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 Supreme Judicial Court Of Massachusetts

REPLY BRIEF FOR THE PETITIONERS

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Respondent does not even attempt to rebut petitioners' compelling showing that the decision of the Supreme Judicial Court ("SJC") is utterly irreconcilable with the rationale of *Quill Corp.* v. *North Dakota*, 504 U.S. 298 (1992), which construed the same "substantial nexus" prong that governs this case. Essentially conceding that no principled ground for distinction exists, respondent merely reiterates the SJC's *ipse dixit* that *Quill* should be limited to its facts, even though this Court has repeatedly cited *Quill* outside the use-tax context. This Court's precedents ought not be so lightly dismissed by lower courts. The SJC's cavalier treatment of *Quill* deserves further review.

Respondent also overlooks the inconsistencies between the judgment below and this Court's other Commerce Clause precedents, and fails to rebut petitioners' showing that the SJC's ruling exacerbates a growing conflict among decisions of multiple state appellate courts. Furthermore, by authorizing an amorphous "economic-nexus" pseudo-test for taxation of non-domiciliaries, the decision below contributes to the growing uncertainty over such taxation, which only this Court is realistically in a position to resolve.

Respondent strives mightily to deny the extraordinary importance of the question presented, but her arguments ring hollow, particularly given the broad array of amicus voices clamoring for review in this case. Most tellingly, respondent offers no response whatsoever to the States' amicus brief urging this Court to grant certiorari and provide

much-needed clarity and timely guidance in this crucial area of the law. The time has come to confirm, as *Quill*'s logic dictates, that "substantial nexus" requires physical presence as a bright-line, irreducible minimum.

A. The Decision Below Is Irreconcilable With *Quill* And Other Precedents Of This Court

1. Respondent first attempts to minimize the importance of *Quill*. Echoing the SJC's errors, she dismisses that controlling precedent as applicable only to "sales and use taxation and the mail-order industry" (Opp. 12), and as resting entirely on the *stare decisis* effect of *National Bellas Hess, Inc.* v. *Department of Revenue of Illinois*, 386 U.S. 753 (1967). Both arguments lack merit.

First, although the facts examined in *Quill* concerned use taxation of mail-order catalogue transactions, this Court based its decision on an interpretation of the Commerce Clause's substantial-nexus requirement, not on constitutional principles somehow unique to mail-order merchandising. As demonstrated (Pet. 11-12), this Court has freely cited *Bellas Hess* and *Quill* in cases outside the sales-and-use-tax context. Those cases endure, yet respondent fails to discuss any of them. Contrary to respondent's implausible theory, *Quill* established no unprincipled, formalistic wall dividing sales and use taxation from income taxation for constitutional purposes. The SJC boldly overstepped its authority in arbitrarily confining this Court's precedents to the particular taxes at issue in those cases.

Respondent's insistence that the physical-presence requirement applies solely to the precise tax addressed in *Quill* also disinters the very formalism this Court laid to rest in favor of examining the

"practical effect" of state taxes under the Commerce Clause. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977); Pet. 17-18. Respondent does not even dispute, much less cure, this further weakness in her position.

Second, respondent is mistaken in arguing that the discussion of *stare decisis* in *Quill* supports limiting the decision to the sales-and-use-tax context. That discussion was necessary to demonstrate that the North Dakota Supreme Court had erred in setting aside *Bellas Hess* as obsolete. Pet. 4-5. But the *Quill* Court did not stop there, as respondent would have it. Instead, the Court went on to hold that the physical-presence requirement is entirely consistent with, and is indeed an interpretation of, the substantial-nexus requirement (504 U.S. at 311)—a requirement that applies equally in this case, which involves essentially identical nexus-related facts.

Respondent's improbable contention is that the logic of *Quill* should be ignored because *Quill* relied in part on *stare decisis*. That argument is not only inherently nonsensical but also incomplete. Even before this Court decided *Bellas Hess*, it applied the physical-presence rule outside the narrow sales-and-use-tax context to a tax analogous to the one challenged here. *Norton Co.* v. *Dep't of Revenue of Ill.*, 340 U.S. 534 (1951); Pet. 12-13.

Respondent fails even to cite (much less distinguish) *Norton*, but that ostrich-like tactic merely reveals the weakness of respondent's position. Thus, contrary to respondent's contention that petitioners are "urging a new rule of physical presence" (Opp. 23), *Norton* confirms that physical presence has long been the constitutional precondition for state taxation of non-domiciliaries, including taxes based on

the taxpayer's gross receipts (*i.e.*, income). Indeed, this Court has ***never*** upheld a state income tax where physical presence was lacking. The growing rebellion by state courts dissatisfied with this Court's validation of the physical-presence requirement should not escape review.[1]

2. Respondent also confuses the Commerce Clause and the Due Process Clause as distinct limitations on state taxing powers. As explained (Pet. 19-20), the SJC effectively collapsed the Commerce Clause's substantial-nexus requirement into the far less demanding "minimum contacts" test under the Due Process Clause, thereby contravening *Quill*'s clear holding that the Commerce Clause test is more rigorous and requires a closer nexus. 504 U.S. at 313. Respondent offers no defense of the SJC's analysis, and suggests no means for keeping the inquiries under the two clauses separate, as *Quill* demands.

Indeed, respondent ardently embraces the SJC's error when she asserts—without citing any authority (Opp. 23)—that small and medium-sized businesses should look to the Due Process Clause, rather than the Commerce Clause, to protect them from the burdens imposed by the uncertainties of state taxation under the economic-nexus theory. *Cf.* Council on State Taxation ("COST") Br. 16-17 (describing spe-

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[1] Respondent states that petitioners' marketing efforts aimed at Massachusetts consumers included "solicit[ing] credit card customers through . . . third parties at marketing events and at retail establishments" (Opp. 7), but the record is clear that, as the SJC found, petitioners "neither owned nor leased any real property" in Massachusetts, they "owned no other Massachusetts property, and no employee, agent, or independent contractor" of petitioners "was located in Massachusetts." App. 3a.

cial burdens on small businesses). In so doing, respondent effectively concedes that the SJC has eviscerated the Commerce Clause's substantial-nexus requirement as an independent safeguard against illegitimate state taxation, instead restoring a regime under which only the Due Process Clause constrains such taxation. *Quill* definitively rejects that approach.

B. The Decision Below Deepens A Concrete And Persistent Conflict

1. Respondent errs in dismissing the division among state appellate courts over the question presented. Opp. 14-15. Multiple state courts have addressed this recurring issue. Pet. 21-25; Virginia ("States") Br. 3-7. Because it hinges entirely on the proper interpretation of this Court's own precedents, however, additional percolation in the state courts will not provide enlightenment.

Furthermore, the conflict cannot be disregarded as "well past its shelf life." Opp. 15. As the amicus States correctly observe in urging certiorari, the continuing split of authority "invites complex litigation and creates uncertainty" for state tax systems. States Br. 2. Review is essential now to avoid exacerbating those and other serious problems that the conflict has already spawned. Pet. 26-33.

2. Denying that the state courts are in disarray, respondent relies heavily (Opp. 15-16) on cases that involve very different nexus-related facts and are thus inapposite, as even the SJC recognized. Pet. 25 n.7. The courts in the intangible-holding-company cases rejected Commerce Clause challenges to state taxation of "foreign corporations with intangible property . . . that was being used in the taxing State by a licensee" physically present in the State (App.

21a n.19), where the licensees and the foreign corporations typically were commonly controlled. *See, e.g.*, *A&F Trademark, Inc.* v. *Tolson*, 605 S.E.2d 187, 195 (N.C. Ct. App. 2004) (taxpayer "licenses trademarks to a related retail company operating stores located within" taxing State).

The Commerce Clause gives States various avenues for taxing inter-company transfers attributable to members of a commonly-controlled group of corporations, one of which does business in-state. *See, e.g.*, *Comptroller of the Treasury v. SYL, Inc.*, 825 A.2d 399, 415 (Md. 2003) (concluding that intangible holding companies "had no real economic substance as separate business entities" for tax purposes). The question of state authority to tax intangible-holding-company royalties is thus far removed from the issue here. Unlike in those cases, there is no suggestion that petitioners derive income from commonly-controlled corporations with a physical presence in Massachusetts. All of petitioners' physical conduct supporting their business transactions with Massachusetts residents occurred outside of Massachusetts. The apparent agreement among state courts over intangible-holding-company cases thus sheds no light here.[2]

Respondent also errs in relying (Opp. 16) on irrelevant cases involving taxpayers physically present within the taxing State. *See Gen. Motors Corp.* v. *City of Seattle*, 25 P.3d 1022, 1024 (Wash. Ct. App. 2001) (taxpayer had physical presence based on regu-

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[2] Notwithstanding respondent's suggestion (Opp. 6-7), the SJC did not rely on the appearance of the "Capital One" trademark on credit cards as a purported basis for the assertion of taxing authority, and there is no suggestion that petitioners earned royalties from any in-state licensee of the trademark.

lar visits by its agents); *Borden Chems. & Plastics* v. *Zehnder*, 726 N.E.2d 73, 81-82 (Ill. App. Ct. 2000) (partnership's in-state presence imputed to taxpayer-partner); *Couchot* v. *State Lottery Comm'n*, 659 N.E.2d 1225, 1230-31 (Ohio 1996) (taxpayer purchased lottery ticket in state); *see also Buehner Block Co.* v. *Wyo. Dep't of Revenue*, 139 P.3d 1150, 1152 (Wyo. 2006) (taxpayer failed to collect sales tax on product delivered to in-state customers).

3. Respondent also attempts to downplay the depth of the state appellate conflict by painting the three key precedents as inapposite or superseded. Opp. 18-20. As the brief of Virginia and South Dakota confirms, however, those cases establish a concrete conflict that continues to generate uncertainty for States and taxpayers alike. States Br. 6-7.

After conceding that the decision below conflicts with *J.C. Penney National Bank* v. *Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), respondent rehashes the SJC's excuse for ignoring that case (Opp. 18), contending that the decision was abrogated by the unpublished decision in *America Online, Inc.* v. *Johnson*, No. M2001-00927COA-R3-CV, 2002 WL 1751434 at *2 (Tenn. Ct. App. July 30, 2002) ("*AOL*"). As explained (Pet. 23 n.5), *AOL* held only that a determination of whether the taxpayer had in-state physical presence required additional factfinding, and in Tennessee (as elsewhere), unpublished dispositions cannot overrule published precedents. Respondent offers nothing in rebuttal. *J.C. Penney* thus stands as binding statewide precedent in Tennessee. Pet. 22-23.

Respondent also misreads *Guardian Industries Corp.* v. *Department of Treasury,* 499 N.W.2d 349 (Mich. Ct. App. 1993). Opp. 18-19. There the court

remanded for factfinding to determine whether the taxpayer had physical presence (through its employees' sales activities) in numerous States to which the taxpayer had made tax payments that it sought to credit against its Michigan tax obligations. 499 N.W.2d at 357. The court held that if the taxpayer's "employees were never present" within those States (*id.*), the taxpayer would not be entitled to a credit because those States could not validly tax the taxpayer's activities—a clear application of the very physical-presence rule that the SJC rejected. Although Michigan rewrote its tax laws after *Guardian* was decided (Pet. 32), nothing indicates that the Michigan courts have abandoned the physical-presence rule that was clearly adopted and enforced in *Guardian*.

Respondent fares no better in her effort (Opp. 19-20) to distinguish *Rylander* v. *Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000). To be sure, the State there sought to tax the taxpayer's state-derived income based on its possession of a certificate to do business within the State. 18 S.W.3d at 299. The crucial point, however, is that in deciding whether the State's assertion of taxing authority was consistent with the Commerce Clause, the court squarely held that in-state physical presence is a precondition for imposition of taxes such as the franchise tax in question. *Id.* at 299-300; *see* Pet. 23-24. The Commerce Clause "substantial nexus" analysis that respondent dismisses as dicta was thus a critical step in the *Rylander* court's reasoning, and that reasoning is directly contrary to the decision below.

C. The Existing And Increasingly Burdensome Uncertainty Over The Question Presented Intensifies The Need For Review

1. Respondent discounts as mere "speculation" the unconstitutional burdens on interstate commerce created by the vague economic-nexus approach and the continuing uncertainty over the scope of the physical-presence requirement. Opp. 21-25. Yet state taxation in defiance of *Quill* threatens "insurers, online retailers, software makers, and other companies that mainly operate in a single state but have customers across the U.S." Jessica Silver-Greenberg, *Corporate Taxes Cross State Lines*, BUSINESSWEEK, June 1, 2009, at 28. Amici provide authoritative accounts of the reality and extent of those harms, belying respondent's breezy assurances that review is not warranted. As amici demonstrate, broad segments of the business community are suffering in ever-increasing measure from the confusion surrounding this issue and from the burdens of state taxation under the economic-nexus theory. COST Br. 6-19; Clearing House Ass'n ("CHA") Br. 9-11; Tax Executives Institute ("TEI") Br. 6-13.

Moreover, even apart from the impact upon *taxpayers*, the submission of Virginia and South Dakota demonstrates that *taxing States* recognize the uncertainty swirling around the question presented and the urgent need to resolve it. States Br. 3-13. It is unsurprising that respondent—having prevailed in the highest forum (other than this Court) with jurisdiction to address the constitutionality of Massachusetts' tax—now seeks to avoid review. But that self-interested preference ought not prevail over the earnest plea of other States for this Court's intervention to settle the controversy for the entire Nation.

2. In contending that income taxes must be distinguished under the Commerce Clause from sales and use taxes, respondent parrots the SJC's unsubstantiated musings about the comparative compliance burdens that purportedly make the latter more onerous than the former. Opp. 21-22. As explained (Pet. 13-16), however, this Court has already addressed that question, and has concluded that income taxes are *more* burdensome than sales and use taxes. A use tax often is not a significant obligation, this Court stated, because the "burden of the tax is placed on the ultimate purchaser," such that the out-of-state vendor itself "is charged with no tax" (*Scripto, Inc.* v. *Carson*, 362 U.S. 207, 211 (1960)), which makes the "case for the validity of the imposition" of use taxes "stronger" than the case for imposition of "fairly apportioned, non-discriminatory direct taxes" (*Nat'l Geographic Soc'y* v. *Cal. Bd. of Equalization*, 430 U.S. 551, 557-58 (1977)). In addition, when more than one State imposes a tax on a corporation's income, the serious "risk of double taxation" that arises has no counterpart in the sales-and-use-tax context. *Id.*

The SJC's refusal to heed those conclusions heightens the conflict between its reasoning and this Court's prior decisions. The difference in burdens, moreover, has not diminished since this Court last considered them: Income taxes remain far more burdensome than sales and use taxes, imposing direct liability (rather than mere collection responsibility) and requiring multiple filings each year (typically including quarterly estimated taxes as well as annual returns) that are subject to a vast array of often-differing rules regarding reporting method, apportionment, computation of tax base and deduc-

tions, depreciation, etc. COST Br. 8-16; TEI Br. 14-16.

3. Respondent also contends (Opp. 24) that the burdens identified by petitioners and their amici should not be relieved through enforcement of the substantial-nexus requirement, but rather through the non-discrimination and fair-apportionment requirements. *See Complete Auto*, 430 U.S. at 279. This Court made explicit in *Quill*, however, that the substantial-nexus requirement serves an independent function as "a means for limiting state burdens on interstate commerce." 504 U.S. at 313. The elements of the *Complete Auto* test cannot be used to undermine each other. Respondent's approach must be rejected, as it would promote double taxation while rendering the substantial-nexus requirement effectively superfluous.

4. Respondent invokes the waiver doctrine (Opp. 24-25) to answer the argument that the economic-nexus approach may have significant and disruptive ramifications for foreign relations. Pet. 29-30; *see* CHA Br. 14-21. Respondent misses the point. The crucial concern—essentially unrebutted by respondent—is that the substantial-nexus approach adopted by the SJC threatens to undermine this Nation's preferred approach to international taxation by encouraging reciprocal violations of the "permanent establishment" principle. Review by this Court is therefore warranted, because reaffirmation of the physical-presence requirement will alleviate the foreign-relations concern by clarifying the constitutional prohibition against state efforts to pursue non-domiciliary foreign businesses.

5. Finally, respondent advocates denial of review on the theory that Congress is "better qualified" to

address whether physical presence is a precondition for state taxation of non-domiciliaries' income. Opp. 25-27. Congressional competence, however, is not at issue.

The SJC's holding rests on a misreading of this Court's constitutional decision in *Quill*, which affirmed the Commerce Clause component of *Bellas Hess* and thus interpreted the Constitution itself. 504 U.S. at 314. Accordingly, the decision below reflects an error in constitutional interpretation, not the mere adoption of unsound policy suited for legislative alteration. This Court's review is necessary to restore the "bright-line rule" of *Quill* (504 U.S. at 317), a rule that some state courts (like the SJC) have eroded since *Quill* was decided. It is well within this Court's competence to secure obedience to its own precedents.

Congress has shown no inclination to take up the constitutional issue presented in this case. Pet. 33-34 & n.14; *see* TEI Br. 12-13 & n.8 (observing that Congress has never voted on "the nexus related portions" of any post-*Quill* bills "that would have legislated the limits of state tax nexus"). The mere possibility of congressional action did not foreclose review in *Quill* (*see* 504 U.S. at 318 & n.11), and should not do so here. It is time for this Court to eliminate the intolerable uncertainty created by the willingness of some state courts to pronounce *Quill* a dead letter in this context.

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For the foregoing reasons, and those stated in the petition, certiorari should be granted.

Respectfully submitted.

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