

No. 06-

IN THE
Supreme Court of the United States

LANCO, INC.,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

**On Petition for a Writ of Certiorari to the
Supreme Court of New Jersey**

PETITION FOR A WRIT OF CERTIORARI

WALTER DELLINGER
ROBERT A. RIZZI
PETER J. RUBIN
O'MELVENY & MYERS
1625 Eye Street, NW
Washington, DC 20006
(202) 383-5300

BETH S. BRINKMANN
Counsel of Record
MORRISON & FOERSTER LLP
2000 Pennsylvania Avenue, NW
Washington, DC 20006
(202) 887-1500

PAUL H. FRANKEL
HOLLIS L. HYANS
AMY F. NOGID
MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, NY 10104
(212) 468-8000

Counsel for Petitioner

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QUESTION PRESENTED

Whether the Supreme Court of New Jersey erred when it concluded – expressly acknowledging a split among the States on the question – that the Commerce Clause of Art. I, § 8, permits a State to impose an income tax on an out-of-state corporation that has no physical presence in the taxing State.

RULE 29.6 STATEMENT

Petitioner Lanco, Inc. was a wholly owned subsidiary of Limited Brands, Inc., a publicly-held company, during the fiscal year ending January 31, 1998, the tax period involved in this dispute. Petitioner was sold on August 16, 2001, to Venice Acquisition Corporation, a subsidiary of Charming Shoppes, Inc., a publicly-held company, after which it became a subsidiary of Charming Shoppes, Inc.; Limited Brands, Inc., however, agreed to indemnify the purchaser for liabilities related to pre-closing tax periods. Petitioner was merged into another subsidiary of Charming Shoppes, Inc., on April 29, 2005.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully seeks this Court's review of the judgment of the Supreme Court of New Jersey.

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (Petition Appendix ("App.") 1a-3a) is reported at 908 A.2d 176. The decision of the Appellate Division of the Superior Court of New Jersey (App. 4a-20a) is reported at 879 A.2d 1234. The decision of the New Jersey Tax Court (App. 21a-42a) is reported at 21 N.J. Tax 200.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on October 12, 2006 (App. 1a). On December 22, 2006, Justice Souter extended the time for filing this Petition to and including February 9, 2007. On January 26, 2007, Justice Souter again extended the time for filing this Petition to and including March 9, 2007. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The relevant New Jersey statutory and regulatory provisions are set forth at App. 43a - 50a.

INTRODUCTION

This Petition presents the question whether the Commerce Clause permits States to impose income and franchise taxes on an out-of-state entity with no in-state physical presence. This is a question of enormous practical importance on which the States are squarely in conflict.

Forty years ago in its seminal decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 754 (1967), this Court confirmed the longstanding rule that a State imposes an unconstitutional burden on interstate commerce when it attempts to force tax collection and remittance responsibilities on an out-of-state entity that lacks any “physical presence in the taxing State.” *Quill Corp. v. North Dakota*, 504 U.S. 298, 314 (1992). Subsequently, in 1977, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court adopted a general test for dormant Commerce Clause challenges to the exercise of state taxing power, deciding in relevant part that, in the absence of congressional action, the Commerce Clause permits taxation of out-of-state businesses only where, *inter alia*, the tax “is applied to an activity with a substantial nexus with the taxing State.” *Id.* at 279. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied this test in the context of sales and use taxes and reaffirmed *Bellas Hess*, holding that an out-of-state corporation has a “substantial nexus” with the State for purposes of such taxes only where the corporation has a “physical presence” in the taxing State. *Id.* at 314.¹

Consistent with the decisions of this Court, “courts traditionally have regarded a corporation’s physical presence in a state as necessary to establish jurisdiction to subject that corporation to income taxation in the state.” J. Hellerstein & W. Hellerstein, *State and Local Taxation* 386 (8th ed. 2005).

¹ The phrase “physical presence” as it is used in both *Quill* and this Petition is a term of art including not only maintenance of an office, ownership of real property, or maintenance of employees in-state, but also the conduct of certain “activities performed in . . . state on behalf of the taxpayer,” for example, the solicitation of orders for sales by independent contractors. See *Tyler Pipe Indus. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987) (internal quotation marks and citation omitted); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Quill*, 504 U.S. at 306 (cataloguing the cases and explaining that “all involved some sort of physical presence within the state”).

Indeed, while both *Bellas Hess* and *Quill* involved state sales and use taxes, neither before *Complete Auto* nor after has this Court ever upheld the imposition of *any* state tax on an out-of-state entity in the absence of some physical presence in the taxing State. This makes sense: This Court has made clear that the relevant question in distinguishing tax statutes for purposes of Commerce Clause analysis is whether they have the same effect. “[D]ifferently denominated tax[es]” that operate in the same way will be treated identically. *Quill*, 504 U.S. at 310; *see Complete Auto*, 430 U.S. at 284 (noting that a gross receipts tax can be reworded as a franchise tax on intangible property in the form of “going concern” value, but that there would be “no real economic difference between the statutes”). In the forty years since *Bellas Hess*, Congress – which “has the final say over regulation of interstate commerce[] and . . . can change the rule of *Bellas Hess* simply by saying so,” *Quill*, 504 U.S. at 320 (Scalia, J. concurring in part and concurring in the judgment) – has never acted to eliminate or modify the physical-presence rule. Indeed, Congress has repeatedly rejected attempts to permit the States broader authority to tax out-of-state entities that engage in interstate commerce. *See, e.g.*, S. 2152, 109th Cong. (2005), S. 2153, 109th Cong. (2005), S. 1736, 108th Cong. (2003), H.R. 3184, 108th Cong. (2003).

Nonetheless, at about the time *Quill* was decided, the taxing authorities in a number of States seeking new ways to obtain revenue from out-of-state taxpayers began imposing corporate income and franchise taxes on out-of-state businesses whose sole contact with the State was sales to in-state customers. States have tried to tax any business operating anywhere in the nation, pursuing music publishers because their songs are available on the radio to in-state listeners; cable TV producers because their programs are available to in-state viewers; and licensors of computer software because

their intangible products are being “used” in a State.² State courts have increasingly sanctioned the unprecedented imposition of such income and franchise taxes. To avoid the force of *Bellas Hess* and *Quill*, these courts have held that physical presence is required *only* for the imposition of sales and use taxes, and not for income, franchise, and other types of business operation taxes. App. 3a.

The first case ever to hold that “the taxpayer need not have a tangible, physical presence in a state for income to be taxable there” was *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E. 2d 13, 18 (S.C. 1993). The *Geoffrey* case generated “an enormous outpouring of commentary.” See Hellerstein and Hellerstein, *supra*, at 394. It also led to a direct conflict in authority among the States about the permissible scope under the Commerce Clause of state authority to tax out-of-state corporations engaged in interstate commerce. In several States, courts have retained the traditional physical presence rule under the Commerce Clause. See *infra* at 9-12. In other States, the courts – including now the New Jersey Supreme Court below – have followed *Geof-*

² See, e.g., 2006 Survey of State Tax Departments, (BNA). Vol. 13, No. 4 at S-20-21 (April 28, 2006), available at <http://www.bna.com/states/statesurvey/2006survey.pdf> (last visited March 5, 2007) (24 States and the District of Columbia indicated that they would assert nexus over a company for purposes of income taxes if the company licenses standard software for use in their jurisdiction); Multistate Tax Commission, Model Statute, Factor Presence Nexus Standard for Activity Taxes (Oct. 17, 2002), available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf (last visited March 5, 2007) (nexus established if sales threshold exceeded, includes sales of intangible and digital products); *Business Activity Tax Simplification Act of 2003: Hearing Before the Subcomm. on Commercial & Administrative Law of The House Comm. on the Judiciary*, 108th Cong., 2d Sess., at 65 (2004) (Rep. Meeke) (“some states have alleged that income-based taxes are due from media corporations simply because they broadcast programs into the state”); *id.* at 88-89 (statement of Bo Home and Kathy Horne, owners of a home-based software development company).

frey's lead and have allowed the imposition of income and franchise taxes even absent a physical presence within the State. *See infra* at 12-15.

There is now a clear and irreconcilable division of authority on this important question. The result is an untenable patchwork of standards, in which some state taxing authorities are permitted to tax out-of-state entities that lack physical presence and others are not, and in which no corporation can predict whether and where its commercial activities will subject it to state taxation. The scope of the States' authority to tax beyond their borders is an issue of fundamental importance to virtually every business involved in interstate or international commerce. It is of particular significance to that critically important sector of the economy that engages in commerce over the internet. These new tax assessments violate settled expectations upon which large segments of the American economy have relied in development and long-term planning, and they directly burden and disrupt the free flow of interstate commerce that the Commerce Clause exists to protect. That disruption will necessarily intensify until this Court clarifies and confirms the application of the longstanding physical presence rule to all state taxes. Certiorari should be granted.

STATEMENT OF THE CASE³

1. Petitioner Lanco, Inc. ("Petitioner" or "Lanco"), was at all times relevant to this litigation a Delaware corporation that owned trademarks, tradenames and service marks ("intellectual property") which it licensed to Lane Bryant, Inc. ("Lane Bryant"), a corporation engaged in the retail sale of women's clothing and accessories, for Lane Bryant's use nationwide. Lane Bryant had stores in New Jersey, and used

³ All the facts recited in this Petition are taken from the stipulated factual record; no facts in this case were ever in dispute.

Lanco's intellectual property that it had licensed in connection with its operations of those stores. App. 6a, 53a.

Lanco had no New Jersey office and conducted all of its business, including all of its licensing activities, outside the State. *Id.* 53a-54a. Lanco had no employees or agents in the State and maintained no bank or other financial accounts in New Jersey. *Id.* 53a. Lanco held no interests in real or personal property located in New Jersey. *Id.* Lanco and Lane Bryant had a common ultimate parent company. As the decisions below specifically found, however, their affiliation was not relevant to the determination by Respondent that tax was owed and was therefore immaterial to the constitutional issue presented by that determination. *See Id.* 6a-7a; *see also infra* at 23 n.9. The parties stipulated that Lanco licensed its property to Lane Bryant at arms-length rates. *Id.* 53a.

Respondent, the Director of the New Jersey Division of Taxation, issued a notice to Lanco that asserted that Lanco was subject to New Jersey's Corporation Business Tax ("CBT"), N. J. Stat. Ann. § 54:10A-1, *et seq.* – which is denominated a "franchise tax" and which imposes a tax upon a portion of a corporation's "entire net income" – because of its receipt of royalties from Lane Bryant. Petitioner filed this action in the New Jersey Tax Court challenging the imposition of this New Jersey tax upon it.

The New Jersey Tax Court concluded that, because Petitioner had "no physical presence" in the State, it did not have a "substantial nexus" to New Jersey, and that imposition of the CBT in this case violated Commerce Clause limitations on the State's taxing authority. App. 21a-42a. The Tax Court rejected Respondent's argument that the Commerce Clause does not require physical presence when a state income tax is at issue, rather than a sales and use tax like the one at issue in *Quill*. The Tax Court explicitly noted the division of authority on this question, App. 32a-33a. Recognizing that "the precedents continue to require physical presence for nexus," the court concluded that if "physical pres-

ence is a constitutional necessity for one, it is illogical that it should not be for both.” App. 29a.

2. The Appellate Division of the Superior Court of New Jersey reversed. App. 4a-20a. The sole basis for imposing the tax on Lanco, the court explained, was “that Lanco derived receipts from sources in the State.” *Id.* 5a. “Thus,” the Appellate Division continued, “the critical issue is whether the taxpayer must have a physical presence in the state in order to constitute the required ‘substantial nexus’ necessary to satisfy the Commerce Clause under *Quill*.” *Id.* 6a.

The Court held that Petitioner need not have a physical presence in the State in order to be subject to the State’s income tax: “We agree with the Director that *Quill* does not apply to taxes other than sales and use taxes, and that the Corporation Business Income Tax may be constitutionally applied to impose a tax on plaintiff’s income from licensing fees attributable to New Jersey.” App. 11a (citation omitted); *see also id.* 20a (restating this holding).

Lanco sought review of the decision in the New Jersey Supreme Court, and the Division of Taxation did not oppose, agreeing that the “Appellate Division decision addresses a substantial question under the United States Constitution on which there is a divergence of precedent and that it is in the [Director’s] interest to have the question resolved.” *See* Certification of New Jersey Assistant Attorney General Patrick DeAlmeida in No. 58,542, *Lanco, Inc. v. Director, Division of Taxation* at 2, ¶18 (N.J. Filed Nov. 15, 2005).

3. The New Jersey Supreme Court affirmed “substantially for the reasons expressed in” the opinion of the Appellate Division. App. 2a. It wrote only to add explicitly that

Since the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court’s holding was limited to sales and use taxes. *See, e.g., A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 193-96 (N.C. Ct. App. 2004) (holding

North Carolina can impose corporate franchise and income taxes on companies not physically present in North Carolina), *certif. denied*, 359 N.C. 320, *cert. denied*, 126 S. Ct. 353 (2005); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 838-39 (Tenn. Ct. App. 1999) (holding Tennessee cannot impose franchise and excise tax on company not physically present in Tennessee), *cert. denied*, 531 U.S. 927 (2000).

We believe that the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes. . . . We therefore affirm the Appellate Division's determination that the Director constitutionally may apply the Corporation Business Tax notwithstanding a taxpayer's lack of a physical presence in New Jersey

App. 2a-3a.⁴

4. Because there is a division of authority about the important constitutional question involved in this case, this Petition followed.

⁴ The New Jersey Supreme Court ordered a remand upon which the New Jersey Tax Court entered judgment for Respondent. *See Lanco v. Tax Division*, No. 005329-1997, Consent Order and Judgment (N.J. Tax Ct. January 8, 2007). This limited remand does not affect the decision's finality for purposes of this Court's jurisdiction under 28 U.S.C. § 1257. *See Pope v. Atlantic Coast Line R.R. Co.*, 345 U.S. 379, 382 (1953).

REASONS FOR GRANTING THE PETITION

I. THE STATES ARE IN CONFLICT OVER THE APPLICABILITY OF THE *BELLAS HESS/QUILL* PHYSICAL PRESENCE REQUIREMENT TO INCOME AND FRANCHISE TAXES.

The States are divided on the question whether the Commerce Clause prohibits the imposition of income and franchise taxes upon out-of-state corporations with no in-state physical presence. With its decision below, the New Jersey Supreme Court has taken one side in this conflict about the meaning of the Constitution. This Court should act to resolve this division of authority.

A. Several State Supreme Court And Appellate Court Decisions Require Physical Presence For Income And Franchise Taxes.

The decision below squarely conflicts with the decision of the highest court of Tennessee and with the unchallenged decisions of appellate courts in other States. In *J.C. Penney National Bank v. Johnson*, the Tennessee Supreme Court upheld on its merits a decision that state taxing authorities could not impose upon out-of-state corporations with no in-state physical presence excise and franchise taxes on corporate earnings or profits. The Tennessee Court of Appeals held that no valid distinction can be drawn for Commerce Clause purposes between excise and franchise taxes and the sales and use taxes at issue in *Bellas Hess* and *Quill*:

The only real issue is whether there is any reason to distinguish the present case from *Bellas Hess* and *Quill*. The Commissioner argues that those cases are distinguishable because they involved use taxes, whereas the present case involves franchise and excise taxes. We must reject the Commissioner's argument. While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case. In fact, the Commissioner is

unable to provide any authority as to why the analysis should be different for franchise and excise taxes.

J.C. Penney, 19 S.W.3d at 839.

The Tennessee Supreme Court then issued an Order denying review and allowing the Court of Appeals decision to be published. See *J.C. Penney Nat'l Bank v. Johnson, Com'm'r of Revenue*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000) (per curiam). Denial of review by the Tennessee Supreme Court – unlike denial of certiorari by this Court – establishes agreement with the result below.⁵ Further, by allowing the Court of Appeals opinion to be published, the Tennessee Supreme Court gave it statewide precedential effect. As the Tennessee Supreme Court has explained, “the published opinions of the intermediate appellate courts are opinions which have precedential value and may be relied upon by the bench and bar of this state as representing the present state of the law with the same confidence and reliability as the published opinions of this Court, so long as either are not overruled or modified by subsequent decisions.” *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1993); see also Tenn. Code Ann. §16-4-113 (2007) (Tennessee Court of Appeals is a court of statewide jurisdiction). It is thus now settled law in Tennessee that taxes upon income are subject to the *Bellas Hess/Quill* physical-presence rule.

⁵ See, e.g., *State v. Cawood*, 134 S.W.3d 159, 164 n.6 (Tenn. 2004) (“when the Supreme Court denies a writ of certiorari, the Court takes jurisdiction and makes a final disposition of the case by approving the final decree of the intermediate court”); *Pairamore v. Pairamore*, 547 S.W.2d 545, 548-549 (Tenn. 1977) (“When we deny the writ, we . . . have made a final disposition of the case by approving the final decree of the Court of Appeals. . . . [D]enial of the writ necessarily puts the stamp of approval on the results reached in the final decree of the intermediate court. . .”).

Appellate courts in Michigan and Texas have also rejected attempts by their state revenue departments to impose taxes on the basis of receipts derived from in-state sources, holding that under this Court's decision in *Quill*, the Commerce Clause precludes a State from imposing franchise or income taxes on an entity that does not have a physical presence in the State.

The Michigan Court of Appeals rejected the State's effort to deviate from *Quill* in *Guardian Industries Corp. v. Department of Treasury*, 499 N.W.2d 349, 377 (Mich. Ct. App. 1993), *appeal denied*, 512 N.W.2d 846 (Mich. 1994). Michigan appellate decisions are binding precedent statewide. *See Tebo v. Havlik*, 343 N.W.2d 181, 185 (Mich. 2004); *Straman v. Lewis*, 559 N.W.2d 405, 406 (Mich. App. 1996). And, while the Michigan Supreme Court has not ruled on the issue, following the denial of review of the *Guardian* case by that court, the Michigan Department of Revenue announced that it would adhere to the physical presence standard. *See J.W. Hobbs Corp. v. Dep't of Treasury*, 706 N.W.2d 460, 463 (Mich. App. 2005). Because the State has accepted this decision, it no longer seeks to impose taxes on corporations that are not physically present, and there is no prospect of further state court judicial review of the question. In Michigan, then, the physical presence test is settled law.

In *Rylander v. Bandag Licensing Corp.*, the Texas Court of Appeals held that a franchise tax could not be imposed on a corporation that lacked physical presence in Texas and whose only connection with Texas was by way of interstate commerce. *See Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 298-300 (Tex. App. 2000), *review denied*, No. 00-0646 (Tex. January 11, 2001). In Texas, that appellate decision is binding precedent. *See Messina v. State*, 904 S.W.2d 178, 181 (Tex. 1995). The Texas decision in *Bandag* has been on the books and has governed taxation by the State for the past six years. The Texas Supreme Court de-

nied review in that case, has not taken it up in the years since, and, because of its discretionary docket, cannot be compelled to address the question. Corporations deciding whether to file tax returns in Texas thus rely on *Bandag*'s holding that the state's taxing power remains governed by the *Bellas Hess/Quill* physical presence rule with regard to all types of taxes.

In addition to these judicial rulings, a number of other States appear to have responded administratively to the movement among the States to tax out-of-state corporations that lack a physical presence in-state by making clear that they will not seek to exercise any such taxing authority. See 2006 Survey of State Tax Departments, (BNA). Vol. 13, No. 4 at S-20-21 (April 28, 2006), available at <http://www.bna.com/states/statesurvey/2006survey.pdf> (last visited March 5, 2007) (indicating that the tax authorities of Connecticut, Mississippi, Missouri, New York and Virginia also would not find a sufficient nexus to support imposition of an income-based tax where an out-of state company licensed trademarks for use in-state). These interpretations of the nexus requirement are effectively the settled law in these States, too, for as long as these interpretations remain in place there will be no judicial review of these positions because no taxes subject to challenge are imposed.

B. Other State Supreme Court And Appellate Court Decisions Reject a Physical Presence Requirement For Income And Franchise Taxes.

On the other side of the split, in addition to the Supreme Court of New Jersey below, the highest courts of South Carolina, West Virginia and Ohio have held that, despite *Quill* and *Bellas Hess*, States may impose income and franchise taxes upon out-of-state entities with no physical presence in the State. See *Tax Comm'r v. MBNA Am. Bank*, 640 S.E. 2d 226, 234 (W. Va. 2006); *Geoffrey*, 437 S.E.2d at 18; *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1230 (Ohio 1996), *cert. denied*, 519 U.S. 810 (1996); *see also*

Buehner Block Co. v. Wyo. Dep't of Revenue, 139 P.3d 1150, 1158 n.6 (Wyo. 2006) (stating that “*Bellas Hess* and *Quill* . . . created [a] specialized jurisprudence” applicable to “sales or use tax case[s]”).

The West Virginia Supreme Court’s recent decision in *MBNA* squarely addresses the issue presented here and – like the decision below – acknowledges the direct conflict in authority:

[T]he United States Supreme Court’s determination in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), that an entity’s physical presence in a state is required to meet the “substantial nexus” prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes. . . . Rather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes. . . . We reject the reasoning in *J.C. Penney*, and decline to apply it to the instant case.

MBNA, 640 S.E.2d at 234. In a microcosm of the broader conflict, the *MBNA* decision divided the West Virginia Supreme Court. A spirited dissent explained why the majority’s refusal to apply the physical-presence test to income and franchise taxes contradicts this Court’s Commerce Clause taxing power jurisprudence:

The reality is that the United States Supreme Court has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved. Rather, the . . . Court has focused instead on the effect of the tax which the taxing state seeks to levy on interstate commerce Indeed, there is no immediately clear doctrinal foundation which can be observed for distinguishing sales and use tax collection on sales between states from

income taxes sought to be collected from out-of-state companies for income realized from out-of-state intangible accounts simply because the out-of-state corporation availed itself of the United States mails and other forms of interstate communication.

640 S.E. 2d at 239 (Benjamin, J., dissenting).

Like the West Virginia Supreme Court, the Ohio Supreme Court has held that “the physical-presence requirement of *Quill* is not applicable” to state income taxation. *See Couchot*, 659 N.E.2d at 1230; *see also id.* at 1230-31 (physical presence test would “in any event have been satisfied” had it been applicable).

State appellate court decisions rendered in several other States have also held that the physical presence requirement for “substantial nexus” under the Commerce Clause applies only in cases involving sales and use taxes. *See Kmart Props., Inc. v. Taxation & Revenue Dep’t of N.M.*, 131 P.3d 27, 35 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22 (N.M. 2005); *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 194-195 (N.C. 2004), *certif. denied*, 611 S.E.2d 168 (N.C.), *cert. denied*, 126 S. Ct. 353 (2005); *Geoffrey, Inc. v. Oklahoma Tax Comm’n*, 132 P.3d 632, 638 (Okla. Civ. App. 2005); *Gen. Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1029 (Wash. App.), *pet. rev. denied en banc*, 84 P.3d 1230 (Wash. 2001), *cert. denied*, 535 U.S. 1056 (2002).

Finally, some other States have amended their statutes, promulgated regulations, or issued other directives that assert authority to tax corporations that lack a physical presence in the State, thereby restricting *Quill’s* physical presence requirement to sales and use taxes. *See, e.g.*, Ark. Reg. 1996-3 (licensing of intangibles in an intragroup intangible licensing transaction creates nexus); Fla. Admin. Code Ann. r. 12C-1.011 (p)1 (2007) (selling or licensing the use of intangibles creates nexus); Iowa Admin. Code r. 701.52.1(422), 52.1(1)d (2007) (citing *Geoffrey* and providing that licensing intangibles to corporations doing business in Iowa creates nexus);

Directive 96-2 (Mass. Dep't of Revenue July 3, 1996) (licensing of intangibles for use in Massachusetts creates nexus); Minn. Stat. § 290.015(1)(c)(3) (2005) (providing that business within Minnesota includes transactions with customers in the State that involve intangible property and results in receipts attributable to Minnesota); Okla. Admin. Code § 710:50-17-3(a)(9) (2005) (licensing of intangible rights for use in Oklahoma creates nexus); Wis. Admin. Code Tax § 2.82(4)9 (2007) (licensing of intangible rights for use in Wisconsin creates nexus).

C. Certiorari Should Be Granted Now To Resolve This Important Conflict.

The States are thus conclusively divided on the question presented; there is no prospect that the conflict will resolve itself absent this Court's intervention. Nor is there any reason to await further development of the conflict, for the split in authority concerning the Commerce Clause has already had serious adverse consequences for taxpayers and taxing authorities alike. Taxing officials in the various States have been held to have different scopes of taxing authority and out-of-state businesses with no physical presence within taxing States are subject to different taxing regimes.

Uncertainty inhibits business planning and investment and is extraordinarily costly from a fiscal and societal vantage point. Federal courts, of course, are generally barred by the Tax Injunction Act from adjudicating the constitutionality of state taxes. *See* 28 U. S. C. § 1341. Thus, absent this Court's review, this patchwork of state court decisions and state regulations construing the federal Constitution will continue – without any federal judicial guidance. If businesses – both domestic and foreign – that lack physical presence in a State need not pay state income and franchise taxes, those businesses should know that. And if state taxing authorities have the power to impose taxes in the absence of physical presence – particularly those who are not exercising that

power in the belief that *Quill* forbids it – those authorities should know that, too.

The need for clarity on this topic is especially pressing in light of new requirements of corporate transparency in accounting. The new Financial Accounting Standards Board Interpretation No. 48 (FIN 48), entitled Accounting for Uncertainty in Income Taxes, prescribes how a company must measure, and disclose in its financial statements, the tax positions that the company has taken, including decisions whether or not to file a return in particular jurisdictions.⁶ FIN 48 requires a company to measure and disclose whether it is “more likely than not” that each taxing authority will conclude (based on the position’s technical merits) whether the company is required to pay taxes in that State, without consideration of the likelihood that the taxing authority will examine the company’s position. Unless a company can show that the taxing authority would, more likely than not, sustain the company’s position that it need not file a return, “the company would be required to recognize a FIN 48 liability, interest, and, potentially, penalties” in its financial statements. Charles E. Berg, Practising Law Institute, Preparation of Annual Disclosure Documents 2007: PricewaterhouseCoopers Datalines Regarding Hot Button Accounting Issues, No. 2006-18 (Jan. 2007). If there is uncertainty about whether the State is correct or the taxpayer is correct, the taxpayer’s decision not to file a tax return “would prevent the statute of limitations from kicking in, and thus the FIN 48 liabilities [on its financial statement] would possibly never reverse, and interest would accrue [on the financial

⁶ This interpretation became effective for fiscal years beginning after Dec. 15, 2006, and public companies must abide by that interpretation in preparation of their financial statements filed with the Securities and Exchange Commission. See SEC, Codification of Financial Reporting Policies § 101, reprinted at 7 Fed. Sec. L. Rptr. (CCH) ¶72,921.

statement] in perpetuity.” *Id.* Uncertainty about the requirements of the law in this area thus could have profound consequences for the publicly reported financial health of a corporation, and for shareholder value, the ability to raise capital, and so on.

This issue also has implications even beyond our national borders. Under most of the more than fifty bilateral tax treaties to which the United States is a party, the United States has agreed to tax foreign corporations only if they have a “permanent establishment” in the United States, which is normally defined as a “fixed place of business through which the business of an enterprise is wholly or partly carried on.” The federal government’s support of the “permanent establishment” concept is most recently reflected in Article V of the Model Income Tax Convention of November 15, 2006, issued by the U.S. Department of Treasury, available at www.ustreas.gov/press/releases/reports/hp16801.pdf (last visited March 5, 2007), which the government uses as a basis for all tax treaty negotiations. These treaties are of particular concern here because they generally do not constrain the power of States and localities to impose taxes on foreign corporations. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-197 (1983); Jerome B. Libin & Timothy H. Gillis, *It’s a Small World After All: The Intersection of Tax Jurisdiction at International, National, and Subnational Levels*, 38 Ga. L. Rev. 197, 254-255 (2003). Consequently, if the decision below is permitted to stand, a foreign corporation without a “fixed place of business” in the United States may find itself subject to tax by States that reject a physical presence requirement, even though the foreign corporation would not be subject to federal income tax based on a bilateral treaty. New Jersey, in fact, has already begun circulating nexus surveys to foreign affiliates of domestic corporations. *See, e.g.*, State of New Jersey Nexus Survey (July 17, 2006), available at <http://www.ofii.org/njltr.pdf> (last visited March 5, 2007). This substantial risk of divergent treatment by federal and state tax authorities is contrary

to the important federal interest underlying U.S. tax treaties, which is to protect U.S. businesses from overly burdensome foreign taxation by ensuring that both the United States and its trading partners assert taxing authority on generally the same terms.

II. THE DECISION BELOW IS WRONG AND CONFLICTS BOTH WITH THIS COURT'S COMMERCE CLAUSE DECISIONS AND WITH THE PRINCIPLES OF FEDERALISM THEY REFLECT.

A. This Court's Commerce Clause Precedents Do Not Distinguish Among Types Of State Taxes.

The courts that have limited the *Bellas Hess/Quill* physical-presence requirement to sales and use taxes – including the court below, *see* App. 3a – have relied heavily on the observation in *Quill* that “we have not, in our review of other types of taxes, articulated the same physical-presence requirement.” 504 U.S. at 314. That phrase, as Respondent’s argument here will likely reflect, has played a critical role in the widespread controversy discussed in this Petition – which is all the more reason this Court should revisit the issue to clarify the implications of its own dictum. In fact the dictum has been fundamentally misread by the lower courts that have relied on it. Those courts have used it as license to hold what there is no principle to support, i.e., that sales and use taxes differ materially from income and franchise taxes for purposes of the Commerce Clause. There is simply no basis in precedent or logic for such a distinction.

The basic Commerce Clause rule has always been a general one: “[T]he interstate business must have a substantial nexus with the State before *any tax* may be levied on it.” *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981) (emphasis added). This Court set forth the analysis that includes the “substantial nexus” requirement in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a case involving sales tax. But *Complete Auto* itself relied on franchise tax precedent. *See id.* at 285-287 (citing *Colonial*

Pipeline Co. v. Traigle, 421 U.S. 100, 101 (1975)). And the Court noted in *Complete Auto* that its analysis had been applied by the Court to “many types of tax.” 430 U.S. at 279. This Court has subsequently used the same analysis to assess the constitutionality of state income taxes under the Commerce Clause. See, e.g., *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 311 & n.10 (1994); *Amerada Hess Corp. v. Dir., Div. of Taxation*, 490 U.S. 66, 73 (1989).⁷

More generally, the Court in *Complete Auto* emphasized that the label given to a tax will not result in different analyses or results under the Constitution. “A tailored tax, *however accomplished*, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce.” 430 U.S. at 289 n.15 (emphasis added). Accordingly, in discussing the Commerce Clause nexus requirement, this Court has routinely referred to cases involving sales and use taxes interchangeably with cases involving direct taxes such as income and franchise taxes, undermining the idea that there are different nexus requirements for different kinds of taxes. See, e.g., *National Geographic Soc’y v. Cal. Bd. of Equalization*, 430 U.S. 551, 555-59 (1977).

Whether a State imposes an obligation to collect sales and use taxes on gross receipts from in-state customers, or a direct tax on the profits or earnings realized from those gross receipts, the taxes are essentially indistinguishable in their economic effects. There certainly is no logical reason a State that cannot under the Commerce Clause impose sales and use taxes upon out-of-state companies with no physical presence in the State should be able to impose income and fran-

⁷ Indeed in the *Barclays Bank* case the Court specifically noted in the course of finding that a State’s imposition of an income tax met the substantial nexus standard that *Quill*’s physical presence requirement was satisfied. See *Barclays Bank*, 512 U.S. at 311 n.10.

chise taxes upon them. No court has been able to demonstrate otherwise.

Indeed, as this Court has explained, if anything, the economic burdens upon interstate commerce of income taxes on interstate businesses are actually *greater* than the consequences of sales and use tax collection obligations. *See National Geographic*, 430 U.S. at 558. The laws invalidated in *Bellas Hess* and *Quill* were not direct taxes on out-of-state entities, but were obligations to collect sales and use taxes from in-state customers. By contrast, income and franchise taxes are *direct* taxes imposed upon the out-of-state entity. Whereas a collection obligation generally imposes only the administrative burden of collecting the tax at the point of sale, a direct tax imposes both administrative burdens *and* immediate financial obligations. *Id.* It also exacerbates the risk of double taxation, a serious and unfair financial burden. *Id.*⁸

Moreover, the complexity and burden of complying with corporate income and franchise taxes are greater than the

⁸ Nor of course is there any bright line between what might be denominated “sales and use” taxes on the one hand, and what might be denominated “franchise and income” taxes on the other. Taxes on “gross receipts,” for example, could be described as taxes on sales within the State, or as taxes on income received outside the State. States have sometimes been quite skillful at using labels to attempt to avoid restrictions on their taxing power. In situations where States have determined that it was advantageous to have a tax not be considered a “net income tax” in order to avoid restrictions imposed by Congress in Pub. L. 86-272, which prohibits imposition of state “net income taxes” based solely upon solicitation of orders in-state for sales of tangible personal property, the States have deftly avoided the congressional limitation. *See* Pub. L. 86-272, 73 Stat. 555, codified at 15 U.S.C. §381. For example, New Jersey has enacted an “alternative minimum assessment,” a component of its corporation business tax, which is computed on gross receipts or gross profits, and it now is applied only to entities that claim protection against state income taxes under Pub. L. 86-272. *See* N.J. Stat. Ann. § 54:10A-5a.e (2007).

complexity and burden of sales and use tax compliance. Income tax compliance involves apportionment formulae, sourcing and inclusion definitions, legal entity classification, classification of income, depreciation, disclosure requirements, and other elements. And each of these elements could and likely would vary among the thousands of potential direct taxing jurisdictions. As a result, abandoning the physical presence test and permitting States and localities to impose broad income and franchise tax liability will force businesses to confront and comply with a bewildering array of differing rules that would generate enormous compliance costs. The costs are at least as burdensome as those that would be involved if the States were allowed to impose sales and use tax collection and remittance obligations.

And, as the Court in *Quill* recognized, the increased compliance obligations created by relaxed nexus requirements for any tax necessarily increase the burden on interstate commerce. This Court noted the broad burden that would have been imposed by the North Dakota law struck down in *Quill* which would have imposed a tax collection duty on every vendor who advertised in the State three times in a single year. 504 U.S. at 313 n.6. New Jersey would impose its tax obligation at least as broadly: a New Jersey statute purports to impose its CBT as broadly as is permitted by the federal Constitution. N.J. Stat. Ann. § 54:10A-2 (2007) (“A taxpayer’s exercise of its franchise in this State is subject to taxation in this State if the taxpayer’s business activity in this State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States.”). Even “more significant” to the *Quill* Court than the breadth of the taxing obligation imposed by the State before it was the fact that “similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions.” 504 U.S. at 313 n.6. The same is true here: absent a physical presence rule, businesses may be subject to income, franchise or gross-receipts taxes wherever they have customers in any of the over 8,000 jurisdictions in the United States

that are authorized to impose such taxes. *See* Ernst & Young, E Tax Alert, Quantitative Economics and Statistics; State and Local Taxation (March 7, 2007) available through http://www.ey.com/global/content.nsf/US/Tax_-_Quantitative_Economics_and_Statistics_-_Overview (indicating number of jurisdictions authorized to impose such taxes).

B. The Bright-Line, Physical-Presence Requirement Provides A Judicially Manageable Default Rule.

The physical presence test provides what this Court has described as a “bright-line” rule, which “encourages settled expectations and, in doing so, fosters investment by businesses and individuals.” *Quill*, 504 U.S. at 316. Equally important, the bright-line, physical-presence requirement is both principled and judicially manageable.

The courts rejecting a physical presence requirement for income and franchise taxes have used varying formulations for the tests that replace it, but none provides any principled, judicially manageable limitation on state authority to tax. The West Virginia Supreme Court’s decision in *MBNA* adopts a general “significant economic presence” test, i.e., the State may tax any business with a significant economic presence in the State. Other state appellate court decisions have applied similarly vague tests based on economic presence or commercial activity within the State. *See, e.g., Gen. Motors*, 25 P.3d at 1028-29. By contrast, other state-court decisions – including the New Jersey decision below – have adopted what may at first blush appear to be a more limited exception to the physical presence rule, holding at least that that the licensing of “intangible property” for use within a State creates a “presence” that is a sufficient nexus for taxing power under the Commerce Clause. *See* App. 13a-20a;

Geoffrey, 437 S.E.2d at 18; *A&F Trademark*, 605 S.E.2d at 195.⁹

These lines are unprincipled and provide no guidance to the judges who would have to apply them. None is rooted in constitutional principle – no one believes the Commerce Clause is peculiarly concerned with sales and use taxes – and each would permit a State to regulate all interstate commerce involving a customer who lives within the State. Just as the reading of the Commerce Clause proposed in *United States v. Lopez*, 514 U.S. 549 (1995), had no clear stopping point with respect to federal power, *see also infra* at 25-26, elimination of the requirement of physical presence within those borders would effectively eliminate all judicially manageable restrictions upon a State’s power to reach beyond its borders to tax interstate commerce.

The “intangible presence” test suggested by the South Carolina Supreme Court in *Geoffrey* and to which the New Jersey Supreme Court below referred provides no limit to state authority because a license for use of intangible property ultimately is indistinguishable from any other commercial sale, license, contract, or other transaction with an in-state resident. *See infra* at 26-28. The contractual right to

⁹ Several decisions rejecting the physical presence requirement involved out-of-state entities in commercial relationships with affiliated in-state entities that paid licensing or other fees to the out-of-state entities, and at least one decision specifically relied on the affiliations as establishing a substantial nexus between the State and the out-of-state entity. *See A&F Trademark*, 605 S.E.2d at 195. Properly understood, this is irrelevant to the constitutional calculus. If a State is concerned about payments by an in-state entity to an out-of-state affiliate based on a belief that the affiliate is some type of sham or there is not, in fact, an arms-length relationship, that concern is properly addressed by the State through examination of the tax liability and returns of the in-state entity. Such a concern does not warrant elimination of the constitutional boundary between what a State may regulate beyond its borders and what it may not.

use intellectual property is no different from the contractual right to receive a product purchased by mail order or online transaction, *see Quill*. The universe of potential taxpayers is therefore the universe of companies that have customers in the taxing State. Likewise, the “economic presence” test articulated by the West Virginia Supreme Court of Appeals in *MBNA* imposes no restraint on state power to tax interstate commerce. All out-of-state companies that sell goods and services to customers in-state have an “economic presence.”

A court could in theory impose some limit on the taxing power under these standards, but only by making an artificial determination of what kind and what degree of economic contact with a State, or of what intangible property present in the State, is sufficient to create a “substantial nexus.” The articulation of those unprincipled lines, however, would involve an inherently legislative judgment.

It is precisely the genius of this Court’s Commerce Clause holdings in *Bellas Hess* and *Quill* that they do not attempt to make this inherently legislative determination themselves, but rather leave Congress with the power to craft a different rule if one is desirable. *Cf. Quill*, 504 U.S. at 320 (Scalia, J. concurring in part and concurring in judgment) (noting that these decisions’ claim to *stare decisis* effect has “special force” because of Congress’s power to alter them). Unlike the Court, if the Congress rejects physical presence as a requirement for state taxation of out-of state companies, it need not replace it with an unmanageable alternative nor need it be concerned with whether its actions are properly animated by consistent constitutional principle. Congress may craft a nuanced approach that it believes meets the nation’s needs and addresses whatever concerns exist about requiring physical presence for taxation. Congress even could carve out *ad hoc* exceptions from the physical presence rule if it were to find the need. This is a task to which the courts are by definition not suited.

C. The Physical-Presence Test Reflects And Reinforces The Structure Of Our Federal System.

Finally, the physical-presence rule is animated by principles of federalism, which divides authority both between the States and the federal government, and among the individual States.

The modern economy may lack borders, but States do not. Indeed, if state boundaries mean nothing, then States mean nothing: the only thing that distinguishes one political entity called a “State” from another in our federal system is the geographic boundaries that define them. Since *Quill*, this Court has emphatically reaffirmed the constitutional significance of the States’ geographical boundaries. It has reiterated the Constitution’s structural limitations on the States’ power to regulate beyond their borders, *see State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 421 (2003); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 569-71 (1996), as well as the Commerce Clause’s limitations on Congress’s power to regulate certain activities having impacts only within those state boundaries, *see United States v. Lopez*, 514 U.S. 549, 567 (1995).

The Commerce Clause requirement of physical-presence is a reflection of the same geographical principle underlying these precedents. Physical borders are the necessary limit of a State’s authority to tax. As Justice Kennedy wrote for the Court in 1992: “In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation.” *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777-778 (1992). By the same token, “[T]he theory that two governments accord more liberty than one requires for its realization two distinct and discernable lines of political accountability: one between the citizens and the Federal Government; the second between the citizens and the States. . . . Our position in enforcing the dormant Commerce Clause is instructive. . . . One element

of our dormant Commerce Clause jurisprudence has been the principle that the States may not impose regulations that place an undue burden on interstate commerce, even where those regulations do not discriminate between in-state and out-of-state businesses.” *Lopez*, 514 U.S. at 576-580 (Kennedy, J., concurring).

By giving decisive weight to the taxpayer’s physical presence within state borders, the rule of *Bellas Hess* and *Quill* respects and reinforces the very concept of the State itself. By contrast, if the physical presence of taxpayers becomes irrelevant to a State’s power over them, and a State is allowed to exert broad taxing authority solely on the basis of activity in commercial markets that are by now essentially borderless and worldwide, then state power becomes effectively unmoored from the very feature of the State that gives it constitutional status, i.e., its sovereignty over a specified geographical area and those who come within it.

D. The Idea That the Use in a Particular State by a Licensee of a Business’s Intangible Property Alone Constitutes a “Presence” of that Business in that State Does Not Provide a Principled Distinction from Instances Where Physical Goods Alone are Shipped into a State.

The decision below permits taxation of income of a company with no in-state physical presence where that company’s intangible property is being used by someone else within the State who has licensed it. As described above, decisions on which the courts below relied asserted that because companies like Petitioner license intellectual property, their “intangible property” is “present” in the State in which the licensee uses it in a way that differentiates them from sellers like those in *Quill* whose physical goods are shipped into the State. App.19a. In fact, the transactions at issue here are indistinguishable in principle from the transactions at issue in *Quill* which the Court found insufficient to establish a “substantial nexus” with the taxing State. The fact that

they involve intangible intellectual property is immaterial to the Commerce Clause question.

To begin with, by its nature intangible property “ha[s] no actual territorial situs.” *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 211 (1930). It is true that it is sometimes said to have a situs for tax purposes, but the situs generally follows the person who owns it or, in some cases, the activities in which he or she is engaged. *Curry v. McCannless*, 307 U.S. 357, 368 (1939). In this case, of course, Petitioner has no presence in and has conducted no activities in the taxing State.

More fundamentally, the transactions at issue in a case like this – the sale by an out-of-state company of a license to intellectual property for its use by an in-state customer – are economically identical to the transactions at issue in *Bellas Hess* and *Quill*: the sale by an out-of-state company of goods for use by an in-state customer. The use of Petitioner’s trademark inside the taxing State by the customers who licensed it is indistinguishable from the use in *Bellas Hess* and *Quill* of the mail order house’s goods inside the taxing State by the customers who purchased them. And those cases make clear that the sale of goods and services within a State is not an adequate basis for imposing tax on an out-of-state entity with no in-state physical presence.

Unsurprisingly, the idea that a licensee’s use of a corporation’s intangible property in a taxing State could be equated for Commerce Clause purposes with physical presence of that corporation sufficient to permit state taxation was woven from whole cloth. The idea was conceived by the *Geoffrey* court, which asserted incorrectly that “[i]t is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus.” *Geoffrey*, 437 S.E.2d at 18. That is simply false: In support of the proposition *Geoffrey* cited a single New Mexico state case that did not even discuss intangible property in the con-

text of the nexus requirement under the Commerce Clause, *Am. Dairy Queen Corp. v. Taxation & Revenue Dep't*, 605 P. 2d 251, 255 (N.M. Ct. App. 1979).¹⁰

Nor has this Court in its modern Commerce Clause jurisprudence ever allowed intangible property alone to form a basis for state taxation. The Petitioner in *Quill* could be said to have had “intangible property” with a “legal situs” in the taxing State: its “going concern value” calculated based on its gross receipts from sales in that State. *See Complete Auto*, 430 U.S. at 284 (describing a tax on such intangible property). Yet in *Complete Auto*, this Court rejected precisely the approach that permitted taxation on the basis of the presence of such property where it was otherwise forbidden by the Commerce Clause. The fact that this case involves intangible intellectual property thus can do nothing to eliminate the conflict with the decisions of this Court.

III. THIS COURT SHOULD AGAIN INTERVENE TO PROTECT THE FREE FLOW OF INTERSTATE COMMERCE.

This is not the first time this Court’s intervention in this context has been necessary. The law challenged in this case is part of a third wave of state tax laws that have targeted

¹⁰ *Geoffrey* also said that a “taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business.” *Geoffrey*, 437 S.E.2d at 18 (citing *Curry v. McCannless*, 307 U.S. 357, 368 (1939)). This confuses the question of “the guidelines necessary to circumscribe the reach of the State’s legitimate power to tax,” with “[t]he constitutional question . . . whether the State has the authority to tax the corporation at all.” *Allied-Signal*, 504 U.S. at 778. But in any event, *Curry*, a Fourteenth Amendment case, actually holds that intangibles may be taxed in the State where their owner conducts “his activities.” 307 U.S. at 367. This is essentially a restatement of the physical presence test, *see supra* at 2 n.1. Only the in-state conduct or presence of the *owner* of the intangibles – here, Petitioner – can provide the constitutionally required nexus for state taxation.

nonresidents in order to enrich state fiscs. The constitutionality of the first wave of laws was resolved by this Court in *Bellas Hess*, when the Court held that the physical presence of a company in a State is required before that State can require a company to collect and remit use taxes to the State.

By 1992, however, 34 States had amended their tax statutes to impose tax collection obligations upon out-of-state direct marketers and, despite the clear prohibition on such taxation set out in *Bellas Hess*, state courts were sustaining the constitutionality of those state laws. That second wave of laws resulted in this Court's invalidation of such laws and affirmation of the *Bellas Hess* physical presence nexus standard under the Commerce Clause in *Quill*.

Now, the constitutionality of a third wave of laws is being litigated throughout the country. And while the Court in *Quill* was concerned with the effect of state taxes on the reliance interests of the mail-order industry, today's economy includes a much broader and even more vital sector of e-commerce businesses that has developed in reliance on the physical presence rule.

Yet the States' arguments today are the same as those made and rejected in *Quill*.¹¹ The state courts have issued irreconcilable decisions. The disputes have been costly, time-consuming and, because of the high financial stakes, will continue unabated until this Court grants review. Al-

¹¹ North Dakota's arguments in *Quill* included assertions that the business had made a lot of money from in-state customers and should have paid tax to that State on that income; that the business had been provided benefits by the State; that the business would be at a competitive advantage to in-State merchants who necessarily must collect the tax; that *Bellas Hess* was repudiated by this Court's decision in *Complete Auto*, and that *Bellas Hess* was rendered obsolete by the technological and economic changes of the late twentieth century. See also *MBNA*, 640 S.E. 2d at 241 (Benjamin, J., dissenting) (this Court squarely rejected "economic exploitation nexus" arguments in *Bellas Hess* and *Quill*).

though many problems of such magnitude are not easily resolved, this Court has the power and ability to address this one and to ensure that the integrity of the judicial process is not eroded, reliance interests are respected, and the clarity provided by the *Bellas Hess/Quill* rule is restored for this country's business community and tax agencies.

In addition to this Petition, the Court currently has before it a Petition for Certiorari in the *MBNA* case. That decision is a concrete demonstration that the States' abandonment of the physical presence rule has expanded well beyond cases involving intangible property licensees, and now includes virtually every type of business. If the court were inclined to review only one of the two cases, and chose to grant certiorari in *MBNA* because it is arguably more broadly applicable, it should hold this case pending disposition of *MBNA*. In our view, however, the Court, the States, and the substantial interests of businesses operating in interstate commerce throughout the country would be best served by granting both Petitions, hearing the cases in tandem, and affirming the continuing vitality of the physical presence rule.

CONCLUSION

The Petition for a writ of Certiorari should be granted.

Respectfully submitted,

WALTER DELLINGER
ROBERT A. RIZZI
PETER J. RUBIN
O'MELVENY & MYERS
1625 Eye Street, NW
Washington, DC 20006
(202) 383-5300

BETH S. BRINKMANN
Counsel of Record
MORRISON & FOERSTER LLP
2000 Pennsylvania Avenue, NW
Washington, DC 20006
(202) 887-1500

PAUL H. FRANKEL
HOLLIS L. HYANS
AMY F. NOGID
MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, NY 10104
(212) 468-8000

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