No. 06-

IN THE

Supreme Court of the United States

MBNA AMERICA BANK, N.A.,
Petitioner,

v.

TAX COMMISSIONER OF THE STATE OF WEST VIRGINIA,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Appeals of West Virginia

PETITION FOR A WRIT OF CERTIORARI

ARTHUR R. ROSEN
DONALD M. GRISWOLD
MCDERMOTT WILL & EMERY LLP
340 Madison Avenue
New York, N.Y. 10173
(212) 547-5400

WALTER DELLINGER
(*Counsel of Record*)
JONATHAN D. HACKER
KARL R. THOMPSON
O'MELVENY & MYERS LLP
1625 Eye Street, N.W.
Washington, D.C. 20006
(202) 383-5300

Attorneys for Petitioner

QUESTION PRESENTED

This Court held in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), that under the Commerce Clause of the U.S. Constitution, art. I, § 8, a state may not (without congressional authorization) impose a sales or use tax collection obligation on a corporation that lacks a physical presence within the taxing state. Notwithstanding that precedent, and expressly acknowledging that it was joining one side of a direct conflict among state courts, the West Virginia Supreme Court of Appeals upheld the imposition of income and franchise taxes on petitioner, which lacks any physical presence in the state.

The Question Presented is:

Whether the Commerce Clause of the U.S. Constitution, art. I, § 8, permits states to impose income and franchise taxes on an out-of-state company with no in-state physical presence, simply because that company has customers in the taxing state.

LIST OF PARTIES AND CORPORATE DISCLOSURE

The petitioner is MBNA America Bank, N.A. ("MBNA"), now known as FIA Card Services, N.A. Petitioner is an indirect, wholly-owned subsidiary of Bank of America Corporation, which is a publicly-held company. This case concerns a dispute over taxes imposed for tax years 1998 and 1999. During that period, MBNA was a wholly-owned subsidiary of MBNA Corporation.

Respondent is the Tax Commissioner of the State of West Virginia.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of *certiorari* issue to review the judgment of the Supreme Court of Appeals of West Virginia in this case.

DECISIONS BELOW

The opinion of the Supreme Court of Appeals of West Virginia is reported at 640 S.E.2d 226 (W. Va. 2006) and is reprinted in the Appendix ("App.") hereto at 1a. The opinion of the Circuit Court of Kanawha County, West Virginia is unpublished and is reprinted at App. 39a. The opinion of the Chief Administrative Law Judge of the West Virginia Office of Tax Appeals is unpublished and is reprinted at App. 53a.

JURISDICTION

The decision and majority opinion of the West Virginia Supreme Court of Appeals was issued on November 21, 2006. A dissenting opinion was issued on January 2, 2007, and a concurring opinion was issued on January 8, 2007. Chief Justice Roberts extended the time in which to file this petition to March 21, 2007. This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a) (2006).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause, U.S. Const. art. I, § 8, provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

The relevant portions of the West Virginia statutes at issue in this case are set forth at App. 70a.

INTRODUCTION

This petition presents the single most important constitutional issue in state taxation of the last four decades: whether the Commerce Clause permits states to impose income and franchise taxes on an out-of-state company with no in-state physical presence, simply because that company has

customers in the taxing state. The longstanding rule governing state taxation provides that states may impose taxes on an out-of-state company only if that company or its representative has a physical presence in the taxing state. This Court expressly endorsed that rule in *National Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967), and affirmed its continuing viability twenty-five years later in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). And although both *Bellas Hess* and *Quill* involved the collection of sales and use taxes, rather than the direct imposition of income and franchise taxes, this Court expressly recognized in *Quill* that it had never upheld *any* kind of state tax on an out-of-state company unless that company had a physical presence in the taxing state.

The physical presence rule provides a clear, judicially manageable test that establishes meaningful limits on the ability of state taxing authorities to engage in extraterritorial taxation of out-of-state companies. The rule thereby fosters the fundamental purposes of the Commerce Clause, preventing undue burdens on the free flow of interstate commerce, limiting the risk that the same income will be taxed multiple times, and generally forestalling the "welter of complicated obligations" the Commerce Clause was designed to avoid. *Bellas Hess*, 386 U.S. at 760.[1]

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[1] As the Court explained in *Quill*, the Commerce Clause is based on "structural concerns about the effects of state regulation on the national economy." 504 U.S. at 312. Specifically, "the Framers intended the Commerce Clause as a cure for th[e] structural ills" caused by the "state taxes and duties" that "hindered and suppressed interstate commerce" under the Articles of Confederation. *Id.*; *see also* The Federalist No. 7, at 62-63 (C. Rossiter ed., 1961) (allowing each State to "pursue a system of commercial policy peculiar to itself" would "occasion distinctions, preferences, and exclusions, which would beget discontent"); The Federalist No. 11, at 89 ("An unrestrained intercourse between the States themselves will advance the trade of each, by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for exportation to foreign markets. The veins of commerce in every part

Nonetheless, in the wake of *Quill*, a split in state court authority developed concerning the applicability of the physical presence rule to taxes other than sales and use taxes. Even before *Quill* was decided, some state tax commissioners began assessing corporate income and franchise taxes on out-of-state businesses that had no in-state employees, representatives, or property. Some state courts—notably the Tennessee courts in *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 2000), *aff'd*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000), *cert. denied*, 531 U.S. 927 (2000)—appropriately invalidated these efforts, concluding that *Quill*'s re-affirmation of the physical presence rule in the sales and use tax context did not imply *rejection* of that rule in other contexts.

But other state courts upheld these aggressive impositions of extraterritorial income and franchise tax. Seizing on dicta in *Quill*, these courts held that the physical presence rule does not apply in the income and franchise tax context. In so doing, these courts misconstrued *Quill*, drew strained distinctions between sales and income taxation that have no relevance to Commerce Clause analysis, and cast aside long-standing practice in state taxation. The first state supreme court to uphold extraterritorial income taxation absent in-state physical presence—the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina Tax Commission*, 437

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will be replenished and will acquire additional motion and vigor from a free circulation of the commodities of every part.").

For this reason, as the Court recognized in *Quill*, the Commerce Clause's limits on state taxation authority are more restrictive than the "minimum contacts" needed to support personal jurisdiction under the Due Process Clause. *Quill*, 504 U.S. at 312-13 (noting that the clauses are "animated by different constitutional concerns and policies"). Whereas due process analysis is concerned with the effects of a state's exercise of power over an individual (and thus focuses on the individual's contacts with the state), the Commerce Clause is concerned primarily with the effects of a state's exercise of power *on other states* (and thus focuses on obstruction of interstate commercial activity). *Id.*

S.E.2d 13 (S.C. 1993)—did so in connection with an out-of-state holding company that owned trademarks and trade names that it licensed for in-state use by its affiliate in South Carolina. The court held that the licensing of intellectual property in that situation was a sufficient basis on which to tax an out-of-state corporation.

Following *Geoffrey*, most state courts of appeal that upheld imposition of income and franchise taxes absent physical presence similarly did so in cases involving companies that licensed intellectual property for in-state use by affiliated entities. But the New Jersey Supreme Court recently took another step, affirming a tax court decision that expressly stated that licensing intellectual property for use in-state would be sufficient to support income and franchise taxation under the Commerce Clause even if the property was licensed to an *un*affiliated in-state company. *See Lanco, Inc. v. Dir., Div. of Taxation*, 879 A.2d 1234, 1236 (N.J. Super. Ct. App. Div. 2005), *aff'd*, 908 A.2d 176 (N.J. 2006).

A scant month and a half later, the West Virginia Supreme Court of Appeals issued its decision in this case, obliterating once and for all any notion that departure from the physical presence rule can be limited to situations involving intangible property licenses or affiliated entities. Petitioner in this case has substantial physical facilities and thousands of employees in, and has paid millions of dollars in taxes to, the State of Delaware. But it has no physical presence whatsoever in the State of West Virginia. Nevertheless, the West Virginia Supreme Court—expressly acknowledging the conflict with the Tennessee courts—held that petitioner is subject to taxation in West Virginia solely because it has *customers* in West Virginia. Thus, under the West Virginia Court's interpretation of *Quill*, essentially any company that receives revenue from West Virginia customers could be subject to income and franchise tax.

The decision below thereby eliminates virtually *any* limit on the states' authority to impose extraterritorial taxation. It thus conflicts frontally with *Bellas Hess* and *Quill*, and

threatens to subject interstate commerce to severe burdens, directly contrary to the purposes of the Commerce Clause. The decision below also brings full circle the conflict that developed in the wake of *Quill*. The *J.C. Penney* case in Tennessee followed the physical presence rule and held that an out-of-state credit-card company cannot be subject to income and franchise taxes merely because it has customers in the taxing state. Other courts rejected the physical presence rule and held that out-of-state intangible holding companies could be taxed on the basis of in-state intellectual property licenses. The West Virginia Supreme Court of Appeals has now departed even more radically from *Quill*, holding that the physical presence rule does not apply to income and franchise taxes *at all*. And in so holding the court reached a conclusion directly contrary to the Tennessee courts' decision in *J.C. Penney* on indistinguishable facts: an out-of-state credit-card company *can* be subject to income and franchise taxes merely because it has customers in the taxing state.

This Court should intervene to resolve this conflict, and to re-affirm meaningful limits on state taxation authority under the Commerce Clause. The scope of the states' extraterritorial taxing authority is an issue of fundamental economic importance to virtually every entity involved in interstate or international commerce, including the rapidly-growing number of small companies involved in commerce over the Internet. Resolution of the issue by this Court is essential to ensuring that the free flow of this commerce is not disrupted.

STATEMENT OF THE CASE

A. Factual Background

Petitioner MBNA is a chartered national bank.[2] Its principal business activity is issuing and servicing major credit cards for customers throughout the U.S. MBNA is incorporated in Delaware. It has its principal place of business in

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[2] After the litigation in this case began, MBNA Corporation was acquired by Bank of America Corporation.

Delaware and a robust physical presence there, including more than ten thousand employees. In 1998 and 1999, MBNA paid millions of dollars in bank franchise (income) taxes to Delaware.

MBNA has no physical presence—no office, no employees, no place of business, no real property, and no tangible personal property—in West Virginia. *See* App. 4a (noting for purposes of decision below that "it was agreed that MBNA does not have a physical presence in West Virginia"). Nonetheless, in tax years 1998 and 1999, West Virginia imposed two kinds of taxes, business franchise and corporate net income taxes, on MBNA based on its income attributable to customers with West Virginia addresses.[3] MBNA paid a franchise tax of $32,010 and a corporate income tax of $168,034 in 1998, and a franchise tax of $42,339 and an income tax of $220,897 in 1999.

B. Proceedings Below

1. In September 2002, MBNA filed claims for refunds of its 1998 and 1999 franchise and corporate income taxes, arguing that the West Virginia Tax Commissioner lacked the constitutional authority to impose those taxes on MBNA. The Tax Commissioner denied the refunds, finding that MBNA regularly engaged in business in West Virginia under the state's statutory tests. App. 3a.

2. MBNA filed a petition for refund with the West Virginia Office of Tax Appeals ("OTA"). The OTA's Chief Administrative Law Judge ("ALJ") ruled in favor of MBNA. The ALJ observed that under this Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a state tax on interstate commerce is valid only if it is "applied to an activity with a substantial nexus with the taxing State."

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[3] Both the business franchise and corporate net income taxes are imposed on out-of-state financial organizations that obtain or solicit business with twenty or more persons in the state, or whose gross receipts attributable to sources in West Virginia equal or exceed $100,000. *See* W. Va. Code §§ 11-23-5a(d), 11-24-7b(d).

App. 60a (quoting 430 U.S. at 279) (alterations omitted). The West Virginia franchise and business income tax statutes, the ALJ noted, employ an "economic-exploitation-of-the-market standard for nexus, rather than a 'physical presence' nexus standard." App. 62a. But, the ALJ observed, this Court made clear in *Quill* that a "'substantial' nexus requires a finding of physical presence in the taxing state, not merely an economic exploitation of the market." App. 63a.

The ALJ concluded that this physical presence rule applies to income and franchise taxes. While *Quill* noted in dictum that this Court had not explicitly articulated a physical presence rule outside the sales and use tax context, the ALJ observed, *Quill* also made clear that the Court had upheld other kinds of state taxes *only* in situations in which the taxpayers had a physical presence in the taxing state. App. 62a. Moreover, the ALJ continued, the Court in *Complete Auto* did not distinguish between different types of state taxes when it set forth the "substantial nexus" requirement under the Commerce Clause. *Id.* If anything, the ALJ added, the "substantial nexus" requirement "should apply with even more force to direct taxes" like income and franchise taxes, because "direct taxes against a taxpayer . . . are more *financially* onerous than mere collection duties." App. 62a n.2. The ALJ thus held that the West Virginia franchise and income taxes, as applied to MBNA, violated the Commerce Clause. App. 68a.

3. The Tax Commissioner appealed, and the Circuit Court of Kanawha County reversed. The court noted that MBNA's gross receipts attributable to West Virginia sources for 1998 and 1999 met the statutory thresholds for nexus under the West Virginia statutes. App. 48a. The court also observed that no West Virginia case law or statute required physical presence in order to establish a taxation nexus, and asserted that the bright-line physical presence rule enunciated in *Bellas Hess* and *Quill* had "no application" because MBNA's case did not concern "sales and use taxes." *Id.* The court then concluded that MBNA had a substantial

nexus with West Virginia based on its revenue from West Virginia citizens, the fact that MBNA extends credit to West Virginia residents, and the fact that West Virginia provided MBNA with "banking[] and consumer credit laws as well as access to its courts." App. 49a.

4. MBNA appealed to the West Virginia Supreme Court of Appeals, which affirmed over a vigorous dissent. The single issue in the case, the court recognized, was whether application of the franchise and corporate income taxes to MBNA, "a business with no physical presence in th[e] state, violates the Commerce Clause of the United States Constitution." App. 5a. After reviewing *Bellas Hess* and *Quill*, the court concluded that the physical presence rule affirmed in *Quill* "applies only to use and sales taxes and not to business franchise and corporation net income taxes." App. 12a. Citing this Court's statement in *Quill* that contemporary Commerce Clause jurisprudence might not dictate the same result as in *Bellas Hess*, the West Virginia court concluded that *Quill*'s reaffirmation of the *Bellas Hess* physical presence rule was "grounded primarily on *stare decisis*." *Id.* The court also suggested that this Court had "expressly limited *Quill*'s scope to sales and use taxes," quoting dicta in which this Court observed that it had not expressly articulated a physical presence requirement in relation to other types of taxes. App. 13a-14a. The West Virginia court further noted that the decisions in *Bellas Hess* and *Quill* relied in part on the burdens sales and use tax would place on interstate commerce, and asserted that "the franchise and income taxes at issue in this case do not appear to cause the same degree of compliance burdens." App. 16a. Finally, the court asserted that the physical presence rule, "articulated in 1967, makes little sense in today's world," because the "growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there." App. 17a.

Based on this analysis, the court concluded that a "significant economic presence test" was a "better indicator of

whether substantial nexus exists for Commerce Clause purposes" than the physical presence rule endorsed by this Court. App. 18a. Such a test, the court indicated, would "incorporat[e] due process purposeful direction towards a state while examining the degree to which a company has exploited a local market," but would also involve "an examination of both the quality and quantity of the company's economic presence," including attention to "the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.* (quotation omitted). The court acknowledged that its "substantial economic presence standard" was "by nature more elastic than the bright-line physical presence test" mandated by *Quill*, but asserted that its standard was not equivalent to the Due Process minimum contacts standard rejected for Commerce Clause purposes in *Quill.* App. 20a.

The Court further acknowledged that its decision conflicted squarely with the decision in *J.C. Penney*, but stated simply that it "reject[ed] the reasoning in *J.C. Penney* and decline[d] to apply it to the instant case." App. 21a. The court then concluded, based on MBNA's solicitation of customers in West Virginia and the amount of its gross receipts, that MBNA's contacts with West Virginia constituted a "substantial nexus" that would support income and franchise taxation. *Id.* Finally, the court emphasized the ostensible significance of "ever-evolving practices of the marketplace" in devising new Commerce Clause analyses:

> James Madison, Benjamin Franklin, and the other Framers at the Constitutional Convention who adopted the Commerce Clause lived in a world that is impossible for people living today to imagine. The Framers' concept of commerce consisted of goods transported in horse-drawn, wooden-wheeled wagons or ships with sails. They lived in a world with no electricity, no indoor plumbing, no automobiles, no paved roads, no airplanes, no telephones, no televisions, no computers, no plastic credit cards, no re-

> corded music, and no iPods. Likewise, it would have been impossible for the Framers to imagine our world. When they fashioned the Commerce Clause, they could not possibly have foreseen the complex and varied ways that commerce is conducted today, especially via the internet and electronic commerce. It would be nonsense to suggest that they could foresee or fathom a time in which a person's telephone call to his or her local credit card company would be routinely answered by a person in Bombay, India, or that a consumer could purchase virtually any product on a computer with the click of a mouse without leaving home. This recognition of the staggering evolution in commerce from the Framers' time up through today suggests to this Court that in applying the Commerce Clause we must eschew rigid and mechanical legal formulas in favor of a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense. This is what we have attempted to do herein.

App. 22a.

Justice Benjamin dissented. He "agree[d]" with the majority that "the 'substantial nexus' prong of [the *Complete Auto*] test [was] ripe for clarification by the United States Supreme Court," App. 30a, but disagreed with the majority's "strained and inaccurate reading" of *Quill*, App. 27a-28a, concluding that, in fact, this Court's precedent made clear that the taxes levied on MBNA were unconstitutional, App. 30a. Specifically, he noted that "the credit card accounts which give rise to MBNA's income are located outside West Virginia," and that the majority had "fail[ed] to show how the[se] out-of-state credit account[s]" met the "substantial nexus requirements of *Complete Auto* and *Quill*." App. 31a-32a.

The majority, Justice Benjamin explained, distinguished *Quill* principally by drawing an invalid distinction between sales and use taxes on the one hand, and income and fran-

chise taxes on the other. This Court, he observed, "has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved," but rather has focused on "the effect of the tax which the taxing state seeks to levy on interstate commerce." App. 33a. In fact, he continued, "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." *Id*. Indeed, collection of sales and use taxes, the dissent observed, is no more complex than the determination of income tax liability for multistate corporations. App. 35a. Moreover, the dissent added, this Court has never held in any state tax case that the nexus requirement can be satisfied absent physical presence, and "[t]he principles of *stare decisis* are no less relevant to state taxes in general, than they are to sales and use taxes particularly." App. 34a. Finally, the dissent noted that the majority's argument for an economic presence standard based on modern economic circumstances was "remarkably like the arguments set forth" in the dissent in *Bellas Hess* and the North Dakota Supreme Court in *Quill*—both of which had been decisively rejected by this Court. App. 37a.

REASONS FOR GRANTING THE WRIT

I. THE STATES ARE IN CONFLICT OVER THE APPLICABILITY OF *QUILL'*S PHYSICAL PRESENCE RULE TO INCOME AND FRANCHISE TAXES

A. This Court's Cases Have Established A Bright-Line Physical Presence Rule For State Taxation

Physical presence has long been the touchstone of state authority to tax out-of-state corporations. *See, e.g.*, J. Hellerstein & W. Hellerstein, *State and Local Taxation* 386 (8th ed. 2005) ("courts traditionally have regarded a corporation's physical presence in a state as necessary to establish jurisdic-

tion to subject that corporation to income taxation"). This Court expressly endorsed this physical presence rule in *Bellas Hess*, 386 U.S. at 753, which held that Illinois could not constitutionally impose use-tax collection obligations on a Missouri mail-order company that had customers in Illinois, but whose only contacts with Illinois were "via the United States mail or common carrier." *Id*. at 754. Canvassing Supreme Court precedent dating back to 1939, the Court observed that it had drawn a "sharp distinction" between "sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier." *Id*. at 758. "[T]his basic distinction," the Court continued, "until now has been generally recognized by the state taxing authorities," and "is a valid one." *Id*. The Court therefore "decline[d] to obliterate it." *Id*.; *see also infra* at 23-30 (discussing reasons for rule).

A decade later, in *Complete Auto*, 430 U.S. at 274, the Court distilled the standards for state taxation under the Commerce Clause into a four-part test, holding that to satisfy the Constitution, a tax (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must be "fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Id*. at 279. Some states treated *Complete Auto* as an invitation to revisit *Bellas Hess* and—despite this Court never having questioned that case—began holding that the physical presence rule had been rendered "obsole[te]" by "the tremendous social, economic, commercial, and legal innovations" that had taken place since it was decided. *State v. Quill Corp.*, 470 N.W.2d 203, 208 (N.D. 1991).

In *Quill*, 504 U.S. at 298, this Court rebuffed these efforts to overturn *Bellas Hess*, rejecting the "changed modern marketplace" argument and reaffirming the continuing viability of the physical presence rule. The Court recognized that the bright-line rule articulated in *Bellas Hess* "furthers

the ends of the dormant Commerce Clause," encouraging settled expectations and fostering investment in interstate commerce. *Id*. at 314-16. The Court also noted the substantial reliance interest that had developed in the physical presence rule, *id*. at 317, and the "undu[e] burden" on interstate commerce that widespread state taxation could impose, *id*. at 313 & n.6.

B. Some State Court Decisions Adhered To *Quill* And Rebuffed State Efforts To Override The Physical Presence Rule

Despite *Quill*'s re-affirmation of the physical presence rule, a split in state court authority quickly developed in the wake of *Quill* over whether that rule continued to apply beyond the sales and use tax context in which *Quill* was decided. Even as *Quill* was working its way through the courts, some states (seeking to expand their revenue from out-of-state sources) began imposing income and franchise taxes on out-of-state companies that had no in-state physical presence. *See, e.g.*, *Geoffrey*, 437 S.E.2d at 15 (noting that South Carolina imposed income tax and business license fees for tax years 1986 and 1987).

Some state courts struck down these aggressive and unprecedented assertions of extraterritorial taxing authority, recognizing that they were fundamentally at odds with the Commerce Clause rationale underlying *Quill*. Within a year of this Court's decision in *Quill*, the Michigan court of appeals had applied *Quill*'s physical presence rule to nexus questions in two cases that involved not sales and use tax collection, but Michigan's unique "single business tax," a business activity tax that (like net income and franchise taxes in other states) was imposed on companies for the privilege of doing business in the state. *See Guardian Indus. Corp. v. Dep't. of Treas.*, 499 N.W.2d 349 (Mich. App. 1993), *leave to appeal denied*, 512 N.W.2d 846 (1994); *Gillette Co. v. Dep't. of Treas.*, 497 N.W.2d 595 (Mich. App. 1993), *leave to appeal denied*, 519 N.E.2d 156 (Mich. 1994), *cert. denied*, 513 U.S. 1103 (1995).

Subsequently, in *J.C. Penney*, 19 S.W.3d at 831, the Tennessee Court of Appeals held that the physical presence rule applies to income and franchise taxes. *J.C. Penney* involved an out-of-state credit card company with no physical presence in Tennessee that was nonetheless assessed franchise and excise (income) taxes based on income from Tennessee cardholders. The Tennessee Court of Appeals held that imposition of these taxes was unconstitutional, applying the physical presence rule articulated in *Quill*. Rejecting the tax commissioner's argument that *Bellas Hess* and *Quill* were limited to sales and use taxes, the court observed:

> 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.

Id. at 839. The tax commissioner appealed this decision to the Tennessee Supreme Court, which issued an order denying the application to appeal and permitting the decision to be published. *See J.C. Penney*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000) (per curiam), *cert. denied*, 531 U.S. 927 (2000). Under Tennessee law, such an order establishes the supreme court's substantive agreement with the result below, and gives the opinion precedential effect. *See Pairamore v. Pairamore*, 547 S.W.2d 545, 548 (Tenn. 1977); *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1992).

The Court of Appeals of Texas has also agreed, holding that the bright-line physical presence requirement endorsed in *Quill* applies to franchise and income taxes. *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 299-300 (Tex. App. 2000).[4]

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[4] While neither the Texas nor the Michigan appellate decisions has the functional status of a state supreme court opinion that *J.C. Penney* has, they are nevertheless binding precedent statewide in those jurisdic-

C. A Direct Conflict Has Arisen As State Court Decisions Have Begun Eliminating The Physical Presence Rule For Income And Franchise Taxes

State court adherence to *Quill* and the bright-line physical presence rule, however, has not been uniform. In contrast to the courts in Tennessee, Michigan, and Texas, courts in other states have held that the physical presence rule is limited only to sales and use taxes, and that the Commerce Clause permits direct taxation of out-of-state companies even absent physical presence.

The first decision to adopt this position was *Geoffrey*, 437 S.E.2d at 13. Like the *Guardian* and *Gillette* decisions in Michigan, *Geoffrey* was decided within a year of *Quill*, but with a diametrically opposite result. *Geoffrey* involved a Delaware corporation that had been established to take ownership of trademarks and trade names that it then licensed back for use to an affiliated company in South Carolina. *Id.* at 15. The Delaware company argued that it could not be taxed on its royalty income because it had no physical presence in South Carolina. *Id.* The South Carolina Supreme Court disagreed, finding that the physical presence rule articulated in *Quill* "had not been extended to other types of taxes," and holding that "by licensing intangibles for use in [South Carolina]" by its affiliates, the Delaware corporation had a "substantial nexus" with South Carolina. *Id.* at 18 & n.4.

Several other state appellate courts subsequently followed suit, concluding that *Quill*'s endorsement of the physical presence rule was limited to the sales and use tax context, and imposing franchise or income taxes on out-of-state companies that licensed intellectual property for in-state

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tions. *See, e.g.*, *Tebo v. Havlik*, 343 N.W.2d 181, 185 (Mich. 1984); *Mesina v. State*, 904 S.W.2d 178, 181 (Tex. 1995). Further, the Michigan Department of Revenue has announced that it will adhere to the physical presence rule, cementing the rule in that state. *See J.W. Hobbs Corp. v. Dep't of Treas.*, 706 N.W. 2d 460, 463 (Mich. Ct. App. 2005).

use by affiliated companies. *See, e.g.*, *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004), *certification denied*, 611 S.E.2d 168 (N.C.), *cert. denied*, 126 S.Ct. 353 (2005); *Kmart Props., Inc. v. Taxation & Revenue Dep't*, 131 P.3d 27 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22 (N.M. 2005).

More recently, in *Lanco*, 908 A.2d at 177, the New Jersey Supreme Court upheld imposition of a business income tax on an out-of-state company based on license income from use of that company's licensed intellectual property in New Jersey. The court recognized that a "split of authority" had developed since *Quill*, but concluded 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." *Id*. Dispelling any thought that prior cases in the *Geoffrey* line could be limited to intellectual property transactions among affiliated entities, the New Jersey courts specifically made clear that "common ownership" between licensor and licensee "is not material to the constitutional issue concerning" the application of the tax. *Lanco*, 879 A.2d at 1236 (quotation omitted).

Finally, in the decision below in this case, the Supreme Court of Appeals of West Virginia adopted a sweeping assertion of extraterritorial state taxation power, essentially concluding that the state could tax *any* company that has customers in West Virginia. The decision here brings the conflict in authority to full maturity. *Geoffrey* started the trend away from the physical presence rule in the context of intangible holding companies. The New Jersey Supreme Court in *Lanco* extended it by expressly rejecting the legal relevance of corporate affiliation. Now the West Virginia Supreme Court has held that a state may tax an out-of-state corporation where there is neither intangible property nor corporate affiliation, but merely sales to in-state customers. And it did so on facts indistinguishable from the facts of the *J.C. Penney* case—*i.e.*, an out-of-state credit-card company with no physical presence in the state—while reaching exactly the

opposite result. That conflict simply illustrates the broader significance of the decision below: by flatly eliminating the physical presence rule outside the context of sales and use taxes, it throws open the gates to direct state taxation of any and all out-of-state businesses in any and all circumstances, so long as those businesses have in-state customers.

D. The Legal Controversy Is Expanding As States Take Legislative And Administrative Steps To Eliminate The Physical Presence Rule, Just As They Did Following *Bellas Hess*

The reported judicial opinions are only the most visible reflection of the current disarray in the standards governing state taxation authority. Even beyond the jurisdictions discussed above, numerous states have enacted statutes or promulgated regulations that, to varying degrees, abandon the physical presence rule and implicitly adopt various alternative interpretations of the substantial nexus requirement—just as they did with respect to sales and use tax collection obligations in the wake of *Bellas Hess*. *See supra* at 12. In the banking and financial services industry, at least eight states have adopted alternative nexus standards by statute. *See* Ala. Code §§ 40-16-1 *et seq.*; Ala. Reg. 810-9-1-01 *et seq.*; Ind. Code §§ 6-5.5-1-1 *et seq.*; Iowa Code § 422.60 *et seq.*; Ky. Rev. Stat. Ann. §§ 136.500 *et seq.*; Mass. Gen. Laws c. 63, §§ 1 *et seq.*; Minn. Stat. § 290.015 (Subd. 2)(a)(2); Tenn. Code Ann. §§ 67-4-2105(e)(1),(2); W. Va. Code §§ 11-24-1 *et seq.* In addition, at least seven states have adopted alternative nexus standards for general corporations. *See* Ark. Reg. 1996-3 (Ark. Dep't of Fin. & Admin. (Aug. 9. 1996)); Fla. Admin. Code r. 12C-1.011; Iowa Admin. Code r. 701.52.1(422); Directive 96-2 (Mass. Dep't of Revenue July 3, 1996); Minn. Stat. § 290.015; Okla. Admin. Code § 710:50-17-3(a)(9); Wis. Admin. Code § 2.82(4)9. These statutory and regulatory schemes subject out-of-state companies who merely have customers within the state to taxation, even absent any physical presence.

Other states have not yet attempted to exert taxation authority absent physical presence, but they are being actively encouraged to do so. The Multistate Tax Commission ("MTC"), an organization of state governments, is urging states to adopt its model nexus statute, which provides that a substantial nexus is established if an out-of-state company has more than $500,000 of sales to customers in the taxing state.[5] In addition, legislation has been introduced in Oregon, Idaho, and New Hampshire, proposing that those states adopt economic nexus provisions. *See* S.B. 177, 74th Leg. (Or. 2007); H.B. 141, 59th Leg. (Idaho 2007) (passed House Feb. 16, 2007; passed Senate Mar. 2, 2007); H.B. 351, 2007 Sess. (N.H.). It is thus a virtual certainty that absent guidance from this Court, states will seek to expand their taxing power beyond their physical boundaries and into the domain of other states, in the face of this Court's precedents and to the increasing detriment of interstate commerce.

II. THE CONFLICT AMONG THE STATES HARMS INTERSTATE COMMERCE AND REQUIRES RESOLUTION BY THIS COURT

The conflict over the appropriate extent of states' extraterritorial taxation authority is highly significant and should be resolved by this Court. Perhaps most critically, uncertainty over state taxation authority disrupts and deters interstate commerce by hampering reliable strategic business planning. A business seeking to predict the tax liability arising from particular business activities cannot be sure what exactly will subject it to taxation in a given jurisdiction—a tangible physical presence, an intellectual property licensee or two, the presence of a few customers, a minimal amount of attributable revenue, or something else. Because the ex-

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[5] *See* MTC, Factor Presence Nexus Standard for Business Activity Taxes, available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf (visited Mar. 4, 2007).

tent of states' tax authority is still being litigated, even the *current* basis for liability in many states is uncertain.[6]

And absent clear guidance from this Court, there is no reliable way for businesses to predict how far jurisdictions will assert taxation authority in the *future*, and whether those assertions will be upheld in court. This renders long-term strategic decisions, including decisions about where to invest, difficult. The situation is particularly acute for small and medium-size companies that conduct business over the Internet, and are too small to risk developing customer bases in other states if there is some chance that doing so may subject them to the significant economic and compliance burdens of additional taxation.

The states themselves also suffer from uncertainty about the limits imposed by the Commerce Clause. On the one hand, those states that continue to apply the physical presence rule may be forgoing revenue. On the other hand, those states that are aggressively asserting extraterritorial taxing power may be inappropriately interfering with the revenue base and commercial conditions of other states. And all states lose when the national market is constrained by conflicting, self-interested state tax obligations, as this Court and the Constitution's Framers recognized. *See supra* note 1.

This issue's importance extends even to *foreign* commerce. The international tax treaties the United States has signed provide that the U.S. will not impose federal taxes on foreign corporations' business income unless they have a "permanent establishment" in the United States, normally

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[6] Indeed, even where states have clearly held that the physical presence rule applies only to sales and use taxes, there is often uncertainty about whether a given tax is properly denoted a sales or use tax, as opposed to an income or franchise tax. 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. Such definitional uncertainties only underscore why the bright-line physical presence rule should apply uniformly to all taxes.

defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." 1996 U.S. Model Income Tax Treaty, Art. 5. These treaties, however, generally do not prevent States and localities from taxing foreign corporations. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-97 (1983). As a result, if the uncertainty in state authority is not resolved, states may begin to impose taxes directly on foreign corporations based simply on the fact that they have customers in the taxing state, effectively frustrating the limitations on tax liability the U.S. tax treaties contemplate. *Cf. Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448-49 (1979) (noting that "a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential"). This in turn may invite foreign jurisdictions to impose retaliatory taxes, harming U.S. companies doing business abroad and undermining the treaties' fundamental purpose. *Cf. id.* at 450 (noting risk of foreign retaliation if "novel state tax" causes an "asymmetry in the international tax structure").

Finally, the current uncertainty over state extraterritorial taxing authority is itself generating enormous—and enormously wasteful—litigation costs. *Cf. Quill*, 504 U.S. at 315 (noting that a clear rule establishing the boundaries of state taxation authority would "reduc[e] litigation concerning those taxes"). States have an incentive to maximize their tax revenues, especially by imposing tax on out-of-state companies that are not members of the state's political society. Accordingly, state tax authorities will likely continue to assert aggressively the power to tax out-of-state companies, as they have in the past. Out-of-state companies, conversely, already pay large amounts of tax to the jurisdictions where they have employees and maintain tangible property, and will continue to resist these aggressive attempts at extraterritorial taxation. It is thus hardly surprising that the extent of state taxation authority has been vigorously litigated, and virtually certain that such litigation will continue if this

Court does not reaffirm the clear Commerce Clause limits on the states' power to engage in extraterritorial taxation.

This Court recognized in *Quill* that "firmly establish[ing] the boundaries of legitimate state authority to impose" taxes is essential, because "application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their" taxation power. *Quill*, 504 U.S. at 315 (quotation omitted). But while *Quill* explicitly reaffirmed the "precise guide" of the physical presence rule in the context of sales and use taxes, its dicta concerning "other types of taxes" gave willing states an opening to disrupt long-settled expectations built upon the traditional physical presence rule. As a result, "controversy and confusion" now dominate the state taxation landscape. This Court should resolve the controversy its *Quill* dicta has wrought by granting certiorari and reaffirming the applicability of the physical presence rule to all forms of state taxation.

III. THE DECISION BELOW IS INCORRECT AS A MATTER OF BOTH PRECEDENT AND POLICY

Long before *Bellas Hess* and *Quill* were decided, physical presence was already the generally-accepted rule limiting states' authority to impose any extraterritorial tax on out-of-state companies. *See supra* at 11-12. *Bellas Hess* and *Quill* confirmed the application of that rule to sales and use taxes. The question here is whether there is any basis in precedent or logic for treating income and franchise taxes differently from sales and use taxes for purposes of the Commerce Clause.

The answer is no. Neither Congress nor this Court has ever endorsed a rule other than physical presence for satisfaction of the Commerce Clause substantial nexus requirement. And contrary to the decision below, *Quill*'s analysis confirms that physical presence is an essential component of the Commerce Clause's nexus requirement for all types of state taxes. The physical presence rule also plays an impor-

tant role in reinforcing the federal system, and provides a well-established, judicially manageable default rule that sets meaningful limits on state taxation authority, thereby furthering the fundamental purposes of the Commerce Clause.

A. *Quill* Does Not Support Application Of Vague Economic Presence Measures For Taxes Other Than Sales And Use Taxes

Neither *Quill* nor this Court's other Commerce Clause precedents provide a basis for abandoning the physical presence rule outside the context of sales and use taxes, or for establishing a unique rule for sales and use taxes alone. It is true—as the West Virginia Supreme Court of Appeals below noted—that this Court stated in *Quill* that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes." App. 13a-14a (quoting *Quill*, 504 U.S. at 314); *see also Quill*, 504 U.S. at 317. But that dicta does not, by its plain terms, purport to *abolish* the physical presence rule outside the sales and use tax context.

Indeed, *Quill* itself expressly recognized that this Court's prior cases upholding state taxes have all "involved taxpayers who had a physical presence in the taxing State." *Quill*, 504 U.S. at 314. These prior cases include numerous cases involving taxes other than sales and use taxes. *See id.* at 314 (citing *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (upholding a business and occupation tax)); *id.* at 311 (citing *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425 (1980) (upholding an income tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623-24 (1981) (upholding coal severance taxes); *Goldberg v. Sweet*, 488 U.S. 252 (1989) (addressing telecommunications excise taxes)). And the analysis in these cases focuses on the in-state physical activities of the taxpayer or its representative, not the general economic benefit derived from customers within the state. *See, e.g.*, *Tyler Pipe*, 483 U.S. at 249-51; *see also Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 454-55, 464-65 (1959).

Further, although *Quill* itself involved sales and use tax collection obligations, the fundamental "constitutional question in . . . *Quill*" was—as this Court subsequently observed—the *general* question "whether the State has the authority to tax the corporation *at all*" under the Commerce Clause. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 778 (1992) (emphasis added). And while the Court in *Complete Auto* synthesized its Commerce Clause taxation analysis into a generally applicable four-part test, nothing in *Complete Auto* (or any subsequent case) suggests that the "substantial nexus" prong of the test can vary based solely on the type (or label) of tax at issue. To the contrary, 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. *See, e.g.*, *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 555-59 (1977). There is thus no basis in this Court's jurisprudence for treating sales and use taxes differently from other taxes for purposes of the Commerce Clause, and nothing in *Quill* that supports eliminating the physical presence rule outside the context of sales and use tax.

B. A Bright-Line Physical Presence Rule Applicable To All Taxes Settles Expectations, Fosters Investment, And Promotes Interstate Commerce

If anything, *Quill*'s reasons for reaffirming application of the physical presence rule to sales and use taxes apply even more strongly to the income and franchise taxes at issue in this case. To begin, the *Quill* court recognized that a strong reliance interest had arisen around the physical presence rule enunciated in *Bellas Hess*, which had become "part of the basic framework of [the] sizeable [mail-order] industry." 504 U.S. at 317. Such reliance, the Court observed, was a key respect in which the bright-line physical presence rule "furthers the ends of the dormant Commerce Clause," by "encourag[ing] settled expectations" and "foster[ing] investment by businesses and individuals." *Id*. at 314-16.

The same reasoning applies here. As in the sales and use context, interstate businesses have already developed a degree of reliance on the physical presence rule. As noted earlier, physical presence has traditionally been the governing limit on state taxation authority. In 1993, the *Gillette* and *Guardian* cases in Michigan expressed the widely-held understanding of the business community that *Quill* had reaffirmed the broadly applicable physical presence rule in the face of a "changed modern marketplace" argument, and that the type of tax at issue in *Quill* did not limit the rule's scope. Despite the strained misinterpretations of *Quill* by the South Carolina Supreme Court and others, many taxpayers (and numerous states) have relied upon the physical presence rule as the only workable, principled rule for limiting income tax jurisdiction (absent a more detailed legislative resolution that Congress has, to date, declined to provide). This reliance was grounded not simply in *Quill* but also on the understanding, noted above, that this Court has never upheld a state tax in the absence of physical presence, and that the Court's nexus analysis in state taxation cases has always focused on the in-state physical activities of the taxpayer or its representative.

Since *Quill* was decided in 1992, the market has witnessed the growth of much more than just the mail order industry that concerned the Court in *Quill*. The interstate banking industry, of which MBNA is a part, has grown and flourished based upon a number of factors, including not only deregulation and technological innovation, but also reliance on this Court's unbroken record of subjecting out-of-state corporations to tax only if they have in-state physical presence. And of course the Internet has facilitated the growth of a huge sector of the economy: businesses, often small in scale, that can market themselves and their products online in all fifty states (and throughout the world) with minimal overhead. If the large mail-order catalog houses of decades past relied on the physical presence rule to clarify their state taxation burdens, that is all the more true of the

online businesses that are the backbone of modern e-commerce. As in *Quill*, abandoning the physical presence rule would upset these various reliance interests and harm important commerce in the financial services and online industries, as well as others.

C. Abandoning The Physical Presence Rule Will Impose Severe Burdens On Interstate Commerce, Undermining The Purpose Of The Commerce Clause

The Court in *Quill* was also concerned that abandoning the physical presence rule and permitting widespread imposition of tax liability might "unduly burden interstate commerce" in violation of the fundamental purposes of the Commerce Clause. *Quill*, 504 U.S. at 313. Noting that the North Dakota law at issue in *Quill* imposed a collection duty on every vendor who advertised in the state three times in a single year, the Court observed:

> absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions.

Id. at 313 n.6.

These considerations apply with even greater force to the income and franchise taxes at issue in this case. As this Court has recognized, the burden on interstate commerce imposed by direct taxes such as income and franchise taxes is greater than that imposed by indirect sales and use tax collection obligations, because unlike collection obligations, direct taxes impose both administrative *and financial* burdens on taxpayers. *See Nat'l Geographic*, 430 U.S. at 558. Moreover, because income and franchise taxes actually im-

pose payment obligations on the taxpayer, they exacerbate the risk that taxpayers will be taxed multiple times on the same revenue. *Id.*

And, like in *Quill*, the compliance burden imposed by abandoning the physical presence rule for income and franchise taxation would be staggering. As the West Virginia Supreme Court's decision in this case illustrates, absent a physical presence rule, businesses may be subjected to income and franchise taxes virtually anywhere they have customers. As the chart reproduced in the Appendix indicates, there are at present more than *2000 different* income, franchise, and gross receipts taxes imposed on businesses nationwide by state and local jurisdictions. App. 83a. Even more striking, there are more than eight thousand different potential direct taxing jurisdictions across the country, which collectively have the authority to impose more than *12,600* different direct tax obligations. App. 78a, 83a. Accordingly, if this Court were to abandon the physical presence rule for income and state taxation, interstate businesses could be subject to more than 12,600 different direct taxes throughout the United States.

Furthermore, contrary to the West Virginia Supreme Court's inexplicable assertion, *see* App. 16a-17a, the burdens of complying with income and franchise tax laws are at least as onerous as those associated with the sales and use tax collection obligations in *Quill.* Income tax compliance involves understanding and applying apportionment formulae, sourcing and inclusion definitions, legal entity classification, income classification, depreciation, disclosure requirements, and numerous other elements. And each of these elements varies widely among the thousands of potential direct taxing jurisdictions with which corporations would have to file returns. The result would be—and to a great degree already is—a bewildering array of differing rules that would generate enormous compliance costs.

As the *Quill* court noted, the Framers intended the Commerce Clause as a "cure for th[e] structural ills" of "state

taxes and duties" that "hindered and suppressed interstate commerce" under the Articles of Confederation. 504 U.S. at 312-13; *see supra* note 1. The Commerce Clause's nexus requirement is intended to achieve this purpose by "limit[ing] the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." 504 U.S. at 313. Abandoning the clear physical presence rule in favor of vague "economic presence" principles would have exactly the opposite effect, burying interstate businesses in the very "welter of complicated obligations" the Commerce Clause was meant to avoid. *Bellas Hess*, 386 U.S. at 759-60.

D. The Physical Presence Rule Fortifies The Integrity Of Sovereign States

The physical presence rule also embodies the concept of territorial sovereignty that underlies the federal system. Reaffirming that rule would thus fortify this Court's recent insistence on the continuing relevance of state boundaries even in light of modern market realities.

In its opinion below, the West Virginia Supreme Court of Appeals suggested that the "development and proliferation" of various kinds of technology, App. 17a, and the "complex and varied ways" in which commerce is now conducted, App. 22a, have rendered physical presence within a state's borders a "poor measuring stick of an entity's true nexus with a state," App. 18a. The court therefore decided to "eschew" the "rigid and mechanical legal formul[a]" articulated in *Bellas Hess* and *Quill* in favor of "a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense." App. 22a. Such an application, it concluded, permitted it to reach out and tax MBNA, a resident of Delaware that had already paid millions of dollars in taxes to its home state.

As discussed, the West Virginia court's analysis ignores the numerous reasons why a bright-line physical presence rule continues to play an essential role in ensuring a free

flow of interstate commerce even in "today's world." App. 17a. But more fundamentally, the West Virginia court's "changed circumstances" argument attacks the concept of territorial sovereignty that underlies the very idea of a state. In essence, the court held that because modern economic transactions cross borders with ease, geographical boundaries are less important than they once were, and therefore no longer can serve as the foundation for viable legal rules.

That argument fundamentally contradicts this Court's many recent cases reaffirming the importance of geographic state boundaries. Even in cases involving economic transactions in borderless markets, this Court has insisted that state power does not extend beyond state borders, and that the physical location of relevant actors and events matters. *See, e.g.*, *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); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 821-23 (1985).

The physical presence rule reinforces the idea of territorial sovereignty in the context of state taxation by ensuring that the physical location of taxpayers is the decisive factor in determining which sovereigns are entitled to tax which corporations. That rule ensures that each state has access to the revenue base of corporate income within its borders, without interference from other states seeking additional sources of revenue. It also permits states to protect their own taxpayers from burdensome foreign taxation. To say that physical location within a state matters, in other words, is to say that states themselves matter.

E. Physical Presence Is An Appropriate And Judicially Manageable Default Rule

The physical presence rule is also easy to apply, and confers a strong measure of certainty and predictability on the limits of state taxation authority. Taxing authorities and courts have been applying the rule for years, *see, e.g.*, *Tyler Pipe*, 483 U.S. at 250-51, and it has proved capable of estab-

lishing "settled expectations," encouraging investment, and fostering interstate commerce. *Quill*, 504 U.S. at 316; *see id.* at 321 (Scalia, J., concurring) (concern about a "flurry of litigation over the meaning of 'physical presence' seems to me contradicted by 25 years of experience") (citation omitted).

The various types of "economic presence" principles invoked by West Virginia and other states, in contrast, are judicially unmanageable and wholly unsuited to the purposes of the Commerce Clause. "Economic presence," to begin with, does not even describe a single legal test: under this rubric, states have imposed a wide variety of different nexus standards, from those applicable only to the in-state presence of intangible property held by affiliates, to the sweeping assertion of extraterritorial jurisdiction at issue in this case.

What is more, courts are particularly ill-suited to determining what that concept means. Relying vaguely on "economic presence" to justify an extraterritorial tax requires courts to decide how many and what type of contacts with a state create a constitutionally adequate nexus while still avoiding harm to interstate commerce. Any number of factors, alone or in combination, could affect that calculus—number of sales, quantity of goods sold, dollar value of sales, advertising investments, and so on. There is simply no judicially manageable basis on which courts can decide which of these contacts matters, and how much they matter. With such a vaguely defined inquiry, it is a virtual certainty that like taxation cases will *not* be treated alike, contrary to the essential function of the judiciary.

"Economic presence," moreover, provides no meaningful conceptual limits on state taxation authority, as the West Virginia court's decision in this case makes clear. Contrary to that court's statement, "economic presence" does not replace a "rigid and mechanical" rule, App. 22a, with an "elastic" standard, App. 20a. Rather, it replaces a well-established, manageable rule with a principle that is insusceptible to

meaningful definition, much less coherent judicial application.

As the Court recognized in *Quill*, the ultimate authority to regulate interstate commerce lies with Congress. *See Quill*, 504 U.S. at 318-19. But absent congressional action, this Court can and must apply a manageable default rule to limit the state taxation schemes that threaten to impede the free flow of interstate commerce. The current uncertainty is untenable. A clear Commerce Clause rule must be adopted, and the only rule courts have the capacity to manage is the physical presence rule. If Congress were to regard that rule as functionally overbroad or insufficiently nuanced, it could replace it with a statutory scheme providing specific, identifiable criteria authorizing state taxation, as well as safe harbors or exceptions applicable in particular situations. But courts obviously cannot establish such reticulated standards—those are inherently the province of legislative action. What courts can do is to apply clear and specific standards like the physical presence rule, which has been the rule governing state taxation for decades. This Court has expressly endorsed that rule twice, and Congress has never acted to alter it. As long experience shows, the physical presence rule provides more than enough clarity and certainty to encourage reliance and investment, thereby promoting the free flow of commerce between the states. For the same reasons recognized in *Quill*, in short, physical presence is the only rule courts can and should apply in Commerce Clause challenges to state taxation schemes.

CONCLUSION

For the foregoing reasons, the petition should be granted.

Respectfully submitted,

ARTHUR R. ROSEN
DONALD M. GRISWOLD
MCDERMOTT WILL & EMERY LLP
340 Madison Avenue
New York, N.Y. 10173
(212) 547-5400

WALTER DELLINGER
(*Counsel of Record*)
JONATHAN D. HACKER
KARL R. THOMPSON
O'MELVENY & MYERS LLP
1625 Eye Street, NW
Washington, D.C. 20006
(202) 383-5300

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