No. 08-1169

IN THE

Supreme Court of the United States

CAPITAL ONE BANK (USA), N.A.,
F/K/A CAPITAL ONE BANK, AND CAPITAL ONE, N.A.,
AS SUCCESSOR TO CAPITAL ONE F.S.B.
Petitioners,

v.

COMMISSIONER OF REVENUE OF MASSACHUSETTS,
Respondent.

On Petition for a Writ of Certiorari to the Massachusetts Supreme Judicial Court

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONER

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INTEREST OF *AMICUS CURIAE*

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari.[1] Tax Executives Institute (here-

[1] Pursuant to Rule 37.6, *amicus* Tax Executives Institute, Inc. states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Pursuant to Rule

inafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code (26 U.S.C.). The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws, reducing the costs and burdens of compliance to the benefit of both the government and taxpayers, and vindicating the Commerce Clause and other constitutional rights of all business taxpayers.

TEI's 7,000 members represent more than 3,200 of the leading corporations in the United States, Canada, Europe and Asia, including many domiciled or doing business in Massachusetts. TEI members represent a cross-section of the business community whose employers are, almost without exception, engaged in interstate commerce. TEI has a keen interest in the issues raised by the decision of the Supreme Judicial Court of Massachusetts in this case – and in that court's related decision in *Geoffrey, Inc. v. Massachusetts Department of Revenue*, 453 Mass. 17 (2009) – and TEI members will be materially affected by the Court's disposition of this matter.

The issue presented in this case is whether the imposition of the Massachusetts Financial Institution Excise Tax ("FIET") on out-of-state taxpayers having no physical presence within Massachusetts violates

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37.2(a), counsel of record for both parties received timely notice of the intent to file an amicus brief under this rule and both parties have consented to its submission in letters filed with the Clerk.

the Commerce Clause of the United States Constitution. In *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), and again in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court set forth a bright-line rule requiring an enterprise have physical presence in the State before being subject to taxation. If the Court were to overrule or narrow these existing holdings, two correlative questions would have to be addressed: (1) whether the Commerce Clause "substantial nexus" requirement as stipulated in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), is met by an enterprise's "economic presence" in the State, and (2) whether the nexus thresholds in the FIET rise to the level of a sufficient economic presence.

ARGUMENT

I. OVERVIEW

During the periods at issue in this case, Capital One Bank (now Capital One Bank (USA), N.A.) and Capital One F.S.B. (now Capital One, N.A.) (collectively, "Banks") were both wholly owned subsidiaries of Capital One Financial Corporation, a publicly traded corporation listed on the New York Stock Exchange. Capital One Bank, during the periods at issue in this case, was a Virginia chartered credit card bank offering Visa and MasterCard credit cards to its customers. Capital One F.S.B. is a federally chartered savings bank that offers consumer lending and deposit products to its customers, including secured and unsecured credit cards and unsecured installment and consumer home loans. Both entities were at the time domiciled in Virginia.

The Banks have no employees, real property, or tangible property in Massachusetts. Their nation-

wide credit card business is conducted solely through the Internet, mail, television advertising, and long distance telephone solicitations, some of which reach residents of Massachusetts. These solicitations are neither initiated in nor from Massachusetts. In addition, the Banks neither receive nor process any accounts receivable in Massachusetts. The Banks, do however, derive receipts (primarily, finance charges) from customers who are Massachusetts residents.

After analyzing the Banks' activities, the Massachusetts Department of Revenue ("Department") determined that the Banks were subject to the FIET as a result of their "economic presence" in the Commonwealth. The Banks appealed this determination to the Massachusetts Appellate Tax Board. Finding that economic presence alone created nexus in the State, the Board found in favor of the Department. The Banks appealed this decision, and the Massachusetts Supreme Judicial Court agreed that the Banks' economic presence in Massachusetts created nexus in the Commonwealth causing the Banks to be subject to the FIET.

II. STATES HAVE DISREGARDED THIS COURT'S NEXUS JURISPRUDENCE, SPAWNING AN UNWORKABLE PATCHWORK OF INCONSISTENT STANDARDS THAT VIOLATE THE COMMERCE CLAUSE

More than 40 years ago, this Court held that under the Commerce Clause of the Constitution an enterprise must be physically present in a State for the State to subject the enterprise to taxation. Regrettably, the States have taken the Court's clear guidance and blurred it through inconsistent, vague, and over-

broad standards creating uncertainty where there rightly should be none.

In 1967, this Court held in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), that a sales and use tax could not constitutionally be imposed on a vendor whose only contacts with the taxing State were through the mail and by common courier.[2] A decade later, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court reiterated that a threshold requirement of the Commerce Clause is the presence of "sufficient nexus" between the State and the person, property, or transaction to be taxed. *Id.* at 279. Fifteen years later in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court confirmed the vitality of the *Complete Auto Transit* construct and effectively harmonized that decision with the clear guidance enunciated in *National Bellas Hess*. It also reaffirmed the constitutional prerequisite for Commerce Clause purposes of the taxpayer's physical presence in the taxing jurisdiction.[3] *Id.* at 308. Thus, *Quill* con-

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[2] In *National Bellas Hess*, the Court struck down Illinois's effort to require an out-of-state mail-order business to collect use tax on mail-order sales made to state residents on both due process and Commerce Clause grounds. The Court explained that permitting the imposition of a use tax collection duty on a business that maintained no physical presence in the State would give rise to "unjustifiable local entanglements" of interstate commerce. 386 U.S. at 760. The Court reasoned that the administrative and recordkeeping requirements that could arise in the absence of a physical presence test "could entangle National [Bellas Hess]'s interstate business in a virtual welter of complicated obligations to local jurisdictions . . . ." *Id.* at 759-60.

[3] The Court in *Quill* overruled the part of *National Bellas Hess* holding that physical presence is also required for *due process* purposes. 504 U.S. at 308.

firmed that a vendor whose only contacts with the taxing State are by mail or common-carrier lacks the substantial nexus required by the Commerce Clause. *Id.*

In *Quill*, the Court embraced *National Bellas Hess's* bright-line, physical-presence test of Commerce Clause nexus not only because such a test "furthers the ends of the dormant Commerce Clause" by "demarcati[ng] . . . a discrete realm of commercial activity that is free from interstate taxation," *id.* at 315, but because it fosters the "interest in stability and orderly development of the law" that undergirds the doctrine of *stare decisis*. *See Runyon v. McCrary*, 427 U.S. 160, 190-91 (1976) (Stevens, J., concurring) (quoted in *Quill Corp.*, 504 U.S. at 315).[4] The Court in *Quill* did not explicitly extend its holding beyond the sales and use tax area, but did caution that its declining to articulate a physical-presence test in other areas "does not imply repudiation of the *[National] Bellas Hess* rule" in those areas. *Id.* at 314.

Despite the Court's caution in *Quill*, States have ignored the core teaching of the decision and have sought to exploit the facts of the case and necessary narrowness of the Court's holding to stretch the concept of nexus outside of the sales and use tax context. The refusal of the States to follow *Quill* has placed a heavy burden on interstate commerce as taxpayers are forced to expend time and energy in order to vindicate their constitutional rights, contend with the attendant uncertainty, and – absent intervention of this Court – pay taxes beyond what the Constitution

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[4] "[T]he continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate the *[National] Bellas Hess* rule remains good law." *Quill Corp.*, 504 U.S. at 317.

allows. In holding that "the constitutionality, under the commerce clause, of the Commonwealth's imposition of the FIET is determined not by *Quill*'s physical presence test, but by the 'substantial nexus' test articulated in *Complete Auto*," *Capital One Bank v. Commissioner of Revenue*, 453 Mass. 1, 15 (2009), the Massachusetts court provided yet another example of the extraterritorial taxation that has been occasioned by the amorphous economic nexus standards conjured by States.

Regrettably, State after State has read the Court's opinion in *Quill* as license to extend the reach of their taxing powers outside of the sales and use tax context with impunity. The first State to take advantage of this approach was South Carolina. In *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13, *cert. denied*, 510 U.S. 992 (1993), the South Carolina Supreme Court determined that the use of intangible property by an affiliated company crossed the substantial nexus threshold even though the taxpayer had no physical presence in the State.

Following this Court's declining to review the decision in *Geoffrey*, other States followed South Carolina's lead to distend the constitutional nexus standard. For example, the New Mexico Court of Appeals opined that "the use of . . . [the out-of-state corporation's] marks within New Mexico's economic market, for purposes of generating substantial income," established sufficient nexus to satisfy the Commerce Clause. *Kmart Properties, Inc. v. New Mexico Taxation and Revenue Department*, 131 P.3d 27, 36 (N.M. Ct. App. 2001).[5]

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[5] On the other hand, the Tennessee Court of Appeals held – in a case with facts much more similar to those of this case – that

Similarly, state legislatures and state departments of revenue have created far-reaching and vague corporate income tax nexus standards untethered to in-state physical presence. Under Georgia's statute, a taxpayer is subject to tax if it derives—

> income from sources within this state to the extent permitted by the United States Constitution. A corporation shall be deemed to be doing business within this state if it engages within this state in any activities or transactions for the purpose of financial profit or gain whether or not . . . [t]he corporation maintains an office or place of doing business within this state.

Ga. Code Ann. § 48-7-31(a). The State of Illinois imposes "a tax measured by net income on . . . [every] corporation for the privilege of earning or receiving income in . . . [the] state," 35 Ill. Comp. Stat. 5/201(a), and does not require a physical presence in the state. *See* Ill. Admin. Code tit. 86 § 100.9720. Louisiana imposes its corporation income tax on net income earned or derived from sources within the State and also does not require a physical presence. *See* La. Rev. Stat. Ann. § 47:287.67. Other States have enacted similarly expansive – but not consistent – nexus rules.[6] However facile the State's reasoning,

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Commerce Clause nexus was lacking where an out-of-state bank was not physically present in the State. *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999).

[6] For example, the District of Columbia imposes its corporation franchise tax on the amount of net income derived in the District for "the privilege of carrying on or engaging in any trade or business within the District *and* of receiving . . . income . . . from sources within the District." D.C. Code Ann. § 47-1810.01 (emphasis added). *See also* D.C. Code Ann. § 47-1805.02(5).

these broad and uncertain standards impermissibly burden interstate commerce.

Two years ago, this Court declined the opportunity to address this issue in the context of a credit card issuer by denying certiorari in *Tax Commissioner v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (2006), *cert. denied*, __ U.S. __, 127 S. Ct. 2997 (2007). While the Court's action formally has no precedential status,[7] that is not how the States interpreted it. Indeed, as was the case following the Court's 1993 denial of certiorari in *Geoffrey, Inc. v. South Carolina*, many States brazenly took the denial of certiorari in *MBNA* as a green light to extend their nexus standards by fashioning ever expanding variations on the economic nexus theme. Thus, New Hampshire codified an open-ended standard that reaches any "purposeful direction of business toward the state." N.H. Rev. Stat. Ann. § 77-A:1(XII) (effective July 1, 2007). In Wisconsin, the legislature pushed the constitutional envelope further by enacting legislation defining nexus to include—

> regularly soliciting business from potential customers in this state; regularly performing services outside this state for which the benefits are received in this state; regularly engaging in transactions with customers in this state that involve intangible property and result in receipts flowing to the taxpayer from within this state; holding loans secured by real or tangible personal property located in this state.

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[7] "The denial of a writ of certiorari imports no expression of opinion upon the merits of the case, as the bar has been told many times." *United States v. Carver*, 260 U.S. 482, 490 (1923).

Wis. Stat. § 71.22(1r) (effective January 1, 2009). Finally, earlier this year California stretched its nexus definition to include corporations having gross receipts from California sources in excess of $500,000 or a sales factor of more than 0.25 percent (sales for this purpose include sales made by independent contractors and agents) – regardless of any physical presence in the State. Cal. Rev. & Tax Code § 23101 (effective January 1, 2011).

Following the refusal to grant certiorari in *MBNA*, state departments of revenue have also aggressively interpreted existing corporate income tax nexus statutes. In October 2007, the Florida Department of Revenue ruled that its "position is that physical presence . . . [is] not required to impose Florida's corporate income tax." Florida Department of Revenue, Technical Assistance Advisement (TAA) #07C1-007 (October 17, 2007).

Likewise, Maine Revenue Services simply stated that it "considers taxpayers with economic nexus alone to be subject to Maine's income tax laws." Maine Revenue Services, Tax Alert, Vol. 18, Issue 2 (February 2008). This publication notes as support for this expansive interpretation that "[t]he State Tax Assessor construes Maine law to assert the tax jurisdiction of Maine to the full extent permitted by the Constitution and laws of the United States." *Id.*

The Oregon Department of Revenue, too, promulgated an expansive nexus regulation in May 2008, providing that "[s]ubstantial nexus exists where a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer and may be established through the significant economic presence of a taxpayer in the state." Oregon Administrative Code § 150-317-010(2).

Finally, the Iowa Department of Revenue issued two rulings in 2008 that strain even the broadest reading of the Court's guidance on the substantial nexus standard. In one case, the Department ruled that an out-of-state corporation had nexus with the State solely as a result of licensing software to customers in Iowa. Iowa Department of Revenue, Policy Letter 08240032 (May 14, 2008). In the second case, the Administrative Hearings Division of the Iowa Department of Inspections and Appeals ruled that an out-of-state franchisor had nexus in Iowa since an in-state franchisee was required to pay the franchisor based on the gross revenue of the franchisee's business in Iowa. *KFC Corp. v. Department of Revenue*, Iowa Department of Inspections and Appeals, Hearings Division, Docket No. 07DORFC016 (August 8, 2008).

Even States that previously followed the physical presence nexus standard have exploited the vacuum created by the lack of Supreme Court guidance since 1992. For example, in 1993, the Michigan Court of Appeals held that "after *Quill*, it is abundantly clear that Guardian [the taxpayer] must show a physical presence within a target state to establish a substantial nexus to it." *Guardian Industries Corp. v. Department of Treasury*, 499 N.W.2d 349, 353 (Mich. Ct. App. 1993). Fifteen years later, however, with the passage of the new Michigan Business Tax, effective beginning January 1, 2008, a taxpayer will have nexus in Michigan if it purposefully solicits persons within Michigan and generates gross receipts from Michigan of greater than $350,000. *See* M.C.L. § 208.1200(1) and Revenue Administration Bulletin 2008-4. Thus, the Michigan Department of Treasury now interprets the Supreme Court's holding in *Quill* to apply only to sales taxes, and has stated that "sub-

stantial nexus" includes economic nexus for purposes of the new Michigan Business Tax. *Id.*

This patchwork of rules imposes unnecessary burdens on interstate commerce.[8] Multistate taxpayers must now cope not only with complex state corporate income and franchise tax law but must engage in prolonged and costly legal battles against unchastened state tax administrators. Additionally, publicly traded corporations are now required to record a liability on their financial statements for income tax positions that are not supported by authority rising to a "more likely than not" level of assurance. This requirement forces taxpayers to deal directly with the consequences of uncertainty in the preparation of their financial statements.[9] Taxpayers and States would greatly benefit from clear guidance by this Court on this important issue. Although Congress "may be better qualified to resolve" this issue, *Quill*, 504 U.S. at 318, in the 17 years since *Quill*, Congress has repeatedly declined to enact limits on the States' ability to tax multistate business – or to lift the limits

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[8] "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. Director, Div. of Taxation*, 504 U.S. 768, 777-78 (1992).

[9] *See* Financial Accounting Standards Board, Financial Accounting Series, No. 281-B, *FASB Interpretation No. 48– Accounting for Uncertainty in Income Taxes* (2006). FIN 48 was issued by the Financial Accounting Standards Board in July 2006 and is effective for fiscal years beginning after December 15, 2006.

this Court has imposed pursuant to the dormant Commerce Clause.[10]

Neither the Court nor the taxpayers should be surprised by the chip-chip-chip war of attrition that the States have engaged in since *Quill*. The same thing happened following the Court's decision in *National Bellas Hess*. Between 1967 and 1992, State after State engaged in wordplay and legislative sleight-of-hand to rationalize why the Commerce Clause holding of *National Bellas Hess* need not be followed.[11] Given the absence of congressional action, the reliance interest invoked in *Quill* – and chipped away by the States – should again be vivified by this Court.

III. DIFFERENT NEXUS STANDARDS FOR INCOME TAX PURPOSES AND SALES AND USE TAX PURPOSES ARE NOT JUSTIFIED

Those States that have moved away from the physical presence nexus standard have almost uniformly justified their departure by the Court's not expressly addressing the application of its holding to income taxes. This is the case even though the Court in *Quill* cautioned that its "silence" with respect to other taxes "does not imply repudiation of the *[National] Bellas Hess* rule." *Quill*, 504 U.S. at 314. While clever,

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[10] *See e.g.*, Business Activity Tax Simplification Act of 2009, H.R. 1083, 111th Cong. (2009); Business Activity Tax Simplification Act of 2007, S. 1726, 110th Cong. (2007); Internet Fairness Act of 2001. H.R. 2526, 107th Cong. (2001); New Economy Fairness Act, S. 664, 107th Cong. (2001).

[11] *See* Laura A Kulwicki, *State Taxation of Mail Order Sellers: An End to the Nexus Wars?*, 1 State Tax Notes 332 (1991).

that interpretation of *Quill* lacks support in this Court's decisions.

Amicus TEI submits that there is no policy basis for distinguishing between the level of nexus required for sales and use tax purposes and that required for income tax purposes. To be sure, the objectives of the Commerce Clause are the same regardless of the type of tax; the focus is not on the form of tax but on the burdens it imposes. As for the lack of a direct holding on the appropriate income tax standard, *amicus* TEI suggests that it is historically due to acceptance of the principle that the same physical presence standard itself governs all taxes.

Indeed, ample grounds exist for concluding that the nexus requirement for income tax purposes is *more* demanding than the requirement for sales and use tax purposes. Unlike sales and use taxes, which are transaction-based, the authority to impose an income tax is predicated on a taxpayer's own links to the taxing jurisdiction – that is to say, whether the taxpayer is sufficiently present, or active, in the State (and derives sufficient benefits from the State) to satisfy the Constitution's minimum contacts requirement. The transactions being taxed under a sales and use taxing scheme are themselves a link between the taxpayer and the State, a connection that must be buttressed by the taxpayer's physical presence in order to survive constitutional scrutiny. Where the tax is imposed not on transactions but on income, an even-more-substantial connection is justified. Where the tax is imposed not on transactions but on a business's entire operations (potentially subject to apportionment), an even more substantial connection – physical presence – is constitutionally required.

One of the principal arguments made in support of a separate standard for sales and use taxes is that those taxes create a much more onerous compliance burden than other types of taxes. That is not the case. To be sure, this Court has recognized the burden of complying with sales and use tax rules in "the Nation's 6,000-plus taxing jurisdictions," *Quill*, 504 U.S. at 313 n.6, but multistate taxpayers also labor under weighty corporate income and franchise tax compliance burdens. Indeed, a 2002 study concluded that state income tax compliance costs are approximately double the costs of the federal burden,[12] in large measure because of differences among the States: "[S]tates differ in their reporting and filing procedures that determine which corporations must file a return, which related entities file together or separately, due dates for filing and paying taxes, and acceptance of federal extensions."[13] Some states require combined reporting, some States require the filing of a consolidated return, and other States allow separate reporting by each entity within an affiliated group.[14] While none of the compliance burdens occasioned by the wide variety of state income tax provisions may by itself be of constitutional moment, in combination with the amorphous economic nexus standard proposed by Massachusetts here they would dwarf the burdens of the various state sales and use taxes that the Court in *Quill* found to unduly burden interstate commerce in violation of the Commerce Clause.

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[12] Sanjay Gupta & Lillian Mills, *How Do Differences in State Corporate Income Tax Systems Affect Compliance Cost Burdens?*, 56 National Tax J. 355-71 (June 2003).

[13] *Id.* at 358.

[14] *Id.*

In addition to corporate income taxes, many States impose franchise or net worth taxes on corporations that have nexus for state income tax purposes. The State of New York, for instance, imposes four different types of taxes on corporations with nexus in the State that all must be calculated as part of the filing of a single corporate income tax return. The heavy compliance responsibilities imposed on multistate taxpayers become crushing when the complexities associated with navigating the nexus labyrinth are added.

The development by States of new and diverse taxes also diminishes any justification that might exist for varying constitutional nexus standards. As States experiment with different types of taxes, the differences between sales taxes and other forms of taxation begin to blur. Examples of these new taxes include (1) Ohio's Commercial Activity Tax enacted in 2005 (based solely on gross receipts); (2) Michigan's Modified Gross Receipts Tax enacted in 2007 (based on gross receipts less certain purchases); and (3) Texas' Margin Tax enacted in 2007 (based on gross receipts less the greater of compensation, costs of goods sold or 30% of gross receipts). A clear standard for all taxes is critical. Permitting differing standards based on tax type would embolden States to continue considering alternative revenue raising methods to avoid the constitutional limits articulated in *Quill*. For example, a corporation whose activities in Michigan before the enactment of the Michigan Modified Gross Receipts Tax did not create nexus could now be subject to tax in Michigan if the constitutional limitations on nexus for an income tax and a gross receipts tax are different. The Court should take this opportunity occasioned by this case

to provide much needed guidance on this issue and to affirm the vitality of the physical presence test.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for a writ of certiorari and reverse the decision below.

Respectfully submitted,

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