, in principle, levied on a destination basis"<sup>34</sup> and that destination-based sales taxation has strong conceptual appeal as a matter of both equity and efficiency.<sup>35</sup> Analyzing the question of where electronic commerce transactions should be taxed under a sales tax, William Fox and Matthew Murray likewise conclude that "a destination tax should be adopted to the maximum extent possible to obtain neutral treatment of services delivered from different locations."<sup>36</sup>

## 2. DEFAULT SITUSING PRINCIPLE: "THROWBACK" AND "THROWAROUND" RULES

To deal with cases in which the vendor is unable to determine the purchaser's billing address, a regime that uses the customer's billing address as the primary nexus and situsing rule might include a sales tax version of the familiar income tax "throwback" rule.<sup>37</sup> Under the "throwback" rule embodied in the Uniform Division of Income for Tax Purposes Act,<sup>38</sup> sales of tangible personal property, which are normally assigned to the destination state in the sales factor of the tax apportionment formula, are "thrown back" to the state of origin when the taxpayer is not taxable in the destination state. In the sales tax context, the statute might provide for a "throwback" of the sale to the state of origin when the vendor was unable by reasonable and good faith efforts to determine

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Every vendor who makes a taxable sale of electronically transmitted information or services to a purchaser in this state shall collect from the purchaser the sales or use tax imposed by [here refer to the state's sales and use tax] on the sale or use of such information or services and shall remit the tax to this state. A purchaser is "in this state" if his billing address is in this state, and if his billing address can be determined by reasonable and good faith efforts.

34. McLure, *supra* note 27, at 1174.

35. *See id.* McLure notes that the benefits of public expenditures are more closely related to household consumption than to production, so that the destination rule (assigning the tax base to the consumer's location) is fair and creates responsible government. *See id.* He also notes that origin-based taxes distort the location of economic activity, unless they are levied at uniform rates. *See id.*

36. William F. Fox & Matthew N. Murray, *The Sales Tax and Electronic Commerce: So What's New?*, 50 NAT'L TAX J. 573, 575 (1997).

37. *See* UDITPA, *supra* note 30, § 16.

38. *See id.*

the purchaser's billing address.<sup>39</sup>

As an alternative to the "throwback" rule, the statute might provide for a "throwaround" rule that effectively distributes sales to unidentifiable purchasers to states where the vendor makes sales to identifiable purchasers. The "throwaround" rule serves the same function as the "throwback" rule, but, rather than assigning the tax base to the single state from which the sales are made or in which the taxpayer's principal place of business is located,<sup>40</sup> it spreads the tax base around all of the states in which the vendor makes taxable sales of electronically-transmitted information or services.<sup>41</sup>

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39. Cf. Jerome R. Hellerstein, *The Quill Case: What the States Can Do to Undo the Effects of the Decision*, 4 STATE TAX NOTES 273-74 (1993). Hellerstein states that:

To plug up the mail-order house and other out-of-state loopholes in use tax collection, I suggest that the states modify their statutes by adding a sales tax throwback provision with respect to sales of property that is delivered to the purchaser in another state, in the event that the state is not empowered under the Supreme Court's decisions to require the vendor to collect that state's use tax and no sales or use tax is in fact paid to the destination state. Under the proposed throwback rule, the sales tax would be imposed by the state only if the purchased property is shipped from an office, store, warehouse, factory, or other place of storage within the state.

Such a provision might read as follows:

If, after making reasonable and good faith efforts to determine the purchaser's billing address, the vendor of electronically-transmitted information or services is unable to determine such address, or, if such a billing address does not exist, the vendor shall collect from the purchaser any sales or use tax that may be imposed by this state on the sale or use of such information or services, if the vendor's principal place of business is in this state.

In the context of sales and use taxation of electronic commerce, a rule more consistent with the traditional throwback concept might throw the sale back to the state from which the vendor electronically transmitted such services. Such a rule, however, can be easily manipulated because of the ease with which the origin of electronic transmissions can be arranged. Moreover, once we deviate from the place of consumption (or a proxy therefor, such as billing address) in a sales tax regime, practical rather than theoretical considerations should play a greater role in the evaluation of our second-best solution. On the other hand, one might object to a throwback to the state of the taxpayer's principal place of business on the ground that the state of the taxpayer's principal place of business might have no connection with the transaction, arguably rendering the throwback unconstitutional. For these reasons, the use of a traditional throwback rule might be more appropriate.

40. See *supra* note 39 and accompanying text.

41. Such a rule might read as follows:

If, after making reasonable and good faith efforts to determine the purchaser's billing address, the vendor of electronically transmitted information or services is unable to determine such address, or if such a billing address does not exist, the vendor shall collect from the purchaser a sales tax equal to the average sales tax rate that the vendor collected on all sales of electronically-transmitted information or services during the preceding calendar year. The tax so collected during any calendar year shall be paid to the states in the same proportion that the vendor's sales and use taxes on electronically-transmitted information or services were paid to the states during the preceding calendar year.

The “throwaround” rule is admittedly a novel concept, which could be criticized on a number of grounds, including the establishment of an “arbitrary” tax rate for the sales and the assumption that all sales are *taxed* rather than merely *taxable*.<sup>42</sup> The principal virtue of the rule is that, by comparison to the throwback rule, the “throwaround rule” results in a more equitable distribution of sales tax revenues than a rule that assigns such revenues to a single state. If the “default” mechanism of a throwback or throwaround rule is to play a significant role in a sales and use tax regime directed at electronic commerce, due to the difficulty in many cases of identifying the billing address of the purchaser, it may make sense at least to think about the possibility of spreading the tax base among the states in which the electronic information or services of the taxpayer are generally “consumed” rather than assigning them to a single state that does not correspond to the state in which the taxpayer’s information or services are consumed. The throwaround rule is also a practical solution to a difficult administrative problem<sup>43</sup>—a solution that assumes that sales with unknown destinations occur in the same pattern as sales with known destinations. Moreover, on that assumption, it reflects the constitutional principle that sales must occur within the taxing state to be taxable.

### 3. COLLECTION OF TAX BY VENDOR FROM PURCHASER

It is important to recognize one assumption that underlies the proposed statutory regime described above. Regardless of the payment mechanism—be it check, credit card, debit card, prepaid cash card (e.g., “Visacash”), or even electronic cash—it is assumed that the vendor would add the appropriate tax to the purchaser’s bill and remit that

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42. Under the traditional “throwback” concept, income (or, in our case, sales) is “thrown back” to the state of origin only when the vendor is not *taxable* in the purchaser’s state (*see* UDITPA, *supra* note 30, § 16), or, in the sales tax context, when the purchaser’s state cannot be determined. *See supra* note 39 and accompanying text. It is the inability of the destination state to tax—rather than its decision to forbear from exercising its taxing power—that justifies the “throwback.” If a taxpayer is taxable in the taxing state, even if the taxing state does not exercise its power to tax, there is no “throwback.” The “throwaround” rule, however, effectively assumes that all sales into states where the purchaser cannot be identified are taxable, even though a portion of such sales are presumably destined for one of the five states that does not impose a sales tax. *See supra* note 20 and accompanying text. While using the average sales tax rate that the vendor collected on *all* sales of electronically-transmitted information or services during the preceding calendar year (*see supra* text accompanying note 41) mitigates the problem by taking account of the identifiable sales to non-tax states (which would be included at a zero rate), the rule is still vulnerable to the charge that it is imposing a tax on some sales that the destination state chose not to tax.

43. *Cf. Goldberg v. Sweet*, 488 U.S. 252, 264-65 (1989) (recognizing, in the context of sales taxation of telecommunications, that the question of fair apportionment “is essentially a practical inquiry” and approving the tax regime there at issue because it represented “a realistic legislative solution to the technology of the present-day telecommunications industry”).



amount to the appropriate jurisdiction.<sup>44</sup>

#### 4. SEPARATE TREATMENT OF SALES TO REGISTERED BUSINESSES

One important variation on the foregoing statutory structure, which was suggested in the first report of the Drafting Committee of the National Tax Association's Communications and Electronic Commerce Tax Project (hereinafter the "NTA Drafting Committee"),<sup>45</sup> could contribute significantly to the administrability and enforceability of a sales and use tax regime redesigned to deal with the problems created by electronic commerce transactions. Essentially, the NTA Drafting Committee proposed to bifurcate sales of electronically-transmitted information or services into two categories—sales for personal consumption (or to unregistered businesses) and sales to registered businesses. The NTA Drafting Committee also created different situsing rules for each category.<sup>46</sup>

The justification for adopting a separate rule for sales to registered businesses is that business purchases might otherwise be subject to manipulation by arrangements designed to ensure that the situs of the sale would be in a state not taxing the sale of electronically-transmitted information or services. In addition, business purchases, unlike purchases for personal consumption, are more likely to be for multiple points of use, a circumstance that may require the application of an apportionment mechanism for assigning the sales tax base in an equitable and economically neutral manner. Finally, and most importantly, registered business purchasers are already obligated and prepared to self-report and self-assess sales and use taxes to the taxing states on their existing sales. By extending this concept to sales of electronically-transmitted information and services, the rule would permit self-reporting and self-assessment for registered business purchasers. This would avoid considerable complexity in the reporting and payment obligations of the retailer who will not necessarily have access to all information necessary to situs sales properly.<sup>47</sup> The NTA Drafting Committee's suggestion that the situs of sales of electronically-transmitted information or serv-

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44. Although a purchaser could refuse to pay the tax, that is no different from a purchaser refusing to pay a tax today on a bill for a shipment of tangible personal property from a vendor with nexus in the state. It does not seem to raise any problems peculiar to electronic commerce.

45. See NTA ELECTRONIC COMMERCE REPORT, *supra* note 1.

46. It is important to note that this was just one of several proposals offered by the NTA Drafting Committee and that all of its proposals were advanced as preliminary suggestions that would be subject to further discussion and modification.

47. The NTA Drafting Committee's statutory proposal read, in pertinent part, as follows:

A sale of electronically transmitted information or services to a person the retailer knows to be registered under [*refer to the state's sales and use tax statute*] is presumed to be in this state, if this state falls within the following categories.

ices to registered businesses be determined on the basis of physical points of use<sup>48</sup> (and apportioned by reference to the relative number of points of use) is analogous to the California Franchise Tax Board's proposal of a sourcing mechanism for receipts from electronic information services based on "connection points" within a state.<sup>49</sup>

##### 5. EVALUATION OF BILLING-ADDRESS NEXUS AND SITUSING REGIME

The proposed nexus and situsing rules have some obvious virtues. First, they are simple. The vendor need know only the purchaser's billing address to determine the scope of its tax obligations. If a separate rule for sales to registered businesses were adopted, the vendor would be relieved of any tax collection obligation with respect to such sales. Second, the rules protect the vendor as long as it makes reasonable efforts<sup>50</sup> to ascertain the purchaser's billing address. Third, the rules protect the sales tax base (at least viewed from a national perspective) in the event that the vendor cannot determine the purchaser's billing address, assuming that the statute incorporated the "throwback" or "throwaround" rule.

These proposed nexus and situsing rules, however, have weaknesses, as well as strengths. First, it may be quite difficult for the vendor to obtain the purchaser's billing address (or other locational data), where the default regime using the "throwback" or "throwaround" con-

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(1) The sale is made to a single point of use, or multiple points of use all of which are, in this state; or

(2) The sale is made to multiple points of use both within and without this state, but only in the proportion that the number of points of use in this state bears a relationship to the total number of points of use.

NTA ELECTRONIC COMMERCE REPORT, *supra* note 1, at 1265.

48. At least for sales to registered business purchasers.

49. See California Franchise Tax Board, § 25137-13. Telecommunications, Subscription Television, Internet Access, and Electronic Information Services—Apportionment of Income (Aug. 20, 1997) (unpublished discussion draft on file with author). Under the draft, gross receipts from providing information services or Internet access services are attributable to the state under a series of rules which are based principally on whether the taxpayer has a physical presence in the state along with a "connection point" (i.e., the physical location of a customer at which a transmission of information originates or terminates). When information is simultaneously received at a number of locations, the regulation apportions the tax base among the states according to the percentage of connection points within the state compared to the total number of connection points. The regulation also has default rules if the taxpayer is not physically present in any of the states in which its customer's connection points are located (namely, the state of the customer's billing address or, if the taxpayer is not physically present in the state of the customer's billing address, the state in which the taxpayer incurs its costs-of-performance).

50. The statute would presumably provide what efforts would be required. For example, it might require that, where the billing address was not provided with the purchase, the vendor must make a reasonable inquiry to determine the purchaser's billing address. It might also require the vendor to condition the purchase of electronic services by credit card or e-cash upon the purchaser's furnishing its billing address (or some other proxy for its location—e.g., its area code and local exchange).

cept would be the rule rather than the exception, at least for sales other than to registered businesses. Under those circumstances, the sales and use tax, which ought to be a levy on consumption,<sup>51</sup> and thus a tax imposed at the destination state where consumption is ordinarily deemed to occur, ends up more closely resembling an origin-based tax than a destination-based tax.<sup>52</sup> The scope of this problem, however, may be substantially reduced if financial intermediaries can be enlisted to assist in identifying purchasers' billing addresses—an issue considered separately below.

Second, the rules may be vulnerable to manipulation. For example, purchasers might establish billing addresses in states without sales taxes<sup>53</sup> (although a separate rule for registered businesses along the lines suggested above would tend to reduce this problem). Third, one may object to the concept of a "throwback" or "throwaround" rule, especially

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51. At least in terms of the retail sales tax theory. *See supra* note 21 and accompanying text (defining retail sales tax). *But see supra* note 24 and accompanying text (providing that producers' purchases make up a significant portion of most states' sales tax).

52. *But see supra* note 39 (suggesting that a second-best default regime should be evaluated more on practical than on theoretical grounds).

53. While this may be a possibility in some cases, certainly for many individual purchasers, the transaction costs of establishing a tax-haven billing address will outweigh the tax savings of doing so. For larger purchasers, the establishment of a tax-haven billing address may be more problematic, but it is no different in principle from the problems states face when, for example, corporations take delivery of corporate aircraft in states without sales taxes. The solution to the problem in the context of sales of tangible personal property suggests an analogous solution to the problem in the context of electronic commerce, namely, the use tax. When the corporation uses the aircraft delivered in a state with a retail sales tax, it pays a use tax to the state identical to the sales tax it would have paid if the aircraft had originally been purchased in the state. *See* 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶ 18.04[2] (2d ed. 1993) (discussing corporate aircraft cases).

The same result should occur with respect to the use of information or services purchased in electronic commerce. If a corporation with an Oregon "billing address" purchases electronically-transmitted information or services that it uses in states that tax such information or services, the corporation will owe a use tax to the state in which the information or services are used. Such liability would presumably be established on audit in the same way that liability is established in traditional sales and use tax audits—by review of the taxpayer's records to ascertain if any purchases have been made on which sales or use tax was due but not paid. *See* DUE & MIKESSELL, *supra* note 20, at 223.

As Due and Mikesell observe:

Business firms frequently make out-of-state purchases of equipment, supplies, and other taxable items tax free and fail to pay use tax, or purchase such goods in-state under exemption certificate and fail to account for tax themselves. One of the principal audit checks is to determine failure to pay tax on these purchases . . . . [F]requently purchase invoices are checked to see whether tax was applied by the supplier. Even where the rest of the audit is done by sample, these large-ticket-price accounts may be audited in detail. Examination of income tax returns aids in revealing purchases on which tax should have been paid. Many states report that this activity constitutes a large portion of audit work.

*Id.*

in the sales tax context, as changing tax attribution rules “in the middle of the stream” for reasons that cannot be justified by the underlying purposes of a retail sales tax.<sup>54</sup>

Whatever the shortcomings of the foregoing provisions, they may nevertheless serve as a useful focus for further discussion of legislative solutions to nexus and situsing issues raised by sales and use taxation of electronic commerce.

B. *The Scope of the Unidentifiable Purchaser Problem: Enlisting Financial Intermediaries in the Effort to Identify Purchasers' Billing Addresses*

One of the critical issues raised by the proposal of a billing-address-based nexus and situsing regime<sup>55</sup> is the ability to identify the purchaser's billing address. In some instances, of course, vendors will have (or be able to require purchasers to furnish) billing information (e.g., in an on-line purchase of a book from Amazon.com). But this will not be true for many Internet sales “due to security concerns about credit card information and the fact that often the seller has no idea who the purchaser is.”<sup>56</sup> In some transactions, financial intermediaries such as Cybercash provide encrypted codes for Internet sales to avoid the risk of unwanted disclosure of a purchaser's credit card information.<sup>57</sup> Since the Internet seller never sees the credit card number and may not know the identity of the purchaser, it may contend that it cannot obtain such information through “reasonable and good faith efforts.”<sup>58</sup>

To be sure, insofar as it is impossible to identify the purchaser's billing address, one may adopt a default situsing mechanism (such as the “throwback” or “throwaround” rules described above)<sup>59</sup> that eliminates the problem of “nowhere” sales. Nevertheless, if we knew at the outset that the percentage of sales to unidentifiable purchasers would be substantial, we might hesitate before adopting a billing-address nexus and situsing regime, because the “exception” (the default principle) would swallow the “rule” and leave us with an unsatisfactory distribution of sales tax revenues.<sup>60</sup>

To the best of my knowledge, there is currently no empirical estimate as to the magnitude of this problem. Whatever its magnitude, how-

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54. See Hellerstein, *supra* note 31, at 778-79.

55. See *supra* Part III.A.

56. R. Scot Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. ENT. L.J. 603, 643 (1996).

57. See *id.*

58. See *supra* note 39 and accompanying text.

59. See *supra* text accompanying notes 37-43, and *supra* Part III.A.2.

60. See *supra* note 31 and accompanying text.

ever, the scope of the problem would be substantially reduced if third-party financial intermediaries could be enlisted to help identify purchasers' billing addresses. Indeed, the paradigmatic electronic commerce transaction that vendors typically describe to illustrate their inability to identify their purchasers' billing addresses is the credit card purchase of electronically-transmitted information.

This raises two additional questions. First, do third-party financial intermediaries possess the information which, if made available to remote vendors, would allow such remote vendors to comply with a billing-address situsing regime? Second, if so, would it be reasonable to impose on financial intermediaries the obligation to provide such information to remote vendors?

The answer to the first question appears to be "yes." After all, the financial institutions that send us our monthly credit card bills know our addresses. Otherwise they would not stay in business very long. Indeed, even the financial services industry, which has vigorously opposed any suggestion that it should be required to provide customer address information to vendors in connection with credit card transactions, does not deny that it possesses the relevant information.<sup>61</sup> Rather, its opposition is based on its response to the second question posed above, namely, whether it "would . . . be reasonable to impose on financial intermediaries the obligation to provide such information to remote vendors."<sup>62</sup>

But, there are many who do not share that view. For example, the United States Communications Association ("USCA"), a trade association of the nation's long-distance and local telecommunications companies, takes the position that the involvement of financial intermediaries in implementing a billing-address situsing regime is both reasonable and necessary:<sup>63</sup>

It appears to the USCA that the financial intermediary is the only party to the transaction that possesses necessary information to make this proposed regime work—the billing address (i.e., the state) of the purchaser. As part of the approval process for every charge by a vendor to the credit card of a purchaser, the vendor is provided with confirmation that the credit card has not been reported lost or stolen, there is adequate credit available to cover the purchase price, and an

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61. See Comments on Behalf of the Financial Institutions State Tax Coalition on the National Tax Association Communications and Electronic Commerce Tax Project and Report No. 1 of the Drafting Committee (Dec. 25, 1997) (on file with author) [hereinafter FIST Coalition Comments].

62. *Id.* See also *infra* notes 71-75 and accompanying text for an elaboration of these views.

63. Comments on Behalf of the U.S. Communications Association on Report No. 1 of the Drafting Committee of the National Tax Association Communications and Electronic Commerce Tax Project 4-5 (Dec. 24, 1997) (on file with author) [hereinafter USCA Comments].

approval code reflecting the first two items. USCA believes it is essential to this regime that financial intermediaries provide the vendor, in addition to the approval code, a two digit code reflecting the Billing Address (i.e., the state) of the purchaser. Clearly with a data base providing such current data as the lost/stolen status and available credit balance, the additional information . . . relating to the state where billing occurs can be included in the data base.<sup>64</sup>

Other observers espouse similar sentiments.<sup>65</sup>

Even those who support the enlistment of financial intermediaries in the implementation of a billing-address regime recognize that it will impose "some incremental burden on financial intermediaries."<sup>66</sup> They view such a burden as neither unreasonable nor unusual. Thus, "the USCA believes it is not unreasonable to expect parties to such transactions to provide information necessary to effect not only the transaction but also to effect the collection of taxes on the transaction."<sup>67</sup> Using the telecommunications industry as an example of an industry that has implemented many burdensome changes in its billing systems to accommodate changes in technology, the USCA observes:

Originating information on each and every one of hundreds of millions of telephone calls is transmitted every day to and from local exchange companies to long distance companies on calling card transactions, 800 calls and 900 calls, from local exchange companies to cellular and PCS providers, and from pay phone providers to long distance providers. These are just a few of the many, many requirements for originating information being provided from one telecommunications company to another to facilitate the proper billing of charges and taxes on telecommunications services.<sup>68</sup>

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64. *Id.* at 4. The USCA further observes that "[s]imilarly, with cybercash, the cybercash provider is the only party to the transaction that, one way or another, knows where the actual cash is coming from. Whether paid directly by check or by a credit card, the cybercash provider will have some state level information that can be used in determining Billing Address." *Id.*

65. See Grierson, *supra* note 56, at 643. Grierson suggests that:

To obtain billing address information in an Internet transaction (and for information services using other types of telecommunications), the state could impose a duty on the seller to acquire the billing address information through the third-party intermediary. Third-party intermediaries are in a perfect position to obtain billing address information without compromising security because the credit card number is never divulged.

*Id.* at 643. To facilitate this process, Congress or state legislatures might need to enact laws requiring credit card companies and other financial intermediaries to honor the vendor's request for billing address information. Additionally, the law would need to restrict the use of such information fulfilling legitimate tax collection obligations in order to protect the purchaser's privacy interests.

66. USCA Comments, *supra* note 63, at 5.

67. *Id.*

68. *Id.*

Similarly, while sellers may balk at this type of requirement as being "administratively cumbersome because it requires them to coordinate tax collection with the billing intermediary,"<sup>69</sup> such arrangements are not uncommon:

The typical 900 number service, for example, uses the telephone company as a third-party billing intermediary, just as Internet sellers will use Cybercash. The telephone company bills the 900 service customer by including the charge in the phone bill. Under such a requirement, the seller would contract with the intermediary for collection of the charge, the intermediary would determine the state according to billing address, and the appropriate sales tax would be collected, passed on to the seller, and remitted by the seller to the state.<sup>70</sup>

It is important to note that when third-party intermediaries (such as telephone companies) perform billing functions for remote vendors, they ordinarily receive compensation for such services.<sup>71</sup> This suggests that, if the burdensome reporting requirements are going to be imposed on financial intermediaries, they should be reimbursed for the costs of undertaking that task.

This is one of the many points the financial services industry raises in opposition to requiring financial intermediaries to provide billing address information to remote vendors as part of the credit card authorization process.<sup>72</sup> It also points out that financial intermediaries cannot currently provide billing address information without the purchaser's permission due to legal privacy and fraud prevention concerns.<sup>73</sup> But these legal restraints could be removed by legislation and would presumably include appropriate safeguards for those providing the information.

The more fundamental concern of the financial services industry is plainly the cost involved in implementing systems changes that would be necessary to provide the requisite billing information. Despite the

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69. Grierson, *supra* note 56, at 643.

70. *Id.*

71. See, e.g., Connecticut Department of Revenue, July 2, 1991, *reprinted in* 2 CONN. ST. TAX REP. (CCH) ¶ 360-421 (describing typical 900-number service and noting that, in a typical 900-number service, the telephone company deducts from the amount otherwise due the vendor of the 900-number service a charge for the service of collecting the 900-number service provider's fee). Opinion of the Tax Commissioner, No. TC 90-0008, Nov. 27, 1990, *reprinted in* OHIO ST. TAX REP. (CCH) ¶ 401-004 [1991-92 Transfer Binder] (same).

72. See FIST Coalition Comments, *supra* note 61; Financial Institution State Tax Coalition, Extent of "Anonymous" Electronic Commerce (EC) Transactions & Role of 3rd Party Intermediaries (undated), submitted to Meeting of Steering Committee of National Tax Association's Communications and Electronic Commerce Tax Project (Feb. 4, 1998) (on file with author) [hereinafter FIST Coalition Supplemental Comments].

73. See FIST Coalition Comments, *supra* note 61, at 3; see FIST Coalition Supplemental Comments, *supra* note 72.

industry's initial unconditional opposition to any suggestion along these lines,<sup>74</sup> it more recently articulated a more flexible response,<sup>75</sup> but urged that any consideration of drafting third-party financial intermediaries into the process of providing billing address information to remote vendors must address the following concerns:

(1) systems would need to have the capacity to report billing addresses for any potential transaction, even though only a small portion of authorized transactions would need the information from the third party intermediary;

(2) serious consideration would have to be given to simplified reporting requirements (*e.g.*, two-digit state code or five-digit zip code as distinguished from full address);

(3) information would have to be provided without materially slowing down the authorization process;

(4) the systems would have to be sufficiently flexible to deal with emerging products (*e.g.*, cybercash);

(5) any discussion of merchant's discount (*i.e.*, reimbursement for sales tax collection) should include means for reimbursing the third party intermediaries for additional systems costs;

(6) customer concerns and legal requirements regarding privacy would need to be addressed;

(7) other parties would need to be involved in the process (such as the Master Card/VISA organizations as well as the American Bankers Association).<sup>76</sup>

In the end, the possibility of enlisting third-party financial intermediaries to implement a billing-address situs regime for state sales taxation of electronic commerce (and other remote sellers) appears to offer a promising solution to the problem of identifying the billing address of purchasers who may be unidentifiable under current practices. It is true, of course, that the full ramifications of implementing such a system have yet to be explored. We clearly need additional information regarding the magnitude of the unidentifiable purchaser problem as well as the cost to the financial services industry of providing billing addresses. Nevertheless, the cooperation of financial intermediaries could go a long way toward resolving one of the key issues raised by adopting a billing-address regime.

### C. *Uniformity, Simplicity, and Administrability*

As a matter of principle, there is widespread consensus among interested (and disinterested) observers that any viable solution to the

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74. See FIST Coalition Comments, *supra* note 61.

75. See FIST Coalition Supplemental Comments, *supra* note 72.

76. *Id.*



problem of state taxation of electronic commerce will need to be uniform, simple, and administrable. As one of the numerous "white papers" devoted to state and local taxation of electronic commerce noted:

No matter how perfectly a taxing system may comport with other requirements of tax policy, if a tax is difficult to understand, if compliance burdens are excessive, and if the costs of administering the tax are unreasonable, the tax will fail to serve its basic function as an effective raiser of revenue.<sup>77</sup>

The Interactive Services Association and the Information Technology Association of America, in their "white papers" on taxation of electronic commerce, stress the goal of uniformity, asserting that "if states do impose taxes on Internet and online services, they should adopt uniform definitions among the states"<sup>78</sup> and that "[w]hatever standards are applied should be done uniformly from state to state and from taxpayer to taxpayer."<sup>79</sup> Yet another "white paper" on electronic commerce similarly declares that if electronic commerce is going to be taxed, such taxes should be "clear and consistent" so that "taxpayers can comply with the rules and take them into account for purposes of business decisions."<sup>80</sup> State tax organizations, no less than business groups, fully embrace the "goal[ ] of . . . administrative ease and efficiency"<sup>81</sup> in taxation of electronic commerce.

The goals of uniformity, simplicity, and administrability are obviously overlapping and reinforcing, since a uniform system is likely to be simple and administrable; a simple system is likely to be uniform and administrable; and an administrable system is likely to be uniform and simple. Moreover, these goals are by no means limited to electronic commerce. Many of the suggestions for increased uniformity, simplicity, and administrability apply broadly to sales and use taxation and, indeed, may be essential to the survival of the retail sales tax in an increasingly service and information-oriented economy characterized by the mobility of factors of production.<sup>82</sup>

The critical questions are how these homilies can be translated into specific, concrete proposals that will achieve the widely accepted goals of uniformity, simplicity, and administrability, and how achievement of

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77. SALT Study Group White Paper, *supra* note 18, at 61.

78. ISA White Paper, *supra* note 13, at 221 (emphasis in original omitted).

79. ITAA White Paper, *supra* note 12, at 10.

80. Karl A. Frieden & Michael E. Porter, *The Taxation of Cyberspace: State Tax Issues Related to the Internet and Electronic Commerce*, 11 STATE TAX NOTES 1363, 1396 (1996).

81. Multistate Tax Commission, *Statement of Direction on Electronic Commerce Issues 2* (Jan. 17, 1997), available in <<http://www.mtc.gov/policy/97-4.htm>> (visited Mar. 3, 1998).

82. See generally NATIONAL LEAGUE OF CITIES ET AL., *IS THE NEW GLOBAL ECONOMY LEAVING STATE-LOCAL TAX STRUCTURES BEHIND?* (1998); McLure, *supra* note 27.

these goals can be squared with traditional notions of state and local sovereignty. The initial report of the Drafting Committee of the National Tax Association's Communications and Electronic Commerce Tax Project,<sup>83</sup> as well as the comments that were submitted by both business and government groups in connection with that project,<sup>84</sup> have advanced a number of specific proposals to implement these goals.

### 1. UNIFORM DEFINITIONS

One specific proposal that commands broad support is the adoption of uniform definitions of taxable and exempt items in the sales tax base. The current system is characterized by a maze of overlapping and inconsistent definitions of similar or identical products and services from state to state (and, in some cases, from locality to locality). For the vendor selling its products in more than one state, the lack of uniformity in the delineation of the tax base creates an administrative and compliance nightmare.

Business groups take the position that "[a]bsolute uniformity is required among the states regarding the definition of relevant terms and concepts."<sup>85</sup> Government groups "recognize that uniformity in sales tax bases would make many other issues of complexity disappear"<sup>86</sup> and that "it would be desirable . . . to work toward a system in which key elements of the tax base are *defined* uniformly from state to state, with the policy makers in each state choosing to tax or not to tax a given category at their discretion."<sup>87</sup> These government groups are somewhat skeptical, however, about the possibility of achieving complete uniformity. Consequently, they express uncertainty as to the source of such definitions.<sup>88</sup>

The existence of uniform definitions is central to any effort at sales

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83. See NTA ELECTRONIC COMMERCE REPORT, *supra* note 1.

84. See NTA Business Group's Suggested Simplification Measures for Sales and Use Taxes (Dec. 10, 1997) (submitted in connection with the National Tax Association's Communications and Electronic Commerce Tax Project), available in <<http://www.cob.asu.edu/nta>> [hereinafter *Business Groups' Simplification Suggestions*]; Government Members of Steering Committee, NTA Communications and Electronic Commerce Tax Project, Preliminary Statement of Direction, Achieving Simplification and Uniformity in State and Local Sales and Use Tax Administration (Jan. 14, 1998) (submitted in connection with the National Tax Association's Communications and Electronic Commerce Tax Project), available in <<http://www.cob.asu.edu/nta>> [hereinafter *Government Members' Simplification Suggestions*]; Memorandum, Business Groups' Discussion Outline for the Feb. 4th Meeting (Jan. 23, 1998) (on file with author) [hereinafter *Business Groups' Supplemental Simplification Suggestions*].

85. *Business Groups' Simplification Suggestions*, *supra* note 84, at 1. See also *Business Groups' Supplemental Simplification Suggestions*, *supra* note 84, at 2.

86. *Government Members' Simplification Suggestions*, *supra* note 84, at 3.

87. *Id.* (emphasis in original).

88. See *id.* at 3-4.

tax simplification, and there exists substantial agreement between business and government interests on the desirability of achieving definitional uniformity. Therefore, there is every reason to believe that substantial progress can be made to achieve such uniformity, which could lay the foundation for progress in other areas. There are a number of possible sources for the uniform definitions (e.g., the U.S. Department of Commerce classifications or the U.S. Department of Treasury classifications used in administering Customs rules). Moreover, the key elements of uniformity—namely, uniformity in definitions—can be achieved without seriously infringing on state sovereignty about *what* to tax:

Perhaps one cannot expect the states to yield sovereignty over the choice of the tax base, that is to adopt a uniform sales tax base. But there is no principled reason they should not adopt a uniform set of *definitions* that would be used in establishing their tax bases. If, for example, there were a detailed and uniform set of definitions of products that might be either taxed or exempted, each state could then choose whether or not to tax each product . . . . Knowing that what they sell is defined the same way in all states, vendors would need only to know whether each of their products is taxed in each of the states where they make sales. The rules for how each state taxes each product—essentially yes or no—could relatively easily be built into software programs.<sup>89</sup>

In short, the adoption of uniform definitions in the sales tax base would substantially ease compliance and administrative burdens for those engaged in electronic commerce (and in other activities) in more than one state.

## 2. UNIFORM ADMINISTRATIVE PROCEDURES

Although not as intellectually tantalizing as some of the issues one confronts in connection with state taxation of electronic commerce (and state sales taxation generally), the adoption of uniform and simplified administrative procedures is another significant issue that is inextricably intertwined with any workable solution to the electronic commerce problem. However, the substantive issues regarding sales and use taxation of electronic commerce are resolved, and particularly if current nexus rules are to be altered along the lines suggested above, there will need to be substantial simplification and increased uniformity in the administration of the sales tax to make compliance for remote sellers on a multistate basis both practical and acceptable.<sup>90</sup>

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89. McLure, *supra* note 27, at 1177 (emphasis in original).

90. The substance of the following discussion of uniform administrative procedures draws freely from the *NTA Electronic Commerce Report*, *supra* note 1, and is derived, in large part, from

### a. Taxpayer Registration

Currently, each seller with responsibility (or voluntarily accepting the responsibility) to collect sales tax on behalf of the state is required to register with the state to evidence the obligation and establish the appropriate accounts and files. This is accomplished by completion of a registration form with certain demographic information about the seller, its principal officers, and other operations in the state. This is done individually with each state, and increasingly involves registration with other appropriate agencies in the state (e.g., unemployment insurance agency, other tax agencies, and Secretary of State). Some states require the posting of a bond or other insurance to insure collection.

A system could be developed where a vendor could register in all states using one standard registration form containing the information required by each state (or supplemented for certain states if necessary). Alternatively, a system could be developed under which a seller could complete a single registration form that would be filed with a single entity which would, in turn, provide the required information to all other jurisdictions. This single entity could be a third-party agent or instrumentality<sup>91</sup> authorized to act on behalf of all states, or it could be a single state chosen by the seller (e.g., home state or base state).<sup>92</sup> Depending on the manner in which states ultimately choose to operate,

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conversations and negotiations between the states and direct marketers (as well as other remote sellers and taxpayers) about the areas of sales tax administration that create the greatest compliance burdens. The suggested options draw heavily on those sources, as well as discussions that have occurred within the Multistate Tax Commission (MTC) Sales Tax Simplification Advisory Committee.

91. The "third party agent" approach could be a new or existing state's instrumentality or a private entity under contract to the state. Issues regarding its activities and functions, however, need to be explored. For example, the single entity could perform the functions of a processor and distributor of information to the states which would, in turn, be responsible for all other aspects of administration. The current FedState electronic filing program resembles this approach, in which a federal and state individual income tax return can be filed through a single transmission to the IRS. Alternatively, the central entity could perform certain functions centrally on behalf of the participating states, much like the MTC multistate audit program. There are, of course, variations on this theme and other points along the continuum.

92. The "base state" approach could be modeled along the lines of the International Fuel Tax Agreement (IFTA) for the administration of motor fuel use taxes of interstate motor carriers among states. Under this agreement, the carrier registers with, and reports to, a single state (the base state) which, in turn, is responsible for distributing the proceeds among all other states in which the carrier has activity. The base state also audits the carrier and provides the other states with all other necessary information. States are in the process of establishing a central clearinghouse to act as a repository of certain information necessary to the administration of IFTA, but not to perform functions centrally on behalf of all states. New York State, for example, has developed and operates a Regional Processing Center (RPC) that furnishes IFTA tax return processing services to about eighteen jurisdictions (including at least two Canadian provinces). The RPC provides a range of services from receiving returns and processing return data to handling financial transactions. However, it does not conduct audits or delinquency control.

the registration information could be provided to all states or retained centrally.

b. Tax Returns and Remittances

Currently, each registered retailer is required to file a return individually with each state in which it is registered and to make remittances of the tax collected and due to each of those jurisdictions. Returns are commonly filed on a monthly basis and contain entries for gross sales, exempt sales, taxes due on consumed goods, net taxable sales, tax due, tax remitted, and other items. The returns (where appropriate) also contain a schedule highlighting local sales and use tax collected by the jurisdiction in which (or for which) it was collected. In most states, the majority of large retailers are required to make remittances by Electronic Funds Transfer (EFT). In most cases, remittances are required monthly, but may be required more frequently in certain instances. Sometimes, remittances must include an estimate for part of the current month and a reconciliation for the prior month. Several states have established electronic sales tax filing programs for both returns and remittances; however, with a couple of exceptions, participation is not currently widespread.

A system could be developed under which a uniform or standard tax return and remittance form would be used in each state. This approach could also include uniformity or standardization of the tax return due dates and the like. Alternatively, as with registration forms, a system could be developed under which a seller could complete a single return and remittance that would be filed with a single entity which would, in turn, provide the required information to all other jurisdictions.<sup>93</sup>

c. Taxpayer Audits

Currently, taxpayers are subject to audit in each state in which they are registered to determine whether the appropriate amount of tax has been collected and remitted. Methods of audit selection and audit techniques vary among the states. Taxpayers' primary concern with the audit process is that they are subject to audit by multiple states, which is a time-consuming and burdensome process.

A system could be adopted that requires states to cooperate in the audit process and limit the number of audits to an individual seller within any tax period. The limit could be one audit per period or some

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93. If the system called for a uniform due date, only a single return (with information for all states) would be required. If differing due dates were allowed, all returns could still be filed with a single entity.

other number. The joint audits could be conducted by a single state on behalf of all states, a group of states on behalf of all, or a third party on behalf of all states.<sup>94</sup>

#### d. Collection Allowances

Currently, about one-half of the sales tax states allow retailers, who make timely returns and remittances, to retain a portion of the tax collected as partial compensation for the costs of collection. These allowances are generally expressed in percentage terms (usually less than two percent), and are often capped at a certain dollar amount to benefit small retailers. As noted above,<sup>95</sup> the "collection allowance" should be expanded to include consideration of reimbursing third-party financial intermediaries if they are required to incur substantial costs in furnishing taxpayer identification information.

#### e. Exemption Certificates

Beyond exempting various goods and services from the sales tax, states also exempt certain types of entities from tax on certain purchases they make. Generally, sellers must retain some documentation received from the buyer indicating a tax exempt purchase was made and the reason for the tax exemption. There is some variety in the types of documentation required, and the sheer handling of multiple exemption forms from multiple states creates a burden for sellers. This burden could be reduced by developing uniform procedures for documenting exempt transactions of this nature and establishing uniform standards for acceptance and retention of the documentation.

### 3. *DE MINIMIS* RULES

Implementing any sensible tax regime for electronic commerce would be facilitated by adopting *de minimis* safe harbor rules to protect small vendors and to assure that the compliance costs do not exceed the tax revenues at stake. Indeed, for the small enterprise making relatively modest sales into a number of states, the compliance burden of determining the billing addresses of its customers could be overwhelming. Accordingly, the obligation of a vendor to determine its customer's billing address might be limited to vendors making more than, say,

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94. The Multistate Tax Commission (MTC) currently operates a joint audit program with approximately twenty-five states for both sales/use tax and corporation income tax. Among the participating states, the MTC routinely audits ten to fifteen of them in accordance with the laws of that state. The MTC auditor takes it to the point at which a recommended assessment/refund is made. At that point, the audit process is turned over to individual states for a final assessment/refund determination and handling of any appeals.

95. See *supra* note 70 and accompanying text.

\$250,000 of sales. At the same time, to avoid revenue losses, one could require small vendors to remit all taxes collected to the state from which the electronic transmission originated or to the taxpayer's principal place of business under a default situsing rule.<sup>96</sup>

#### 4. LOCAL TAXES

One of the most important—and most controversial—challenges to uniformity, simplicity, and administrability in state sales tax systems as applied to electronic commerce (as well as to other activities) is the local taxation problem. As the Supreme Court noted in *Quill*, while there may be only forty-five states with sales taxes, there are more than 6,000 state and local jurisdictions with such taxes.<sup>97</sup> Any meaningful solution to sales and use taxation of electronic commerce cannot ignore the more than ninety-nine percent of the jurisdictions with power to impose such taxes.

The business community is adamant in its view that there must be complete uniformity between state and local taxes in both base and rate.<sup>98</sup> The states, while sympathetic to the business community's desire for a "one rate per state" approach, nevertheless believe that the possibility of maintaining diverse rates at reasonable administrative costs should be explored in light of developments in technology and tax compliance software, particularly since the "one rate per state" approach could be thwarted by state constitutional requirements.<sup>99</sup>

Notwithstanding the states' misgivings, it is difficult to escape from the conclusion that such powers must be severely curtailed, if not altogether prohibited, in any workable tax regime applied to electronic commerce, in light of the extraordinary compliance burdens that independent local base- or rate-making rules introduce into the existing sales tax structure.<sup>100</sup> Congressional bills introduced to provide for state taxation of mail-order sales have already embraced this principle.<sup>101</sup> Whatever

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96. See *supra* notes 37-43 and accompanying text. A statutory provision implementing such a default regime might read as follows:

Any vendor whose gross receipts from the sale of electronically-transmitted information or services during the preceding calendar year did not exceed \$\_\_\_\_\_ may elect to treat all of its sales for the succeeding calendar year as if they were made to a purchaser in the state of the vendor's principal place of business.

97. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.6 (1992).

98. See *Business Groups' Simplification Suggestions*, *supra* note 84; *Business Groups' Supplemental Simplification Suggestions*, *supra* note 84.

99. *Government Members' Simplification Suggestions*, *supra* note 84, at 3.

100. See McLure, *supra* note 27, at 1177-80.

101. See, e.g., Consumer and Main Street Protection Act of 1997, S. 1586, 105th Cong., 2d Sess. (Jan. 29, 1998). Under the bill, Congress removes *Quill's* Commerce Clause bar on requiring vendors without physical presence in the state to collect sales and use taxes, and it authorizes the states to require a vendor who is subject to the state's personal jurisdiction under

state constitutional objections might be raised to such provisions are likely to be either unsuccessful or short-lived.<sup>102</sup>

#### IV. FEDERAL CONSTITUTIONAL CONSIDERATIONS

Any effort to design legislation establishing uniform rules for state taxation of electronic commerce must consider the constitutional concerns that such legislation might raise. The states, of course, are restricted by the Commerce and Due Process clauses in exercising their taxing power over interstate commerce and out-of-state taxpayers. While some of the statutory provisions set forth above might pass muster under existing constitutional restraints, others plainly would not. For example, the sales and use tax provision creating a tax collection responsibility for an out-of-state vendor of electronically-transmitted information or services based on the existence of a purchaser with an in-state billing address would, at least in some applications, clearly be unconstitutional under *Quill*.<sup>103</sup> More fundamentally, if one of the principal purposes of creating a uniform taxing statute is to establish clarity and certainty in an area currently beset by confusion and doubt, the last thing

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the Due Process Clause to collect state *and local* taxes if, among other things, such local taxes are "uniform." See *id.* § 3. Sales taxes imposed by local jurisdictions are "uniform" if:

- (A) such local taxes are imposed at the same rate and on identical transactions in all geographic areas of the State, and
- (B) such local sales taxes imposed on sales by out-of-State persons are collected and administered by the State.

*Id.* § 4.

102. There is no question that Congress has broad authority to prescribe the rules under which the states (and their political subdivisions) may tax interstate commerce. See Part IV *infra*. The question here is whether Congress, having authorized the states (and localities) to tax interstate commerce in a particular way, can empower the states to override their own internal legal or constitutional restraints. Presently, Congress may do so when it acts in a prohibitory mode. For example, Congress can prevent the states from taxing railroad property more onerously than other commercial and industrial property in the state, even if the state's own constitution provides that railroad property (along with other utility property) is to be assessed at a higher percentage of fair market value than other commercial and industrial property. See Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. § 14502 (1996). On the other hand, if Congress authorizes the states to impose sales taxes on interstate commerce only if there is a single "blended" state tax rate, but the state for some reason lacks the internal constitutional authority to require a combination of state and local rates, one might maintain that the state would not have authority to tax interstate commerce under state law. In the unlikely event that a court would so hold, the fiscal and political pressures on the state to amend its constitution to capture revenues from interstate commerce would be such that any such limitation on state taxing powers is likely to be temporary. Indeed, to deal with this problem, Congress could postpone the effective date of the statute to allow states to amend their laws or constitutions, if necessary, to conform to the requirements of the federal statute. This is precisely what Congress did in enacting section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976, postponing the effective date of the provision prohibiting discrimination against railroad property for three years to permit states to amend their laws to conform to the federal nondiscrimination principle.

103. 504 U.S. 298 (1992).



we need is a statutory regime that will trigger significant constitutional controversy. For that reason, the wiser course in attempting to implement any significant restructuring of the present pattern of state taxation of electronic commerce is to seek congressional approval.

The remaining question is whether congressional action in this domain—whether through consent to legislation requiring states to develop on their own initiative or by affirmative federal legislation that is thrust upon unwilling states—can resolve the Commerce and Due Process clause difficulties.

The answer to half of this question is easy. Congress possesses ample power to remove any Commerce Clause impediment to legislation of the type described above.<sup>104</sup> Thus, Congress may consent to state legislation affecting interstate commerce that would be unconstitutional under the so-called “dormant” Commerce Clause in the absence of such consent, and it may preempt state legislation that would be constitutional under the clause in the absence of such preemption. Because it has plenary power over the channels of interstate commerce, “Congress may keep the way open, confine it broadly or closely, or close it entirely,”<sup>105</sup> subject only to the restrictions placed upon congressional authority by other constitutional provisions. Since the legislation under consideration indisputably has a substantial effect on interstate commerce, there can be no serious question of any Commerce Clause bar to such legislation, if Congress either consents to it or affirmatively enacts it.<sup>106</sup>

The answer to the other half of the question is more difficult. That question is whether congressional consent to (or enactment of) legislation of the type described above would eliminate any due process objections to such legislation or its application. The question must be answered in two parts. First, would the foregoing draft legislation authorize violations of the Due Process Clause and, if so, does Congress have the power to eliminate the due process bar?

The answer to the first part of the question depends on whether a state would have the “definite link” or “minimum connection” that the Due Process Clause requires “between a state and the person, property or transaction it seeks to tax.”<sup>107</sup> As noted above, the Court in *Quill* construed this requirement to remove any condition that the “link” or “connection” be physical: “The requirements of due process are met

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104. See *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 434 (1946) (sustaining a state tax that allegedly discriminated against interstate commerce because Congress had consented to such legislation).

105. *Id.*

106. Cf. *Quill*, 504 U.S. at 318 (“Congress is . . . free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”).

107. *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-45 (1954).

irrespective of a corporation's lack of physical presence in the taxing State."<sup>108</sup> What is required is that the out-of-state taxpayer "purposefully direct" its activities towards residents of the taxing state.<sup>109</sup> Whether a billing-address nexus standard would satisfy this criterion is open to question and might require resolution on a case-by-case basis.

The answer to the second part of the question is likewise subject to debate. The Court in dicta has declared that "while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce . . . , it does not similarly have the power to authorize violations of the Due Process Clause."<sup>110</sup> Nevertheless, one can credibly argue that Congress has power to consent to violations of the Due Process Clause as long as they are not restraints by which Congress itself is bound.<sup>111</sup> Under this theory, Congress can authorize what would otherwise be federalism-based violations of the Due Process Clause, but not due process violations of individual rights.

In the end, it seems unlikely that the U.S. Supreme Court would hold that the framers of the Constitution and the Fourteenth Amendment left the nation powerless, short of a constitutional amendment, to legislate an administratively workable solution to the problem of state taxation of electronic commerce, despite the joint exercise by Congress and the states of their respective powers under the Constitution.<sup>112</sup>

108. *Quill*, 504 U.S. at 308.

109. *See id.*

110. *Id.* at 305. *See also id.* at 318; *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 350 n.14 (1982) (O'Connor, J., dissenting).

111. *See* William Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 *STAN. L. REV.* 387, 388-89 (1983) (discussing confusion over Congress' scope of authority over state laws); *see also generally* William Cohen, *Congressional Power to Interpret Due Process and Equal Protection*, 27 *STAN. L. REV.* 603 (1975).

112. As Professor Donald Regan, an eminent constitutional scholar, has put it:

The crucial question then becomes: Can Congress overturn Supreme Court decisions invalidating state laws on grounds of extra-territoriality? It is an understatement to say there is no settled doctrine on this question. Nonetheless, I would confidently expect the Court to hold that Congress can overturn most, if not all, such decisions, precisely because extra-territoriality is more a matter of federalism than of fundamental fairness.

Letter from Donald H. Regan to Chairman Peter W. Rodino, Jr., U.S. House of Representatives, regarding the "Constitutionality of H.R. 3521 and Similar Bills Authorizing States to Require Tax Collection by Mail-Order Sellers," in *Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 Before the Subcomm. on Monopolies and Commercial Law of the House Judiciary Comm.*, 100th Cong., 2d Sess. 708 (1989); *see also* Jerome R. Hellerstein, *Significant Sales and Use Tax Developments During the Past Half Century*, 39 *VAND. L. REV.* 961, 986-92 (1986).