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Part H - Stern, Coburn, Wecker, Rabinor, Greves

SENDER _____

A-3285-03T1

LANCO, INC., a Delaware corporation,	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-3285-03T1
Plaintiff-Respondent,	Civil Action
v.	On Appeal from a Final Judgment Of the Tax Court of New Jersey
DIRECTOR, DIVISION OF TAXATION,	Sat Below: Hon. Peter D. Pizzuto, J.T.C.
Defendant-Appellant.	

BRIEF OF DEFENDANT-APPELLANT DIRECTOR, DIVISION OF TAXATION

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PRELIMINARY STATEMENT

The case presents the question of whether a company that licenses its trademarks and service marks to its sister corporation for use in connection with the retail sale of merchandise in New Jersey must pay its fair share of corporation business tax ("CBT") to the State. Because plaintiff, Lanco, Inc., undisputedly receives significant monetary payments from the use, ownership, and employment of its property in business transactions in New Jersey, the Director, Division of Taxation (the "Director") issued a final determination that plaintiff is subject to the State's CBT.

Lanco disputes its obligation to pay the tax. While admitting that it directly benefits from New Jersey's marketplace, Lanco contends that it is not subject to the CBT because the property that it uses in the State to generate considerable profits is intangible in nature. Plaintiff's claim belies the plain language of the Corporate Business Tax Act (the "CBT Act"), N.J.S.A. 54:10A-1, et seq., in which the Legislature unequivocally declared that a corporation's use and employment of property in the State for business purposes triggers application of the tax. Nothing in that statute carves out an exemption from taxation for a corporation's use of intangible trademarks and service marks to conduct business activity in New Jersey.

In addition, plaintiff claims that requiring it to pay its fair share of taxes to New Jersey would violate the Due Process and Commerce Clauses of the United States Constitution. Plaintiff's due process argument is entirely specious and should be readily rejected by this Court. Lanco has purposely availed itself of the benefits and protections afforded by its deliberate exploitation of the New Jersey retail sales market. Even the most exacting interpretation of fundamental fairness leads to the conclusion that Lanco can reasonably expect to be subject to New Jersey's laws.

To support its position on the Commerce Clause, plaintiff promotes an unnecessarily wooden interpretation of the Constitution premised on the notion that a corporation must be physically present in a State in order to be compelled to pay corporate taxes on the money that it earns there. Although such an idea may have had some surface appeal in past centuries, the modern business environment renders plaintiff's proposed test unrealistic and wholly unworkable. If adopted by this Court, Lanco's position would place a stranglehold on State taxing authority just as modern technology is poised to trigger a rapid expansion of the already wide scale exploitation of markets by companies with no physical presence in the market's host State.

With current advances in communication technology, an entity's physical presence in a State is not at all determinative

of the corporation's ability to secure substantial economic benefits from the State's marketplace and to benefit from that State's services. With each passing day, the correlation between where a company's physical assets are located and where that company derives its profits becomes increasingly remote. Quite simply, a constitutional standard based on the physical presence of a taxpayer's property is an obsolete notion. Surely, the Constitution does not demand that a company that earns profits from the intentional use of its property in New Jersey can escape paying its share of corporate taxes merely because the assets employed in the State are intangible.

Unfortunately, the trial court failed to recognize the realities of modern business practices. Instead, the court, while acknowledging that Lanco conducts business in New Jersey, and derives benefits from the State, decided that the Constitution requires that a corporation be physically present in a State before it can be subject to taxation. The trial court's decision misinterprets controlling legal precedents and imposes an unnecessary restriction on the State's ability to collect taxes from businesses exploiting New Jersey's marketplace. The decision below should be reversed and the Director's final determination reinstated.

PROCEDURAL HISTORY AND STATEMENT OF FACTS*

Lanco is a Delaware corporation, (Da1, Complaint ¶2; Da12, Answer ¶2), that owns various trademarks, trade names, and service marks. (Da18, Joint Stipulation of Facts dated October 5, 1999 ("Stip.") ¶¶4-5). Lanco was formed for the express purpose of owning, protecting, and licensing this valuable property. (Da18, Stip. ¶5). Plaintiff deliberately directs the use of its property in New Jersey through a licensing agreement with a sister corporation, Lane Bryant, Inc., which operates numerous retail clothing outlets in the State. Lane Bryant, is owned by the same parent as Lanco, (Da18, Stip. ¶11), and uses Lanco's trademarks and service marks, including the name "Lane Bryant" to sell women's clothing and accessories throughout New Jersey. (Da19, Stip. ¶14). Lanco's trademarks and service marks make Lane Bryant's merchandise identifiable and widely marketable to New Jersey consumers. As Dr. James R. Kearl, an expert microeconomist, testified at trial, "from an economist[']s perspective a store that is a Lane Bryant store but doesn't have any visual representation of that isn't a Lane Bryant store." (2T50).** Without the use of Lanco's property at Lane Bryant's

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* Because the Procedural History and Statement of Facts are closely interwoven, they are being combined to avoid repetition and for the convenience of the court.

** "1T" refers to the transcript of trial proceedings on November 30, 1999. "2T" refers to the transcript of trial proceedings on May 15, 2000.

New Jersey stores, "[n]o one would be attracted to come there to shop." Ibid.

The value derived from the use of plaintiff's property in New Jersey is evidenced by the significant percentage of Lane Bryant's gross profits that are turned over to Lanco for the right to use plaintiff's trademarks and service marks. Beginning on February 11, 1983, Lanco granted Lane Bryant the right to use Lanco's trademarks and service marks at Lane Bryant's New Jersey stores through a series of licensing agreements. Under the agreement currently in effect between plaintiff and its sister company, Lane Byrant is authorized to use plaintiff's property "in connection with the ownership and operation of stores . . . and catalogues . . . engaged in the sale of apparel and/or personal care products and accessories" in New Jersey. (Da19, Stip. ¶12; Da98, Stip. Exh. E, §1).

Lanco's ownership interest in its property is spelled out in unmistakable language in the agreement: "[Lane Bryant] acknowledges [Lanco's] exclusive right, title and interest in and to the [trademarks and service marks] and will not at any time do or cause to be done any act or thing contesting or in any way impairing or tending to impair any part of such right, title and interest." (Da103, Stip. Exh. E, §8). Lane Bryant is obligated to inform Lanco of any third-party infringement on Lanco's trademarks or service marks, (Da104-Da105, Stip. Exh. E, §11.1),

and Lanco is obligated to defend any suit against Lane Bryant claiming that its use of Lanco's property infringes upon another party's trademark, (Da105, Stip. Exh. E, ¶11.2).

Lanco requires Lane Bryant to take several steps to protect plaintiff's property during its use in New Jersey. Lane Bryant must abide by plaintiff's conditions for the quality of Lane Bryant's stores, distribution facilities, and merchandise. (Da99, Stip. Exh. E, §2). In addition, Lanco requires that Lane Bryant comply with all applicable New Jersey laws when using plaintiff's trademarks and service marks in the State. (Da99, Stip. Exh. E, §2.5). Lane Bryant's New Jersey stores are subject to inspection by Lanco, (Da100, Stip. Exh. E, §3.3), and all of Lane Bryant's advertising using Lanco's trademarks or service marks in New Jersey is subject to review by plaintiff. (Da100, Stip. Exh. E, §4).

Although plaintiff has no officers, employees, or agents in New Jersey, (Da19, Stip. ¶¶20-23), it profits directly from the sales generated in the State through the use of its trademarks and service marks here. Section 6.1 of the licensing agreement guarantees Lanco 5.5% of Lane Bryant's net sales derived from the use of Lanco's trademarks and service marks in New Jersey. (Da101, Stip. Exh. E, §6.1). Net sales is defined in the agreement as "gross revenues of all of [Lane Bryant's] Retailers using" Lanco's trademarks and service marks and "gross

revenues from the sale of Merchandise using" plaintiff's property other than through retailers in New Jersey, with some adjustments. (Da101, Stip. Exh. E, §6.2). Dr. Kearl testified that this provision is akin to Lane Bryant's properly accounted gross revenues from sales in the State. (2T41). Thus, the more sales that take place in New Jersey, the more profits that rain upon Lanco.

As eloquently explained by Dr. Kearl, plaintiff's use of its well-recognized trademarks and service marks generate more economic activity in the State, resulting in significant costs to New Jersey. (2T38). Plaintiff's use, ownership and employment of its property in New Jersey "creates the kinds of burdens that all commercial activity creates, traffic, roads, policing, the necessity of enforcing contracts . . . providing . . . a legal . . . framework within which property is secure." (2T68-2T69). Yet, plaintiff insists that it pay no taxes to New Jersey to defray these costs.

Notably, prior to the tax periods beginning after January 1, 2002, Lane Bryant, the licensee, also paid no taxes on the percentage of its profits that it conveyed to Lanco. Prior to a 2002 amendment to the CBT, corporations were entitled to deduct payments under a licensing agreement with a related company for use of a trademark or service mark as a business expense on New Jersey CBT returns. See N.J.S.A. 54:10A-4(k). As

a result, the amount of tax that Lane Bryant paid to New Jersey was significantly reduced by the exportation of its Lanco royalty payments to Delaware, which does not impose a tax on income from the use of intangible property. See Del. Code Ann. tit. 19, §1902(b)(8).*

New Jersey, therefore, collected no corporate tax revenue on the profits generated in the State through the use, ownership, and employment of plaintiff's property. At the same time, the State was and is compelled to provide the services and infrastructure support necessary to support the increased sales generated by the association of Lanco's trademarks and service marks with merchandise offered for sale in the State. Simply put, despite benefitting financially from the use of its trademarks and service marks in the retail clothing market in New Jersey, plaintiff pays no corporate taxes for the privilege of doing business in this State.

In fact, as explained above, Lanco pays no taxes to any State on the money it earns from retail sales in New Jersey. Because Delaware law excludes income from intangible property from its corporate taxes, plaintiff does not pay taxes to that State on the substantial revenue stream it receives from use of

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* Pursuant to L. 2002, c. 40, §4, corporations subject to the CBT may no longer deduct royalty payments to related companies for use of intangible property in the State. N.J.S.A. 54:10A-4.4. The application of that statutory amendment to the agreement between Lanco and Lane Bryant is not at issue in this appeal.

its property to create sales in New Jersey. Lanco escapes State taxation entirely on its New Jersey profits.

On or about June 10, 1997, Lanco completed a New Jersey Schedule N, Nexus-Immune Activity Declaration. (Da17-Da18, Stip. ¶2; Da30, Stip. Exh. A). On that form, Lanco admitted that it licensed the use of its property in New Jersey beginning on February 11, 1983. Ibid. In response to that admission, on June 26, 1997, the Director sent Lanco a notification that it was subject to the CBT for the period February 11, 1983 to present. The Director requested that, as an initial step, Lanco file returns for the period 1994 through 1996. (Da17-18, Stip. ¶2; Da 28, Stip. Exh. A).

The final determination did not assess any amount of tax, interest, or penalty against plaintiff. Nor did the final determination attempt to apportion to New Jersey the amount of Lanco's net income reasonably allocable to the State. Instead, the final determination merely states that Lanco must file CBT returns so that the appropriate amount of tax owed by Lanco, based on the amount of Lanco's business activity that is reasonably apportioned to New Jersey, can be calculated.

On September 8, 1997, Lanco initiated a challenge to the June 26, 1997 final determination through the filing of a Complaint in the Tax Court. (Da1, Complaint). The parties thereafter submitted a Stipulation of Facts, (Da17), and the Tax

Court gathered testimony from three expert witnesses during two days of trial. The matter was submitted to the Tax Court for decision on December 18, 2000.*

The Tax Court, Hon. Peter D. Pizzuto, J.T.C., issued its opinion on October 23, 2003. 21 N.J. Tax 200. The court correctly found that Lanco's activities in New Jersey fell within the CBT's definition of doing business in the State, and that the Due Process Clause permitted New Jersey to subject Lanco to tax. Id. at 214-215. Judge Pizzuto erred, however, in deciding that the Commerce Clause requires that a corporation maintain a physical presence in a State before it can be subject to State taxation. Id. at 214.

As a result, on January 9, 2004, the Tax Court entered a Consent Order and Judgment in favor of plaintiff, reversing the Director's final determination subjecting Lanco to CBT. (Da147).

On February 20, 2004, the Director filed a Notice of Appeal with this court. (Da149).

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* While this matter was pending below, Lanco and the Director executed a Closing Agreement pursuant to the 2002 State tax amnesty program. The parties agreed to resolve Lanco's CBT liability for the original years at issue, except not for the fiscal year ended January 31, 1998, leaving that year and the tax years beginning after execution of the Closing Agreement to be resolved by the courts. 21 N.J. Tax 200, 203, n.1; (Da152).

ARGUMENT

POINT I

THE TAX COURT CORRECTLY HELD THAT LANCO'S OWNERSHIP AND EMPLOYMENT OF ITS TRADEMARKS AND SERVICE MARKS IN NEW JERSEY FOR BUSINESS PURPOSES SUBJECT THE COMPANY TO THE CORPORATION BUSINESS TAX.

The CBT applies to any corporation that does business in New Jersey or employs property in the State. The Tax Court correctly determined that Lanco satisfies both of these criteria. 20 N.J. Tax at 214. Plaintiff does business in the State by fueling increased retail clothing sales at New Jersey stores that use plaintiff's trademarks and service marks to attract customers. Lanco's deliberate and systematic exploitation of the State's marketplace is evidenced by its licensing agreement with Lane Bryant, which ties plaintiff's profits directly to the amount of money produced by sales that take place in New Jersey. In addition, plaintiff employs its property in the State by facilitating its use at New Jersey retail outlets. Lanco's licensing agreement has one primary objective -- the use and employment of plaintiff's trademarks and service marks to generate sales, and profits in New Jersey. Thus, Lanco's New Jersey business activities plainly fall within the scope of the CBT Act and the regulations interpreting that statute. The Tax Court's decision in this regard should be affirmed.

As a threshold matter, plaintiff's challenge must be viewed in light of the presumptive validity of the Director's decision. The assessment of tax is entitled to a presumption of correctness. L&L Oil Service, Inc. v. Director, Div. of Taxation, 340 N.J. Super. 173, 183 (App. Div. 2001); Meadowlands Basketball Assocs. v. Director, Div. of Taxation, 19 N.J. Tax 85, 90 (Tax 2000), aff'd, 340 N.J. Super. 76 (App. Div. 2001). "Courts have recognized the Director's expertise in the highly specialized and technical area of taxation." Aetna Burglar & Fire Alarm Co. v. Director, Div. of Taxation, 16 N.J. Tax 584, 589 (Tax 1997)(citing Metromedia, Inc. v. Director, Div. of Taxation, 97 N.J. 313, 327 (1984)).

Like all administrative regulations, the Director's rules are entitled to a presumption of reasonableness, with the burden on the party challenging the regulation to demonstrate that the rule is arbitrary, capricious, unduly onerous or otherwise unreasonable. See New Jersey Guild of Hearing Aid Dispensers v. Long, 75 N.J. 544 (1978). "When an administrative agency interprets and applies a statute it is charged with administering in a manner that is reasonable, not arbitrary or capricious, and not contrary to the evident purpose of the statute, that interpretation should be upheld, irrespective of how the forum court would interpret the same statute in the absence of regulatory history." Blecker v. State, 323 N.J.

Super. 434, 442 (App. Div. 1999); Aetna, supra, 16 N.J. Tax at 589. "Courts are not free to substitute their judgment as to the wisdom of a particular administrative action for that of the agency so long as that action is statutorily authorized and not otherwise defective because arbitrary or unreasonable." Sutton Warehousing, Inc. v. Director, Div. of Taxation, 290 N.J. Super. 686, 697 (App. Div. 1996)(quotations omitted).

It is against this backdrop of presumed validity and substantial deference to the Director's expertise that this court must determine if plaintiff has met the difficult burden of establishing that it is not subject to the CBT. See Metpath, Inc. v. Director, Div. of Taxation, 96 N.J. 147, 152 (1984). The record plainly indicates that Lanco failed to meet its heavy burden.

The CBT Act requires every corporation that does business in New Jersey, or employs or owns property in the State, to pay an annual tax. N.J.S.A. 54:10A-2 clearly sets forth the circumstances in which business entities are subject to taxation. At the time that the Director issued his final determination in this matter, the statute provided:

> Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for . . . each year, as herein provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this

> State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act . . . .
>
> [N.J.S.A. 54:10A-2].

While this matter was pending in the Tax Court, the Legislature enacted the Business Tax Reform Act ("BTRA"), amending N.J.S.A. 54:10A-2, and clarifying that corporations are subject to the CBT "for the privilege of deriving receipts from sources within this State, or for the privilege of engaging in contacts with this State . . . ." L. 2002, c. 40, §1. The BTRA also makes clear that the reach of the CBT is coextensive with the jurisdiction permitted by the United States Constitution.

> A taxpayer's exercise of its franchise in this State is subject to taxation in this State if the taxpayer's business activity in this State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States.
>
> [Ibid.]

These amendments are applicable to privilege periods and taxable years beginning on or after January 1, 2002. L. 2002, c. 40, §33.

The statute provides for only three exceptions to CBT subjectivity, none of which apply to plaintiff:

> A foreign corporation shall not be deemed to be deriving receipts, engaging in contacts, doing business, employing or owning capital

> or property in the State, for the purposes of this act, by reason of (1) the maintenance of cash balances with banks or trust companies in this State, or (2) the ownership of shares of stock or securities in this State if such shares or securities are pledged as collateral security, or deposited with one or more banks or trust companies or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (3) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation.
>
> [N.J.S.A. 54:10A-2.]

Income from no other form of intangible property employed in New Jersey is exempted from CBT.

These provisions are sufficient to support the Director's determination that Lanco's activities in New Jersey subject the company to CBT. Clearly, the Legislature intended the use of intangible property to constitute "deriving receipts," "engaging in contacts," "doing business" or "employing property" within the meaning of the Act. Had that not been the case, there would have been no need for the Legislature to provide three exemptions from taxation for three distinct circumstances involving the use of intangible property.

The three exemptions provided in N.J.S.A. 54:10A-2 for specified uses of intangible property are meaningful only if a corporation's use of intangible property in the State would otherwise trigger application of the CBT. If, as plaintiff

contends, the Legislature did not intend for a corporation's use of intangible property in New Jersey to subject the entity to CBT, there would have been no need to provide exemptions relating to the use and employment of cash balances, stocks, and securities. Under Lanco's reading of the Act, the exemptions would be superfluous, a result frowned upon by well-established jurisprudence on statutory interpretation. See Paper Mill Playhouse v. Millburn Township, 95 N.J. 503, 521 (1984).

Basic tenets of statutory construction mandate the presumption that the Legislature intended all provisions of the statutes it enacts to have meaning. Gabin v. Skyline Cabana Club, 54 N.J. 550, 555 (1969). Statutory "construction that will render any part of a statute inoperative, superfluous or meaningless, is to be avoided." Paper Mill, supra, 95 N.J. at 521(quotations omitted); accord McCann v. Clerk, City of Jersey City, 167 N.J. 311, 321 (2001).

Moreover, no convincing argument can be made that the use of trademarks and service marks can somehow be squeezed in to the exceptions set forth in N.J.S.A. 54:10A-2. "Taxation is the rule and exemption is the exception to the rule. The legislative design to release one from his just proportion of the public burden should be expressed in clear and unequivocal terms." AT&T Co. v. Director, Div. of Taxation, 13 N.J. Tax 534, 543 (Tax 1993)(citing Board of Nat'l Missions v. Neeld, 9 N.J. 349, 353

(1952)). Here, the statutory provision providing for exemptions from the CBT specifically designates the use of certain intangible assets as exempt from taxation under the Act. Trademarks and service marks are not included within the specified exemptions. Had the Legislature intended to remove the use of that property from the scope of doing business and using or employing property under the Act it could easily have done so. It did not.

Moreover, plaintiff's business activities fall squarely within N.J.A.C. 18:7-1.6(a), which clarifies the circumstances in which foreign corporations are required to pay the CBT. The regulation reasonably interprets the statute, providing:

> Every corporation not expressly exempted is deemed to be subject to tax under the Act and is required to file a return and pay a tax thereunder provided it falls within any one of the following:
>
> * * *
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> 2. If a foreign corporation,
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> * * *
>
> iii. Doing business in this State; or
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> * * *
>
> v. Employing or owning property in this State; or
>
> * * *
>
> vii. Deriving receipts from sources within this State; or

* * *

viii. Engaging in contacts within this State.

[N.J.A.C. 18:7-1.6(a)].

Lanco falls within the first two provisions for the open tax periods prior to January 1, 2002 and within all four provisions for the tax periods beginning after January 1, 2002. The provisions are examined below in turn.

A. Plaintiff Does Business In New Jersey Through The Intentional Exploitation Of The State's Retail Clothing Market.

The expansive scope of "doing business" within the meaning of the CBT is explained by the Director in N.J.A.C. 18:7-1.9. That regulation provides:

> The term 'doing business' is used in a comprehensive sense and includes all activities which occupy the time or labor of men for profit.
>
> [N.J.A.C. 18:7-1.9(a).]

The rule continues:

> Whether a foreign corporation is doing business in New Jersey is determined by the facts in each case. Consideration is given to such factors as:
>
> 1. The nature and extent of the activities of the corporation in New Jersey;
>
> 2. The location of its offices and other places of business;
>
> 3. The continuity, frequency and regularity of the activities of the corporation in New Jersey;

4. The employment in New Jersey of agents, officers and employees;

5. The location of the actual seat of management or control of the corporation.

[N.J.A.C. 18:7-1.9(b).]

"There is no one, single controlling factor nor is there a bright line standard that determines whether a foreign corporation's in-state activities meet the Director's regulatory requirements for doing business. Rather, it is only by close scrutiny of all the facts of the case, taken as a whole, that a final determination can be made." Thomson-Leeds Co. v. Taxation Div. Director, 8 N.J. Tax 24, 32 (Tax 1985)(citing Ringgold Coal Mining Co. v. Taxation Div. Director, 4 N.J. Tax 321, 332 (Tax 1982)). "[I]t is not only a quantitative but also a qualitative examination of the nature and extent of plaintiff's business activities that determines if the definitional factors of 'doing business' have been met." Thomson-Leeds, supra, 8 N.J. Tax at 34.

Indeed, an example in the applicable regulations illustrates the applicability of the CBT to the use of trademarks and service marks in New Jersey:

Foreign corporation R holds trademarks that were assigned to it by its parent corporation. R receives fees as a result of licensing those trademarks to certain New Jersey companies for use in New Jersey. R is subject to the corporation business tax on its apportioned income as a result of its trademark licensing activities.

[N.J.A.C. 18:7-1.9(b).]

The Director's interpretation of N.J.S.A. 54:10A-2, as expressed through the example to N.J.A.C. 18:7-1.9(b), is consistent with the Legislature's unequivocal intent to include within the CBT those corporations that conduct business in the State by employing intangible property here. As the Supreme Court explained over 30 years ago, the "basis of the tax is a broad one . . . [i]t was certainly intended to reach foreign corporations . . . as far as could constitutionally be done, and its disjunctive recital of the various privileges must be considered with the intended overall coverage in mind." Roadway Express, Inc. v. Director, Div. of Taxation, 50 N.J. 471, 483 (1967), app. dis., 390 U.S. 745, 88 S. Ct. 1443, 20 L. Ed. 2d 276 (1968). Surely, the Legislature intended to include within the Act a corporation, such as plaintiff, that regularly and systematically exploits the New Jersey retail market for more than two decades through use of its intangible property to promote retail sales in the State.

While Lanco may not have officers or employees in New Jersey, the continuity, frequency, and regularity of Lanco's activities in New Jersey are readily apparent. Over a period of more than twenty years, plaintiff has entered into a series of licensing agreements permitting the use and employment of its trademarks and service marks in the State. For two decades Lanco has continuously and regularly permitted its property to be used

to generate profits from increased sales in New Jersey. As expert testimony at trial established, the presence of Lanco's property in the State generates the sale of merchandise here. Without the use of Lanco's property at Lane Bryant's New Jersey stores, "[n]o one would be attracted to come there to shop." (2T50).

The nature and extent of Lanco's activities in New Jersey are well illustrated by the record. Plaintiff's property is used at retail outlets throughout the State. The trademarks and service marks are employed directly in the sale and advertising of merchandise at New Jersey locations. Indeed, Lane Bryant's New Jersey stores are subject to inspection by Lanco, (Da100, Stip. Exh. E, §3.3), and all of Lane Bryant's advertising using Lanco's trademarks or service marks in New Jersey is subject to review by plaintiff. (Da100, Stip. Exh. E, §4). Clearly, Lanco plays a significant and meaningful role in directing and controlling how its property is used and employed in this State for commercial purposes.

Given the broad scope that the Legislature intended for the CBT, Stryker Corp. v. Director, Div. of Taxation, 18 N.J. Tax 270, 279 (Tax 1999), aff'd, 333 N.J. Super. 413 (App. Div. 2000), aff'd, 168 N.J. 138 (2001), plaintiff's business activities plainly trigger application of the tax. The Director's regulations comport fully with the broad net cast by the

Legislature in this area and Lanco cannot wiggle free by pointing to the irrelevant distinction that it draws between tangible and intangible property. Just as surely as Lane Bryant's use and employment of its stores in New Jersey constitutes doing business under the Act, plaintiff's use and employment of its trademarks and service marks falls within the CBT. The mere fact that plaintiff's valuable property happens to be intangible is a distinction without a substantive difference.

B. Plaintiff Employs Property In New Jersey By Licensing The Use Of Its Intangible Assets To Retail Clothing Outlets In The State.

Even if this Court were to conclude that plaintiff is not doing business in New Jersey, its use and employment of its property in the State subject Lanco to the CBT. Any foreign corporation that employs or owns property in the State is subject to the CBT. Roadway Express, supra, 50 N.J. at 483; Somerset Apartments, Inc. v. Director, Div. of Taxation, 134 N.J. Super. 550 (App. Div. 1975). Lanco unquestionably "employs" and "owns" "property" in this State within the meaning of both the CBT Act and the relevant regulations.

Statutory construction begins with consideration of the statute's plain language. Merin v. Maglaki, 126 N.J. 430, 434 (1992). "A statute should be interpreted in accordance with its plain meaning if it is 'clear and unambiguous on its face and admits of only one interpretation.'" Board of Educ. v. Neptune

Township Educ. Ass'n, 144 N.J. 16, 25 (1996)(quoting State v. Butler, 89 N.J. 220, 226 (1982)); Cumberland Holding Corp. v. City of Vineland, 11 N.J. Tax 457, 462 (Tax 1991).

"[T]he best approach to the meaning of a tax statute is to give to the words used by the Legislature their generally accepted meaning, unless another or different meaning is expressly indicated." Public Serv. Elec. & Gas Co. v. Township of Woodbridge, 73 N.J. 474, 478 (1977)(quotations omitted). Absent an explicit indication of special meaning words of a statute are to be given their ordinary and well-understood meaning. Renz v. Penn Central Corp., 87 N.J. 437, 440 (1981); Levin v. Township of Parsippany-Troy Hills, 82 N.J. 174, 182 (1980); Global Terminal v. Director, Div. of Taxation, 9 N.J. Tax 152, 162 (1987). "Courts are to presume that the legislative intent is expressed by the ordinary meaning of the words used." Briarglen II Condominium Ass'n v. Township of Freehold, 330 N.J. Super. 345, 353 (App. Div.), certif. denied, 165 N.J. 489 (2000).

Plaintiff cannot seriously dispute that it owned and employed property in New Jersey from the period February 11, 1983 to the present. The standard dictionary definition of "own" is "to have or hold as property . . . ; [to] have a rightful title to, whether legal or natural." Websters Third New International Dictionary (1990). To "employ" is "to make use of" and "to devote to or direct towards a particular activity or person."

Ibid. "Property" is "something that one has the right to use." Ibid. Trademarks and service marks undeniably are property. "One who adopts a trade-name for use in his business and builds upon it public good will, acquires a property interest in both the trade-name and the good will . . . ." J.B. Liebman & Co. v. Leibman, 135 N.J. Eq. 288, 292 (Chan. 1944).

The stipulated facts amply demonstrate that plaintiff owned intangible property within the State during the relevant period. Lanco was formed for the express purpose of owning, protecting, and licensing its trademarks and service marks. (Da18, Stip. ¶5). Lanco's ownership of its intangible property is spelled out in unmistakable language in the agreement: "[Lane Bryant] acknowledges [Lanco's] exclusive right, title and interest in and to the [trademarks and service marks] and will not at any time do or cause to be done any act or thing contesting or in any way impairing or tending to impair any part of such right, title and interest." (Da103, Stip., Exh. E, §8).

In addition, true to the proposes for which it was formed, Lanco took great pains to protect its ownership interest in its property. Lane Bryant is obligated to inform Lanco of any third-party infringement on Lanco's trademarks or service marks, (Da104-Da105, Stip., Exh. E, §11.1), and Lanco is obligated to defend any suit against Lane Bryant claiming that its use of Lanco's property infringes upon another party's trademark,

(Da105, Stip., Exh. E, ¶11.2). Plaintiff also requires Lane Bryant to take several steps to protect plaintiff's property during its use in New Jersey. Lane Bryant must abide by plaintiff's conditions for the quality of Lane Bryant's stores, distribution facilities, and merchandise. (Da99, Stip., Exh. E, §2). Lanco requires that Lane Bryant comply with all applicable New Jersey laws when using plaintiff's trademarks and service marks in the State. (Da99, Stip., Exh. E, §2.5). Lane Bryant's New Jersey stores are subject to inspection by Lanco, (Da100, Stip., Exh. E, §3.3), and all of Lane Bryant's advertising using Lanco's trademarks or service marks in New Jersey is subject to review by Lanco. (Da100, Stip., Exh. E, §4). Lanco's ownership of property within the meaning of the CBT cannot be disputed.

Plaintiff uses and employs its property in New Jersey by allowing a New Jersey business to exploit the good-will and name recognition associated with the trademarks and service marks for commercial gain. The property is used to increase retail sales in the State. In return, Lanco receives a percentage of the profits generated from this use of its property. Plaintiff intentionally and deliberately enters into agreements with the express purpose of permitting the use and employment of its property in conjunction with business activity at stores located throughout New Jersey.

The Director's interpretation of the CBT Act, as expressed in both the final determination at issue here and in the example accompanying N.J.A.C. 18:7-1.9(b), unquestionably comport with the CBT Act and was properly affirmed by the Tax Court.

C. In The Tax Years Beginning After January 1, 2002, Lanco Derived Receipts From Sources Within This State And Engaged In Contact With This State.

As noted above, two newly adopted provisions of N.J.S.A. 54:10A-2, subject entities to the CBT for "[d]eriving receipts from sources within this State" and for "[e]ngaging in contacts within this State." L. 2002, c. 40, §1; N.J.A.C. 18:7-1.6(a). Those provisions are applicable to tax periods beginning after January 1, 2002. L. 2002, c. 40, §33. Because the dispute over Lanco's subjectivity to the CBT is ongoing, the question of whether these provisions subject Lanco to taxation in New Jersey is before this court.

Plaintiff cannot seriously contest the fact that it derives receipts from sources within this State. To derive is to "obtain or receive from a source." American Heritage Dictionary of the English Language (2000). Without question, Lanco derives substantial payments from Lane Bryant stores located in New Jersey. Those payments are measured as a percentage of sales at the New Jersey retail outlets of Lane Bryant. Lanco regularly received receipts from retail sales in this State.

Moreover, plaintiff engages in consistent contacts with New Jersey. Lanco deliberately and intentionally entered into a contract with a related company that operates retail stores in this State to use plaintiff's property to generate retail sales in New Jersey. Plaintiff maintains contractual control over the use of its property, including in advertising. In addition, Lanco reserves the contractual right to inspect Lane Bryant's New Jersey stores to ensure that the use of its property in the State meets plaintiff's standards. These actions on the part of plaintiff bespeak of an organized and consistent pattern of contacts with the State for the purpose of generating business income. The newly enacted provisions of the CBT plainly subject Lanco to tax for the tax years beginning after January 1, 2002.

POINT II

THERE ARE NO CONSTITUTIONAL IMPEDIMENTS TO APPLICATION OF THE CORPORATION BUSINESS TAX TO PLAINTIFF, GIVEN ITS SUBSTANTIAL NEXUS TO NEW JERSEY.

Lanco's significant contacts with New Jersey, as evidenced by its continuous agreements to permit the extensive use of its property in the State to generate retail sales, its significant involvement in how its property is employed in New Jersey, the services and protections that it receives from the State, and the increased burdens visited on New Jersey as a result of its commercial activities here, firmly establish that Lanco's constitutional claims are bogus. The Tax Court

incorrectly imposed a physical presence requirement in the context of a State corporate income tax through an unwarranted extension of Supreme Court holdings applicable to the narrow factual complex of imposing a sales and use tax collection obligation on a foreign corporation. The trial court's error must be corrected.

While this court frequently defers to the judgment of the Tax Court, that deference is not absolute. As this court recently explained when reversing an erroneous Tax Court decision:

> While we generally defer to the Tax Court's expertise and have a limited scope of review following a determination of that court, we must also recognize the Director's expertise, particularly when exercised in the specialized and complex area covered by the provisions of the [CBT Act].
>
> [Reck v. Director, Div. of Taxation, 345 N.J. Super. 443, 446 (App. Div. 2001) (citations and quotations omitted), aff'd, 175 N.J. 54 (2002).]

The circumstances of this case warrant reversal of the trial court so that the Director's sound determination may be reinstated.

A. The Tax Court Rightly Held That Lanco's Conscious Use And Ownership of Its Trademarks And Service Marks In New Jersey And Its Purposeful Availment Of The State's Retail Sales Market Permit Application Of The CBT To Plaintiff Without Offending The Due Process Clause.

The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-345, 74 S. Ct. 535, 539, 98 L. Ed. 744 (1954). In addition, the "income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'" Moorman Mfg. Co. v. Blair, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197 (1978)(citation omitted). The "minimum contacts" test set forth in International Shoe Co. v. Washington, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945), guides the Due Process analysis in the area of State taxation. Application of a State's tax laws to a corporate entity is permitted so long as doing so "does not offend 'traditional notions of fair play and substantial justice.'" Id., 326 U.S. at 316, 66 S. Ct. at 158, 90 L. Ed. 95 (quoting Milliken v. Meyer, 311 U.S. 457, 463, 61 S. Ct. 339, 343, 85 L. Ed. 278 (1940)). "[T]he due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power

over him." Quill Corp. v. North Dakota, 504 U.S. 298, 312, 112 S. Ct. 1904, 1913, 119 L. Ed. 2d 91 (1992).

The Supreme Court has expressly held that a foreign corporation may be subject to that State's laws without offending the Due Process Clause if the corporation "purposefully avails itself of the privilege of conducting business" in the State or "purposefully direct[s]" its economic activity towards residents of the State. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184, 85 L. Ed. 2d 528 (1985). "The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State." Quill, supra, 504 U.S. at 308, 112 S. Ct. at 1911, 119 L. Ed. 2d 91.

The sheer extent of plaintiff's continuous and significant contacts with New Jersey unquestionably satisfies the Due Process Clause's limitation on State taxation. Without a doubt, Lanco can reasonably expect to be subject to the laws of the State from which it derives extensive business profits as the result of the use and employment of its property.

For more than twenty years, Lanco has entered into licensing agreements designed to permit the use and employment of its property with the specific aim of increasing the sale of clothing and accessories in New Jersey. This unbroken series of agreements were made with a sister corporation that Lanco was

aware operated retail clothing stores throughout the State. Under the agreements, a significant percentage of the profits generated by the New Jersey sales were turned over to Lanco as payment for use of its property in New Jersey.

In addition, as detailed more fully above, Lanco retained the right to inspect the New Jersey stores to ensure that its trademarks and service marks were being used properly. In addition, plaintiff placed strict controls on the use of its property in New Jersey and held final approval over all advertising for New Jersey sales that employed Lanco's trademarks and service marks. Lanco cannot contend seriously that it has not purposely availed itself of New Jersey's economic market. The primary purpose of plaintiff's licensing agreement was to allow Lanco to derive monetary profits from the use of its property for sale of merchandise in this State. Surely, Lanco has had "fair warning that [its] activity may subject [it] to the jurisdiction of" New Jersey laws. Shaffer v. Heitner, 433 U.S. 186, 218, 97 S. Ct. 2569, 2587, 53 L. Ed. 2d 683 (1977).

The Tax Court held that "it is impossible to conclude that [Lanco's] agreement with Lane Bryant does not satisfy the Quill due process standard" given that "Lanco has purposefully availed itself of the benefits of an economic market in New Jersey." 21 N.J. Tax at 214. In addition, the trial court found that "[a]lthough it is not physically present in the state, Lanco

clearly enjoys the same benefits provided to Lane Bryant." Id. at 215. These holdings are unassailable.

B. The CBT May Be Applied To Plaintiff's Business Activities In New Jersey In A Manner Consistent With The Commerce Clause.

The Tax Court incorrectly concluded that application of the CBT to Lanco's income-generating activities in New Jersey would violate the Commerce Clause. Although the express text of Article I, Section 8, Clause 3 of the Constitution merely authorizes Congress to "regulate Commerce . . . among the several States," the Supreme Court has long recognized that the Commerce Clause also creates a "negative" or "dormant" power that prevents States from interfering with interstate commerce or discriminating against interstate trade. Oregon Waste Sys., Inc. v. Department of Envt'l Quality, 511 U.S. 93, 114 S. Ct. 1345, 128 L. Ed. 2d 13 (1994). "In its negative aspect, the Commerce Clause 'prohibits economic protectionism -- that is, 'regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.'" Fulton Corp. v. Faulkner, 516 U.S. 325, 330, 116 S. Ct. 848, 853, 133 L. Ed. 2d 796 (1996)(citations omitted).

In the area of State taxation, a tax on interstate economic activity does not offend the Constitution if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against

interstate commerce, and is fairly related to the services provided by the State." Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079, 51 L. Ed. 2d 326 (1977). Application of the CBT to plaintiff satisfies each prong of this test.

(1) Lanco Need Not Be Physically Present In New Jersey To Have A Substantial Nexus To The State.

Commerce Clause nexus analysis is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." Quill, supra, 504 U.S. at 312, 112 S. Ct. at 1913, 119 L. Ed. 2d 91. State tax laws may not unduly burden interstate commerce. Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 101 S. Ct. 1309, 67 L. Ed. 2d 580 (1981); City of Philadelphia v. New Jersey, 437 U.S. 617, 98 S. Ct. 2531, 57 L. Ed. 2d 475 (1978). While the analysis for Due Process nexus and Commerce Clause nexus are similar, it is possible that a corporation's presence will constitute sufficient "minimum contacts" for due process purposes but insufficient nexus for Commerce Clause purposes. Quill, supra, 504 U.S. at 313, 112 S. Ct. at 1913-14, 119 L. Ed. 2d 91. Appropriately, the analysis is flexible.

The Tax Court incorrectly held that the decision in Quill establishes a bright-line test requiring a corporation's physical presence in a State to constitute substantial nexus for

Commerce Clause purposes. The trial court's interpretation of the holding in Quill is seriously flawed.

In Quill, supra, North Dakota sought to impose a sales tax collection duty on an out-of-state mail-order house that had neither outlets nor sales representatives in the State. 504 U.S. at 301, 112 S. Ct. at 1907, 119 L. Ed. 2d 91. Some twenty-five years earlier the Court held that a similar Illinois statute was an unconstitutional burden on interstate commerce. National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967). The North Dakota Supreme Court rejected the holding in Bellas Hess on the grounds that "'tremendous social, economic, commercial, and legal innovations' of the past quarter-century [had] rendered its holding 'obsole[te].'" Quill, supra, 504 U.S. at 301, 112 S. Ct. at 1907, 119 L. Ed. 2d 91. The United States Supreme Court framed the task before it as "we must either reverse the State Supreme Court or overrule Bellas Hess." The summary of their conclusion was telling: "While we agree with much of the state court's reasoning, we take the former course." Id., 504 U.S. at 301-302, 112 S. Ct. at 1907, 119 L. Ed. 2d 91.

Quill was a Delaware corporation with either insignificant or nonexistent tangible property in North Dakota. The company sold office supplies and equipment through catalogs, flyers, advertisements in national periodicals, and telephone

calls. Ibid. Despite its lack of physical presence in the State, it was the sixth largest vendor of office supplies in North Dakota, delivering its goods by common carrier from out-of-state. Id., 504 U.S. at 302, 112 S. Ct. at 1907-1908, 119 L. Ed. 2d 91. North Dakota's sales tax statute requires every retailer that "'engages in regular or systematic solicitation of a consumer market in th[e] state'" to collect a sales tax on transactions within that State. Id., 504 U.S. at 302-303, 112 S. Ct. at 1908, 119 L. Ed. 2d 91 (quoting N.D. Cent. Code §57-40.2-07 (Supp. 1991)). Quill's advertising activities satisfied the statutory requirement for systematic solicitation under North Dakota law. The company challenged an attempt by North Dakota to require Quill to pay the uncollected sales tax on its transactions in that State.

The Court first recognized the insignificance of a business's physical presence in a taxing State for Due Process Clause purposes. Thus, the Court "abandoned more formalistic tests that focused on a defendant's 'presence' within a State in favor of a more flexible inquiry" of due process claims. Id., 504 U.S. at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d 91. The Court explained, "[i]n 'modern commercial life' it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in

the taxing State." Id., 504 U.S. at 308, 112 S. Ct. at 1911, 119 L. Ed. 2d 91.

The rationale for abandoning a physical-presence requirement for Due Process Clause purposes recognizes that businesses engage in significant levels of commercial activity in a State without ever "setting foot" there. Enterprises readily foresee being subject to State laws, including tax laws, as a result of their commercial activity directed at a particular State. There is no principled reason why the Commerce Clause should require a corporation's physical presence to justify State taxation, given that the test for the two are similar, provided the State can establish that the corporation derives significant benefits from continued and deliberate economic activity in the taxing State.

While acknowledging that over the last half of the 20th century the Court had also crafted a pragmatic approach to the Commerce Clause, the powerful influence of stare decisis ultimately swayed the Court to follow its holding in Bellas Hess with respect to sales and use tax collection obligations. Id., 504 U.S. at 309-311, 112 S. Ct. at 1911-1912, 119 L. Ed. 2d 91.

The Court explained:

> While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, Bellas Hess is not inconsistent with Complete Auto and our recent cases.

[Id., 504 U.S. at 311, 112 S. Ct. at 1912, 119 L. Ed. 2d 91.]

Having expressed its doubts about the underlying wisdom of the Bellas Hess holding in the business climate of the early 1990's, the Court nonetheless declared that it would not abandon "the rule that Bellas Hess established in the area of sales and use taxes." Id., 504 U.S. at 317, 112 S. Ct. at 1916, 119 L. Ed. 2d 91. Thus, the admittedly "artificial" bright-line test requiring a company's physical presence to justify imposition of a sales tax collection obligation was sustained. Id., 504 U.S. at 315, 112 S. Ct. at 1914, 119 L. Ed. 2d 91. As the New York Court of Appeals describes it "the Quill decision cannot be substantively construed as other than a somewhat begrudging retention of the Bellas Hess physical presence requirement" for imposition of a sales tax collection obligation. Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954, 960 (N.Y.), cert. denied sub nom, 516 U.S. 989, 116 S. Ct. 518, 133 L. Ed. 2d 426 (1995).*

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* The decisive role of stare decisis in the adoption of the Bellas Hess test in Quill cannot be overstated. The influence that the doctrine had on the holding in Quill is revealed in the concurring opinion of Justices Scalia, Kennedy, and Thomas, who would have adhered to the Bellas Hess holding on grounds of stare decisis alone, id., 504 U.S. at 319-20, 112 S. Ct. at 1923, 119 L. Ed. 2d 91, and in the partial dissent of Justice White, who thought the physical presence rule so anachronistic that he would have abandoned it in spite of stare decisis, id., 504 U.S. at 322, 112 S. Ct. at 1916-17, 119 L. Ed. 2d 91.

For several reasons, the holding in Quill is of limited application in the context of a corporate franchise tax, such as the CBT, and to the type of continuous and systematic exploitation of a State's marketplace carried out by Lanco in New Jersey for the past 21 years. Although the Quill Court felt constrained to follow the holding in Bellas Hess, given the factual similarities between the two cases, the record before this court presents a sharply different set of facts, justifying the rejection of the wooden application of Quill to the facts of this case.

As characterized by the Supreme Court, the holding in Bellas Hess, supra, created a safe harbor for vendors "'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.'" Quill, supra, 504 U.S. at 315, 112 S. Ct. at 1914, 119 L. Ed. 2d 91. This is certainly not true here. Lanco's connection to New Jersey is through its long-term contractual relationship with a related corporation that operates retail clothing outlets throughout the State.

The agreement between the two parties promotes increased retail purchases of merchandise in the State. The growth in retail sales burdens the State by increasing traffic, requiring police and fire protection, and imposing demands on the State's labor pool. Thus, unlike the plaintiffs in Bellas Hess and Quill, who merely sent mail order catalogs into the

respective taxing States, Lanco's economic activity exacts a significant price on New Jersey in the form of increased services and labor demand. Even in the absence of a physical presence in the State, Lanco requires the expenditure of resources by New Jersey far in excess than would be required for an out-of-State mail-order company that sends its catalogs to New Jersey residents.

Second, the holding in Quill quite plainly does not apply to taxes other than sales and use taxes. The Supreme Court was very careful to limit its holding to the taxes that were at issue in Bellas Hess and Quill. The Court observed:

> 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 . . . .
>
> [Quill, supra, 504 U.S. at 314, 112 S. Ct. at 1914, 119 L. Ed. 2d 91.]

Indeed, in every instance in which the Quill Court refers to the physical-presence test, it expressly links that test to sales and use taxes.

Thus, while the Quill Court may have sanctioned a bright-line, physical-presence test in measuring State sales and use taxes collection obligations against the Commerce Clause, it has left other State taxes to be adjudicated under the nexus requirements embodied in the first prong of the general standards

for State taxation of interstate commerce announced in Complete Auto Transit, supra.

Significant differences between a sales and use tax and the corporate franchise tax at issue in this case are immediately apparent. The Quill Court expressed great concern that more than 6,000 local taxing jurisdictions in the United States might impose various rates, exemptions, and reporting requirements for sales and use taxes on the operator of a mail order catalog. Quill, supra, 504 U.S. at 313 n.6, 112 S. Ct. at 1913 n.6, 119 L. Ed. 2d 91. Because sales and use tax returns are generally due on a monthly basis, firms with nationwide business would face the possibility of having annually to compute 72,000 different tax liabilities and file tens of thousands of returns. Thus, the administrative cost to an out-of-State seller of complying with thousands of distinct taxing jurisdictions might be significant, although with the availability of modern computer technology even that assumption is now suspect. These concerns are greatly reduced, however, in the realm of a corporate franchise tax like the CBT.

The CBT Act requires annual returns. N.J.A.C. 18:7-11.1(a). In addition, the net income to be reported closely follows the reporting requirements for the federal corporate income tax. N.J.S.A. 54:10A-4(k). Thus, unlike in the context of a sales and use tax, Lanco already has to collect and report

the information necessary for compliance with the CBT. Even though there may be some adjustments to net income and other variations under the CBT, the compliance burden is in no sense equivalent to the administrative burden that animated the Court's decision in Quill.

Only forty-eight jurisdictions -- forty-six States, the District of Columbia, and the City of New York -- collect a corporate franchise or income tax. Each such jurisdiction requires an annual return. CCH Multistate Corporate Income Tax Guide ¶196. Approximately 44 States use the same measure of income as is employed by the federal government. Id. at ¶125. Thus, the CBT and other corporate franchise taxes are computed on information that a business must compile annually for federal financial reporting purposes.

As one noted commentator put it:

> it may well be that the need for a "bright-line" rule in the context of income taxation is less compelling than in the context of sales and use taxation because the burdens of complying with the income tax laws of various state and local jurisdictions are less daunting than the burden of complying with the laws of the nation's 6,000-plus sales and use tax jurisdictions to which the Court alluded in Quill.
>
> [J. Hellerstein & W. Hellerstein, State Taxation (Warren, Gorham & Lamont 3d ed. 1998) ¶6.30[5]].

The realities of State corporate franchise and income-based taxes in general, and the CBT in particular, simply do not threaten to impose a meaningful administrative burden on interstate economic actors.

The Tax Court brushed aside this critical distinction, holding that "it does not appear" that the differences between the sales tax collection obligation and income tax liability "are so significant as to justify a different rule for each" with respect to physical presence. 21 N.J. Tax at 208. Incongruously, the trial court observed that "the record-keeping and classification tasks, considered complicated and onerous in 1967 when Bellas Hess was decided, are considerably less difficult under contemporary data-processing technology." Id. at 209. But, the complexity of sales tax collection was a reason for imposing a physical presence requirement in Quill. If that justification for a physical presence standard is no longer viable because of advances in technology, then those advances militate against extending the physical presence rule to the considerably less complicated arena of corporate income taxation. Yet, the trial court reached the illogical opposite result. This flaw in the trial court's reasoning, along with several other lapses in logic, are noted by one commentator in the State tax community. James H. Peters, Lanco Inc.: The Commerce Clause and

State Income Taxes, State Tax Notes, Vol. 31, No. 11 (March 15, 2004).

Another crucial fact is that sales and use taxes are unique because they are designed to be passed on to the final consumer as a separately-stated additional charge over and above the negotiated price and not borne by the seller out of its earnings. The seller is obligated to pay the tax only if it fails to collect the tax from the purchaser at the time of sale. This means that a business against which a sales tax is assessed for failure to collect, as was the case in Quill, must pay out of its own pocket taxes that should have been borne by its customers. This feature makes a sales and use tax collection obligation particularly burdensome to businesses that are assessed after the sale and no longer have a practical means of passing the tax liability on to customers. This concern is greatly lessened in the context of the CBT, which is designed to be paid out of a corporation's earnings.

Additionally, the holdings in Bellas Hess and Quill did not prevent the respective States from collecting the tax due on the transactions at issue in those cases. While the out-of-State corporations could not be compelled to collect the sales tax, the underlying consumers were responsible for the equivalent use tax on the transaction. As is the case with sales taxes throughout the country, a purchaser who does not pay the tax at the time of

sale is liable for use tax in the same amount as should have been collected in sales tax.

In the context of the CBT, on the other hand, New Jersey will be left with no tax revenue from the significant profits generated for Lanco by the increased retail sales in New Jersey resulting from the use and employment of Lanco's property in this State. If Lanco is not subject to the CBT, the revenue generated by Lanco's property in New Jersey will escape taxation, even though that same revenue generating activity will impose burdens on the State. In fact, as noted above, because Delaware, Lanco's principle place of business, does not tax corporate income from intangible property, no State will derive tax revenue on the revenues garnered by plaintiff from the use and employment of its property to generate sales and revenue in New Jersey.

Clearly, in the area of sales and use tax a physical-presence test, while burdening the State's tax collection ability, does not insulate completely from taxation an entire category of commercial activity. However, when the same test is applied in the context of the CBT, New Jersey will be denied financial recovery from the continuous exploitation of its commercial markets for profit, at the expense of the State in the form of services.

Such a result would be particularly unfair to the State, given the benefits and protections Lanco enjoys from the

use and employment of its property in New Jersey. Lanco enjoys numerous benefits provided by New Jersey. Foremost among those is the protection afforded by the New Jersey judiciary to Lanco's rights under the licensing agreement and its right to protect is trademarks and service marks. "The courts of this state have long entertained actions to enjoin unfair trade practices including infringement of trademarks and trade names." Edison Elec. Co. v. Edison Contracting Co., 203 N.J. Super. 50, 52 (Law Div. 1985)(Skillman, J.). A foreign corporation is free to initiate suit in New Jersey's courts after filing a business activities report pursuant to N.J.S.A. 14A:13-15. First Family Mort. Corp. v. Durham, 108 N.J. 277 (1987), app. dis., 487 U.S. 1211, 108 S. Ct. 2860, 101 L. Ed. 2d 897 (1988).

That Lanco may not yet have needed to file suit in a New Jersey court to preserve its rights under its licensing agreements does not vitiate the benefit that plaintiff is receiving from the maintenance of the New Jersey court system. Dr. Kearl explained that the mere presence of a functioning judicial system provides an incentive for individuals to abide by their agreements. (2T39). "[I]t is the judicial system and the historical enforcement of property rights and contracts that lessens the necessity of actually engaging the system that is a direct benefit to" Lanco. (2T82).

In addition, Lanco benefits from New Jersey's maintenance of a highway system in the State. According to the expert testimony offered at trial, Lanco's trademarks and service marks make Lane Bryant's clothing and merchandise more appealing, and thus, more marketable, to more shoppers. Increased vehicular traffic on New Jersey's roads arises as those shoppers make their way to the Lane Bryant stores. Because Lane Bryant enjoys increased sales from consumers who use New Jersey's roadways to travel to its stores, Lanco also benefits from those well-maintained roads in the form of increase royalty payments. (2T48).

Lanco also benefits from an educated workforce in New Jersey. Lane Bryant can draw on that workforce, thereby reducing its costs on employee training. (2T48-2T49). As a result, Lanco receives a percentage of a greater net profit from Lane Bryant's sales. This is true even though Lanco itself employs no people in the State. Providing an education to the future members of New Jersey's workforce who will be available to work for Lane Bryant and to increase Lanco's revenues from commercial activity in this State, is a significant expense borne by New Jersey for Lanco's benefit.

In addition, Lanco's trademarks and service marks are of no value to Lane Bryant if they are not manifested within New Jersey in some physical form, because it is the physical

manifestations of that property that make the goods Lane Bryant offers for sale in the State more attractive. (2T49-2T50). These physical manifestations, even if owned by Lanco's sister corporation, require police, fire, and judicial protection. Plaintiff's own witness agrees that Lanco receives a host of indirect benefits from New Jersey. Professor Wildasin testified that New Jersey's maintenance of a roadway system, and its provision of fire protection and police services to the Lane Byrant stores indirectly benefit Lanco. (1T60-1T61). All of those services require the expenditure of funds and resources by New Jersey, expenses not recovered in any form from the profits Lanco exports from the State to a no-tax haven in Delaware.

An out-of-State mail-order company simply does not impose equally significant burdens on the States into which its catalogues are sent and goods delivered. This distinction from the facts presented in Quill is critical and requires a flexible approach to the application of the physical presence test in the CBT context.

Additionally, the Supreme Court has not required a taxpayer's physical presence in the context of taxes other than the sales and use tax. For example, the Court has long held that State income taxes may be levied against nonresidents.

In Shaffer v. Carter, 252 U.S. 37, 52, 40 S. Ct. 221, 225, 64 L. Ed. 2d 445 (1920), the Court upheld the imposition of

an Oklahoma income tax on an Illinois resident under both the Due Process Clause and Commerce Clause, observing that

> just as a state may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to nonresidents from their property or business within the state, or their occupations carried on therein . . . .

The Court cited this decision in upholding Tennessee's excise tax in Memphis Natural Gas Co. v. Beeler, 315 U.S. 649, 656, 62 S. Ct. 857, 862, 86 L. Ed. 1090 (1942), stating that an excise tax could be imposed with respect to "net income derived from within the state" without violating the Commerce Clause. Similarly, in upholding a Wisconsin tax on corporate dividends distributed to stockholders, the Supreme Court in International Harvester Co. v. Wisconsin Dep't of Taxation, 322 U.S. 435, 441-42, 64 S. Ct. 1060, 1064, 88 L. Ed. 1373 (1944), reasoned

> [p]ersonal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.

While there may have been some form of physical presence in these instances, the Court's reasoning and the rules it announced in these cases did not make physical presence a prerequisite for the levy of State income taxes.*

Moreover, one of the reasons that the Quill Court noted for abiding by the Bellas Hess decision was its view that retaining the physical-presence test would comport with "settled expectations and, in doing so, foster[] investment by businesses and individuals." Quill, supra, 504 U.S. at 316, 112 S. Ct. at 1915, 119 L. Ed. 2d 91. No such "settled expectations" exist concerning other types of State taxes, because no Supreme Court decision has imposed a physical-presence test for any tax other than sales and use tax. Indeed, as detailed more fully below, State court authority is split on whether the physical-presence test of Quill applies outside the sales and use tax context.

In the leading post-Quill case, Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13, cert. denied, 510 U.S. 992, 114 S. Ct. 550, 126 L. Ed.2d 451 (1993), the South Carolina Supreme Court upheld the application of that State's corporate income tax in circumstances strikingly similar to those presented

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* Subsequent State court decisions upheld income-based and other State taxes even though the taxpayer did not have a physical presence in the State. See In re Heftel Broadcasting Honolulu, Inc., 554 P.2d 242 (Hawaii 1976), cert. denied, 429 U.S. 1073, 97 S. Ct. 811, 50 L. Ed. 2d 791 (1977); American Dairy Queen Corp. v. Taxation and Revenue Dep't, 605 P.2d 251 (N.M. Ct. App. 1979).

here. Geoffrey was a Delaware corporation with no employees, officers, or tangible property in South Carolina. Id. at 15. The company owned several valuable trademarks and trade names, including "Toys R Us," a trademark that matched the name of its parent corporation. Ibid. Through a licensing agreement with its related company, Geoffrey permitted the use of its trademarks by Toys R Us in South Carolina. As consideration, Geoffrey received a percentage of the parent's net sales of merchandise in that State. Ibid. As is the case with Lanco, the net effect of the corporate relationship between Geoffrey and Toys R Us and their licensing agreement is the creation of "nowhere" income that escapes all State taxation. Id. at 15 n.1. In fact, in 1990, Geoffrey, without any full-time employees, had an income of approximately $55 million and paid no income taxes to any State. Ibid.

South Carolina ultimately made a determination that Geoffrey was subject to that State's corporate income tax. Id. at 15. Geoffrey claimed that the Commerce Clause allowed it to shield all of the profits that it made in South Carolina from State taxation merely because the assets it employed in that State for commercial gain were intangible. Id. at 16. Thus the taxpayer in Geoffrey raised the same argument relied upon by Lanco to escape paying its fair share of taxes to New Jersey.

The court found that both the Due Process Clause and the Commerce Clause were not offended by application of South Carolina's tax to Geoffrey. With respect to the Commerce Clause, the court found that reliance on the Bellas Hess physical-presence test was "misplaced." Id. at 13. The court began its analysis by remarking that the Supreme Court in Quill, while reaffirming Bellas Hess for sales and use tax purposes, "noted that the physical presence requirement had not been extended to other types of taxes." Id. at 13 n.4. Recognizing legal precedents that permit the imposition of taxes other than sales and use tax in the absence of physical presence, the court held "that by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina" for Commerce Clause purposes. Id. at 18.

This decision comports with the commentary of a leading expert on State taxation who opined that "any corporation that regularly exploits the markets of a state should be subject to its jurisdiction to impose an income tax even though not physically present." Ibid. (citing J. Hellerstein & W. Hellerstein, State Taxation, supra, at ¶6.08); see also, Michael T. Fatale, Geoffrey Sidesteps Quill: Constitutional Nexus, Intangible Property and the State Taxation of Income, 23 Hofstra L. Rev. 407 (1994); Michael T. Fatale, State Tax Jurisdiction and

the Mythical "Physical Presence" Constitutional Standard, 54 Tax Lawyer 105 (2000).

Similarly, in Couchot v. State Lottery Comm'n, 659 N.E.2d 1225, cert. denied, 519 U.S. 810, 117 S. Ct. 55, 136 L. Ed. 2d 18 (1996), the Ohio Supreme Court declined to apply the Quill physical-presence test to State income taxes. In determining that Ohio could impose its income tax on the lottery winnings of non-residents, the court held that "[t]here is no indication in Quill that the Supreme Court will extend the physical-presence requirement to cases involving taxation measured by income derived from the state." Id. at 1230.

In Borden Chemicals and Plastics, L.P. v. Zehnder, 726 N.E.2d 73 (Ill App. Ct.), app. denied, 731 N.E.2d 762 (Ill. 2000), the court upheld the application of that State's "personal property tax replacement income tax" to an out-of-state limited partner in a partnership operating in Illinois. The court rejected out of hand the suggestion that Quill "left open" the question of whether a physical presence is required concerning taxes other than sales and use tax. Instead, it unequivocally held that "the physical presence requirement of Quill is inapplicable to the instant case." Id. at 80. Instead, the "Quill court merely carved out a narrow exception in the area of use tax collection duties." Ibid.

Other published decisions have resulted in mechanical application of the Quill physical-presence test to areas outside the sales and use tax. See J.C. Penney National Bank v. Johnson, 19 S.W.3d 831, 839 (Tenn Ct. App.)(holding that "[a]ny constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in Bellas Hess and Quill are not within the purview of this court to discern"), cert. denied, 531 U.S. 927, 121 S. Ct. 305, 148 L. Ed.2d 245 (2000); Guardian Indus. Corp. v. Department of Treasury, 499 N.W.2d 349, 356 (Mich. Ct. App. 1993), app. denied sub nom, 512 N.W.2d 846 (Mich. 1994)(holding "after Quill, it is abundantly clear that Guardian must show a physical presence within a target state to establish a substantial nexus" to impose any tax); Cf. General Motors Corp. v. City of Seattle, 25 P.3d 1022, 53-54 (Wash. Ct. App.)(declining to extend physical presence standard of Quill to business and occupation tax assessment on corporation which sends sales, service, and parts representatives into taxing jurisdiction), rev. denied, 84 P.3d 1230 (Wash. 2001), cert. denied, 535 U.S. 1056, 122 S. Ct. 1915, 152 L. Ed. 2d 825 (2002).*

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* In the trial court, plaintiff relied on several unpublished decisions to support its position. See e.g. Cerro Copper Products, Inc. v. Alabama Dept. of Revenue, No. F.94-444 (Ala. Adm. Judge, Dec. 11, 1995), State Tax Notes, Jan. 1, 1996, at 65, 66 (holding that if taxpayer does not have sufficient nexus with Alabama for sales and use tax purposes, which it clearly does not have under Quill, then it is incongruous that the taxpayer would have

These decisions fall wide of the mark. Instead of following the Supreme Court's flexible approach to the Commerce Clause when considering taxes other than the sales tax, these decisions are evidence of the unfortunate fact that the Complete Auto test is too frequently addressed in isolation, de-coupled from concerns about the potential effects of the State tax on the national economy. This approach threatens to stretch the Commerce Clause beyond its intended purposes by encouraging State tax laws to be struck down purely on the basis of a factual

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"substantial nexus" to be subject to Alabama's franchise tax); MCI Int'l Tel. Corp. v. Comptroller of the Treasury, 1999 WL 322702 (Md. Tax. Ct. 1999), aff'd, 2000 STT ["State Tax Today"] 60-22 (Md. Cir. Ct. 2000)(courts "hesitate[d] to expand the Quill physical presence requirement to taxes other than sales and use," but nevertheless apply similar analysis). These decisions, along with other similar unpublished opinions referred to below by Lanco, do not have the authoritative weight of published opinions and their wooden application of the Quill physical-presence test are not adequate substitutes for the flexible Commerce Clause analysis that had dominated the United States Supreme Court's jurisprudence in contexts other than a State's attempt to impose a sales tax collection obligation on an out-of-State entity. Notably, an unpublished decision of Court of Appeals of New Mexico examined a trademark licensing agreement between two related entities that is nearly identical to the agreement at issue here. The Court held that the extensive use of trademarks by the licensee in generating retail sales constituted "the functional equivalent of physical presence" of the trademark holding company. Kmart Properties, Inc. v. Taxation and Revenue Dep't, 2001 STT 233-18 [State Tax Today] (Nov. 27, 2001), app. granted, 40 P.3d 1008 (2002). The Kmart matter has been stayed pursuant to the automatic say provision of the bankruptcy law. See Comptroller of the Treasury v. SYL, Inc., 825 A.2d 399, 417 n.6 (Md. 2003). Two courts have avoided the question of whether the Commerce Clause permits taxation of a trademark licensing company in these circumstances by determining that such agreements between related entities constitute sham transactions. Id.; Syms Corp. v. Commissioner of Revenue, 765 N.E.2d 758 (Mass. 2002).

inquiry into whether a corporation is physically present in a State, rather than based on a reasoned analysis of whether application of a particular tax has a detrimental effect on interstate economic activity.

This is precisely the mistake made by the Tax Court in this case. Judge Pizzuto mechanically applied the Quill physical presence standard without undertaking a meaningful analysis of whether imposition of the CBT truly would impose a burden of such significance that the Commerce Clause would be violated. The trial court opinion provides no explanation for the rote application of Quill's restrictive holding in a setting in which a corporation has entered into an ongoing contractual relationship with a related entity for the purpose of dodging State taxation on significant amounts of revenue from retail activity in the State. True, as the Tax Court notes, lawful avoidance of tax is not improper, 21 N.J. Tax at 219. However, the expansion of Constitutional protection to preclude the collection of tax to business activity that unquestionably imposes burdens on a State is not mandated or warranted. The Tax Court went too far in placing Constitutional obstacles before the State's taxing authority in the facts presented in this case.

If the Commerce Clause is to be realistically applied in today's business climate, courts must "look[] past 'the formal language of the tax statute [to] its practical effect'" and

determine whether its application actually burdens interstate commerce or discriminates against economic activity. Quill, supra, 504 U.S. at 310, 112 S. Ct. at 1912, 119 L. Ed. 2d 91 (quoting Complete Auto, supra, 430 U.S. at 279, 97 S. Ct. at 1079, 51 L. Ed. 2d 326). The bright line drawn in Quill in the sales-tax collection context is anachronistic and ignores the modern reality of interstate businesses. The use of this test for State corporate franchise and income-based taxation will stunt the evolution of Commerce Clause jurisprudence, as courts will be precluded from engaging in the type of balancing of interests more appropriate for today's changing economic environment.

A sharper focus should be placed on the Commerce Clause inquiry: whether the activities of the business have a sufficient connection with the taxing State and whether the level of economic activity and exploitation of the State's markets is such that the entity reasonably should expect to draw on State protection and services and, in turn, to pay for that protection and services. The remaining elements of the Complete Auto test -- that the tax is fairly apportioned, non-discriminatory against interstate commerce, and fairly related to the services provided by the taxing State -- ensure that companies that engage in intrastate activity will not be favored over interstate economic actors, fully effectuating the purposes of the Commerce Clause.

Technology has progressed in quantum leaps and bounds in the twelve years since Quill and the twenty-seven years since Complete Auto were decided. See Christina R. Edson, Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce, 48 Tax Lawyer 893 (Summer 1996). The Commerce Clause should not be mired in an outdated view of how interstate business is conducted in today's world. The Clause simply cannot be interpreted in a stiff fashion that effectively bars the States from collecting much-needed revenue in the increasingly common circumstance in which a corporation earns significant profits in a State without being physically present there. Nothing in the holding in Quill requires an interpretation of the Constitution that would have such a detrimental effect on State taxing authority.*

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* In the trial court, Lanco went to great lengths to argue that the Director's position does not reflect "sound tax policy." Of course, no number of experts can bestow on plaintiff the authority to establish tax policy for the State of New Jersey. The authority to decide the State's tax policy rests in the Executive and Legislative Branches and the power to carry out that policy has been delegated to the Director. If plaintiff objects to the soundness of the Director's position from a policy standpoint, its only avenues of recourse are to statutory or policy changes through the State's elected officials. Plaintiff takes a mistaken approach by urging a court to make a legal decision based on plaintiff's notion of sound tax policy. The Tax Court correctly opined that its role is to examine the Director's position to determine its legal validity, not to opine on the soundness of his policy determinations. To the extent that the testimony of plaintiff's witnesses is proffered to bolster plaintiff's policy arguments, it should be disregarded in its entirety. Besides, the value of the testimony offered by plaintiff in this regard is dubious. As Lanco's own expert admitted, "[t]here is a saying that any group of

(2) The CBT Act Requires That Plaintiff's Income Be Fairly Apportioned To New Jersey, Rendering The Tax Internally And Externally Consistent.

The fair apportionment prong of the Consolidated Auto test prohibits taxes that pass an unfair share of the tax burden onto interstate commerce. Quill, supra, 504 U.S. at 313, 112 S. Ct. at 1913, 119 L. Ed. 2d 91. The "central purpose" of the fair apportionment requirement "is to ensure that each State taxes only its fair share of an interstate transaction." Goldberg v. Sweet, 488 U.S. 252, 260-261, 109 S. Ct. 582, 588, 102 L. Ed. 2d 607 (1989). In order to be fairly apportioned a tax must be both "internally consistent" and "externally consistent." Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 185, 115 S. Ct. 1331, 1338, 131 L. Ed. 2d 261 (1995).

"Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." Ibid. This test "simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." Ibid. "A failure of internal consistency shows as a matter of

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3 economists will have at least 4 opinions." (1T72). In an area where reasonable minds can differ as to which tax policy is best suited for the State's needs, it is the Director whose opinion is entitled to prevail.

law that a State is attempting to take more than its fair share of taxes from the interstate transaction . . . ." Ibid. Application of the CBT by every State in the Union to taxpayers in plaintiff's position would not disadvantage interstate commerce for the benefit of intrastate economic activity.

Pursuant to N.J.S.A. 54:10A-6, a corporation, such as plaintiff, that is subject to the CBT and which maintains a regular place of business outside the State, "is obligated to pay tax only on that portion of its entire net income which is allocable to this State." Stryker, supra, 18 N.J. Tax at 272-273. The amount of the taxpayer's income subject to CBT is determined by multiplying the corporation's entire net income by an allocation factor. N.J.S.A. 54:10A-4(b). The factor is equal to the average of three fractions: a property fraction, a payroll fraction, and a receipts fraction. The fractions have as their numerators, the property, payroll, and sales receipts of the taxpayer fairly attributable to New Jersey, and as their denominators the total property, payroll and sales receipts of the taxpayer. Stryker, supra, 18 N.J. Tax at 276-277. The purpose of the allocation factor is to limit application of the CBT to only that income that has a sufficient nexus to the State to satisfy constitutional constraints on State taxation. Central National-Gottesman, Inc. v. Director, Div. of Taxation, 14 N.J.

Tax 545, 552 (Tax 1995), aff'd, 291 N.J. Super. 277 (App. Div.), cert. denied, 146 N.J. 569 (1996).

In addition, N.J.S.A. 54:10A-8 allows for adjustments to the allocation factor to account for any unusual circumstances that can result in an allocation of too much income to New Jersey. That statute provides:

> If it shall appear to the [Director] that an allocation factor determined pursuant to section 6 does not properly reflect the activity, business, receipts, capital, entire net worth or entire net income of a taxpayer reasonably attributable to the State, he may adjust it by:
>
> (a) excluding one or more factors therein;
>
> (b) including one or more other factors, . . .;
>
> (c) excluding one or more assets in computing entire net worth; or
>
> (d) excluding one or more assets in computing an allocation percentage; or
>
> (e) applying any other similar or different method calculated to effect a fair and proper allocation of the entire net income and the entire net worth reasonably attributable to the State.
>
> [N.J.S.A. 54:10A-8.]

The Director has promulgated regulations to assist in determining a taxpayer's allocation factor and any necessary adjustments to the factor. See N.J.A.C. 18:7-7.1 through N.J.A.C. 18:7-10.1; Brunswick Corp. v. Director, Div. of Taxation, 135 N.J. 107 (1994).

Because the CBT has incorporated within its provisions safeguards to ensure that the tax is imposed only on that income that is reasonably attributable to New Jersey, its application is internally consistent for Commerce Clause purposes. If every State subjected plaintiff to its corporate tax and all of the States used the allocation and adjustment provisions of the CBT, plaintiff would be required to pay tax to each State on no more than the fair share of Lanco's income attributable to each State, whether that income was from interstate or intrastate activity. Lanco's interstate activity would suffer no burden from which its intrastate activity is insulated. The income from each type of activity would be apportioned only to the States to which it is reasonably attributable.

In addition, application of the CBT to plaintiff would satisfy the Commerce Clause's external consistency requirement. An examination of external consistency looks "to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." Oklahoma, supra, 514 U.S. at 185, 115 S. Ct. at 1338, 131 L. Ed. 2d at 272. As explained above, the allocation and adjustment provisions of the CBT ensure that New Jersey levies its tax only on that portion of a corporation's income reasonably attributable to the State. The economic justification

for the imposition of the CBT on plaintiff is the State's recovery of the expense of providing the roads, police, fire, and judicial services that protect Lanco's trademarks and service marks and that create a viable marketplace for the sale of merchandise associated with and identified by plaintiff's intangible property.

(3) The CBT Does Not Discriminate Against Interstate Commerce Because It Applies To All Corporate Income Reasonably Attributable To New Jersey, Whether From Interstate Or Intrastate Activity.

Application of the CBT to plaintiff will not discriminate against interstate commerce. A State discriminates against interstate commerce "by providing a direct commercial advantage to local business" over out-of-state entities. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458, 79 S. Ct. 357, 362, 3 L. Ed. 2d 421, 427 (1959). The CBT does not, either on its face or in its application, disadvantage interstate commerce for the benefit of local economic activity. The tax applies to all corporate income reasonably attributable to New Jersey, whether generated from interstate or intrastate economic activity. The allocation factor and the adjustment provision ensure that any income not reasonably attributable to New Jersey will not be subject to the tax. There is no danger that income from activities that take place in New Jersey will escape taxation while income from Lanco's licensing in other States will be subject to tax.

(4) Lanco's Tax Burden Will Be Fairly Related To The Services Provided To Plaintiff By New Jersey.

New Jersey's application of the CBT to plaintiff's income reasonably attributable to the State will be fairly related to the benefits conferred on Lanco by the use of its intangible property in New Jersey to generate retail sales of clothing and merchandise. The fourth prong of the Commerce Clause test "focuses on the wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue." Goldberg, supra, 488 U.S. at 267, 109 S. Ct. at 592, 102 L. Ed. 2d 607. Plaintiff cannot deny that it enjoys the benefit of services provided by New Jersey.

Foremost among those benefits is the protection afforded by the New Jersey judiciary to Lanco's rights under the licensing agreement and its right to protect is trademarks and service marks. As noted above, the "courts of this state have long entertained actions to enjoin unfair trade practices including infringement of trademarks and trade names." Edison Elec., supra, 203 N.J. Super. at 52. A foreign corporation is free to initiate suit in New Jersey's courts after filing a business activities report pursuant to N.J.S.A. 14A:13-15. See First Family, supra.

In addition, Lanco benefits from New Jersey's maintenance of a highway system in the State. Lanco's trademarks and service marks make Lane Bryant's clothing and merchandise

more appealing and more marketable to shoppers. Increased vehicular traffic on New Jersey's roads arises as those shoppers make their way to the Lane Bryant stores. Because Lane Bryant enjoys increased sales from consumers who use New Jersey's roadways to travel to its stores, Lanco also benefits from those well-maintained roads in the form of increase royalty payments. (2T48).

Lanco also benefits from an educated workforce in New Jersey. Lane Bryant can draw on that workforce, thereby reducing its costs on employee training. (2T48-2T49). As a result, Lanco receives a percentage of a greater net profit. This is true even though Lanco employs no people in the State itself.

As Dr. Kearl explained at trial, there is no precise relationship between the amount of corporate tax collected from a particular taxpayer and the services provided to that taxpayer by the State. (2T35). Plaintiff's own witness agrees with this proposition. (1T58). Typically, State corporate income tax is based on net revenues. However, the demands placed on a State by a corporate taxpayer do not necessarily correlate to the amount the taxpayer's taxable income. One could easily imagine a corporate software firm with tremendous profits but few demands on the State in the way of traffic, pollution, or police protection. On the other hand, a heavy industry may generate few profits but present the State with significant burdens related to

transportation needs, pollution, police and fire protection, and health concerns. (2T35-2T36).

Moreover, Dr. Kearl testified that many of the benefits that accrue to corporate entities are difficult to quantify precisely. Additional traffic on a roadway and the expense of providing an educated workforce are just two of the many areas that fit into this category. (2T46-2T47).

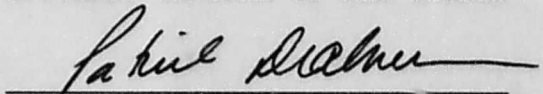
Surely, the tax that New Jersey seeks to collect from plaintiff is fairly related to the numerous services that result in an economic benefit to Lanco from the use and employment of its property in this State. Lanco's benefit from the provision of these services is quite tangible -- increased retail sales resulting in increased profits for plaintiff.

CONCLUSION

For the foregoing reasons, the Director respectfully requests that the January 9, 2004 Judgment of the Tax Court be reversed and that his final determination subjecting Lanco, Inc. to the Corporate Business Tax be affirmed.

Respectfully submitted,

PETER C. HARVEY
ATTORNEY GENERAL OF NEW JERSEY

By: 
Patrick DeAlmeida
Deputy Attorney General

Dated: Trenton, New Jersey
May 5, 2004

A-3285-03T1

LANCO, INC., a Delaware corporation, Plaintiff-Respondent, v. DIRECTOR, DIVISION OF TAXATION, Defendant-Appellant.	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-3285-03T1 Civil Action On Appeal from a Final Judgment Of the Tax Court of New Jersey Sat Below: Hon. Peter D. Pizzuto, J.T.C.

APPENDIX OF DEFENDANT-APPELLANT DIRECTOR, DIVISION OF TAXATION

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INDEX TO APPENDIX

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Attorneys for Plaintiff
Lanco, Inc.

LANCO, INC., a Delaware corporation, Plaintiff, -vs.- DIRECTOR, DIVISION OF TAXATION, Defendant.	TAX COURT OF NEW JERSEY DOCKET NO. Civil Action COMPLAINT (Corporation Business Tax)

Plaintiff, LANCO, INC. ("Lanco"), a Delaware corporation, seeking review and reversal of the determination made by the Director of the Division of Taxation ("Director") by a letter dated June 26, 1997 (the "Subjectivity Notice") (a true copy of which is annexed hereto as Exhibit A) that Lanco is required to file Corporation Business Tax ("CBT") returns from February 11, 1983 through the present, respectfully says:

Party Plaintiff

1. Unless specified otherwise, all allegations set forth herein shall refer to the period February 11, 1983 through the present ("the period at issue").

2. Lanco is a corporation organized under the laws of the State of Delaware, currently having its principal office at 1105 North Market Street, Suite 902, Wilmington, Delaware 19899–8985.

3. Lanco was formed to acquire and protect certain trademarks and service marks. These marks are utilized by Lane Bryant, Inc. ("Lane Bryant") in connection with nationwide retail sales, primarily of clothing and accessories.

4. Lanco actively protects its trademarks and service marks from infringement. Lanco has retained trademark counsel to assist it in protecting its valuable trademarks.

5. Lanco has taken numerous actions to protect its rights in its marks in the United States as well as in foreign jurisdictions, including registration of its marks with the United States Patent and Trademark Office and in numerous foreign countries as well as the filing of notices of opposition to the registration of similar marks when appropriate.

6. Lanco does not have any offices or employees in New Jersey. Lanco maintains no accounts in any banks, brokerage houses, or other financial institutions in New Jersey.

7. Lanco does not hold a certificate, registration, license, or authorization issued by any New Jersey department or agency authorizing it to engage in business activity within the State.

8. Lanco does not employ or own real property, tangible personal property or intangible personal property in New Jersey.

9. Lanco disputes all of the filing requirements and the resulting liabilities set forth in the Subjectivity Notice.

<u>New Jersey Activities</u>

10. Lanco licenses the use of trademarks and service marks to Lane Bryant. A portion of the royalty fees earned by Lanco is derived from the licensing of trademarks and service marks

used by Lane Bryant in New Jersey. Lane Bryant utilizes the trademarks and service marks in connection with the sale of clothing and accessories in New Jersey.

11. During the period at issue, Lanco conducted its licensing activities from outside New Jersey.

12. Lanco submitted a New Jersey Schedule N (Nexus-Immune Activity Declaration) (a true copy of which is annexed hereto as Exhibit B) which it received from the Division of Taxation ("Division").

13. After a review of information submitted by Lanco, the Division, by the Subjectivity Notice, determined that Lanco was purportedly required to file CBT returns for the period at issue.

14. The Subjectivity Notice constitutes a final determination of the Director.

15. The amount in controversy, exclusive of penalties and interest, exceeds $2,000.00.

First Claim for Relief

16. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

17. Lanco was not subject to the tax under the CBT Act and is not required to file CBT returns for the period at issue since it did not engage in sufficient business activities in New Jersey under N.J.S.A. 54:10A–2.

Second Claim for Relief

18. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

19. Lanco is engaged in interstate commerce.

20. Any determination that Lanco is required to file CBT returns for the period at issue and pay CBT taxes on its apportioned Entire Net Income under the CBT Act when Lanco did not have a "substantial nexus" or substantial physical presence in New Jersey effects a discriminatory and impermissible burden upon interstate commerce in violation of the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3, and is therefore invalid and unenforceable as to Lanco.

Third Claim for Relief

21. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

22. Any determination that Lanco is required to file CBT returns for the period at issue effects an arbitrary and unreasonable deprivation of property in violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution and of Article I, paragraph 1 of the New Jersey Constitution (1947).

WHEREFORE, Plaintiff Lanco demands judgment as follows:

A. That the determination that Lanco is required to file CBT returns for the taxable period February 11, 1983 through the present be reversed and set aside; that Lanco has not engaged in sufficient activities in New Jersey to be subject to taxation under the CBT Act.

B. That to the extent that the CBT Act is construed to require Lanco to file CBT returns for the period at issue, such CBT Act be declared null and void and unenforceable as against Lanco since such Act as so construed violates (i) the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3; and (ii) the Due Process

Clause of the Fourteenth Amendment of the United States Constitution and Article I, paragraph 1 of the New Jersey Constitution (1947).

C. That such other and further relief as the Court may deem just and appropriate be granted.

STRYKER, TAMS & DILL

BY: _____
Charles M. Costenbader

_____
Paul H. Frankel

Attorneys for Plaintiff
Lanco, Inc.

Dated: September 8, 1997

Of Counsel:

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(212) 468-8000

Exhibit A

State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF TAXATION
CN 269
TRENTON NJ 08646-0269

CHRISTINE TODD WHITMAN
Governor

BRIAN W. CLYMER
State Treasurer
In reply respond to:

June 26, 1997

John Ristoro
Office Audit E
Phone: (609) 984-6429
Fax: (609) 633-2681

LANCO INC.
1105 N. MARKET STREET
PO BOX 8985, SUITE 1300
WILMINGTON DE 19899-8985
ATTN: EDWARD JONES, SECRETARY

RE: LANCO INC.
FID# 510-267-535/000

Dear Mr. Jones:

I have received your completed New Jersey Schedule N.

Based on your response to the questionnaire, the corporation is required to file a New Jersey Corporation Business Tax returns from 2/11/83 to the present.

In order to simplify the process of filing these returns, the Division requests the corporation to file complete 1994 through 1996 New Jersey Corporation Business Tax returns along with a complete copy of Federal Form 1120. In addition, the corporation may in lieu of filing complete New Jersey Corporation Business Tax returns, submit a schedule reporting the corporation's Federal taxable income (Line 28) for 1983 through 1993; based on the results of the completed 1994 through 1996 New Jersey Corporation Business Tax returns, the corporation can apply the average allocation factor of these years to the 1983 to 1994 years if this factor adequately represents the allocation factor of those years.

The requested information should be forwarded directly to this office within thirty (30) days from the date hereof. Should you have any questions please contact the undersigned.

Very truly yours,

John Ristoro,
Auditor

Exhibit B

SCHEDULE N
(2-96)

NE. JS-IMMUNE ACTIVITY DECLARATION

For taxable year beginning _____, 19___ and ending _____, 19___

CORPORATION NAME	FEDERAL ID NUMBER
Lanco, Inc.	51-0267535

Read the instructions on the reverse side before completing this schedule.

Did this corporation, during the period covered by this return, perform any of the following activities in New Jersey:

☐ Yes ☒ No (1) Own, lease or rent any real property in New Jersey?

☐ Yes ☒ No (2) Lease tangible property to others for use in New Jersey?

☐ Yes ☒ No (3) Own or lease vehicles registered in New Jersey which are provided to people who are not sales people?

☐ Yes ☒ No (4) Own, lease or rent any type of property located in New Jersey (consignments, inventory, drop shipments, c like transactions)?

☒ Yes ☐ No (5) License the use of any intangible rights from which royalties, licensing fees, etc., are derived for the use o these rights in New Jersey (for example without limitations, software licenses, trademarks)?

First date of activity - NJ: 2/11/83

☐ Yes ☒ No (6) Solicit sales in New Jersey for services through the use of employees, officers, agents and/or independen contractors or representatives?

☐ Yes ☒ No (7) Perform any type of service in New Jersey (other than solicitation) such as constructing, erecting, installing repairing, consulting, training, conducting seminars or meetings or administering credit investigations throug the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (8) Provide any technical assistance or expertise which is performed in New Jersey through the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (9) Perform any detail work in New Jersey without limitations such as taking inventory, stocking shelves, maintaining displays, arranging delivery through the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (10) Carry goods, merchandise, inventory, or other property into New Jersey for direct sale to customers in New Jersey?

☐ Yes ☒ No (11) Pick-up and/or replace damaged, returned or repossessed goods from New Jersey customers with company owned vehicles or through contract carriers?

☐ Yes ☒ No (12) Make pick-ups or deliveries to points in New Jersey with company owned vehicles or through contract carriers? **Transportation Companies Only.**

☐ Yes ☒ No (13) Provide any type of maintenance program which is performed in New Jersey by either this entity or an independent contractor?

☐ Yes ☒ No (14) Have sales representatives who have the authority to accept or approve sales orders from customers located in New Jersey in which acceptance/approval takes place in New Jersey and not from an out-of-state location?

☐ Yes ☒ No (15) Have employees, independent contractors or representatives with in-home offices in New Jersey for which they are reimbursed for expenses other than telephone or travel?

☐ Yes ☒ No (16) Serve as a general partner in a partnership doing business in New Jersey?

AFFIRMATION OF INFORMATION BY AN OFFICER / RESPONSIBLE INDIVIDUAL

I/We certify that this schedule, including any accompanying riders, is to the best of my knowledge a true, correct and complete report

Name Edward J. Jones Title Secretary

Edward J. Jones Date 6/10/97

CERTIFICATION PURSUANT TO RULE 4:5-1

Pursuant to R. 4:5-1, LANCO, INC. certify that the matter in controversy is not the subject of any other action pending in any court or arbitration proceeding and that no such proceeding is contemplated.

Charles M. Costenbader

Dated: September 8, 1997

CERTIFICATION OF SERVICE

The undersigned, an attorney-at-law of the State of New Jersey, hereby certifies as follows:

1. On September 8, 1997 I caused a copy of the within complaint to be personally served upon Peter Verniero, Attorney General of the State of New Jersey.

2. On September 8, 1997 I also caused a copy of the within Complaint to be personally served upon Richard D. Gardiner, Director, New Jersey Division of Taxation.

I certify that the foregoing statements made by me are true. I am aware that if these statements are willfully false, I am subject to punishment.

Charles M. Costenbader

Dated: September 8, 1997

PETER VERNIERO
Attorney General of New Jersey
Attorney for Defendant
Director, Division of Taxation
R.J. Hughes Justice Complex
P.O. Box 106
Trenton, New Jersey 08625-0106

By: Patrick DeAlmeida
Deputy Attorney General
(609) 984-0183

TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC., a Delaware corporation, Plaintiff,	Civil Action
v.	ANSWER
DIRECTOR, DIVISION OF TAXATION, Defendant.	

Defendant Director, Division of Taxation, by way of the undersigned counsel, hereby responds to the allegations set forth in the Complaint, and by way of an Answer to said Complaint states:

STATE TAX INFORMATION SCHEDULE

1. Admitted.

2. Admitted.

3. Admitted.

4. Admitted.

5. Admitted.

6. Admitted.

7. Admitted.

8. Admitted.

Party Plaintiff

1. Defendant neither admits nor denies the allegations set forth in paragraph 1 of the Complaint, as said allegations do not call for a response from defendant.

2. Admitted.

3. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in the first sentence of paragraph 3 of the Complaint. Defendant admits the allegations set forth in the second sentence of paragraph 3 of the Complaint.

4. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 4 of the Complaint.

5. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 5 of the Complaint.

6. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 6 of the Complaint.

7. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 7 of the Complaint.

8. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 8 of the Complaint.

9. Admitted.

New Jersey Activities

10. Admitted.

11. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 11 of the Complaint.

12. Admitted.

13. Admitted.

14. Admitted.

15. Admitted.

First Claim for Relief

16. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 15 of the Complaint as if fully set forth herein.

17. Denied.

Second Claim for Relief

18. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 17 of the Complaint as if fully set forth herein.

19. Admitted.

20. Denied.

Third Claim for Relief

21. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 20 of the Complaint as if fully set forth herein.

22. Denied.

WHEREFORE, defendant respectfully requests the following relief from the Court:

a) dismissal of the Complaint with prejudice;

b) the entry of judgment in favor of defendant and against plaintiff affirming the June 26, 1997 final determination of the Director, Division of Taxation.

FIRST AFFIRMATIVE DEFENSE

At all times and in all respects the Director has acted with respect to plaintiff in accordance with all controlling statutes and regulations.

SECOND AFFIRMATIVE DEFENSE

The Complaint fails to state a claim upon which relief can be granted.

THIRD AFFIRMATIVE DEFENSE

The June 26, 1997 final determination of the Director is sound in all respects and comports with all controlling statutes and regulations.

DESIGNATION OF TRIAL COUNSEL

Pursuant to R. 4:5-1(c) Deputy Attorney General Patrick DeAlmeida is hereby designated as trial counsel for defendant.

Respectfully submitted,

PETER VERNIERO
ATTORNEY GENERAL OF NEW JERSEY

By: Patrick DeAlmeida
Patrick DeAlmeida
Deputy Attorney General

DATED: Trenton, New Jersey
November 7, 1997

CERTIFICATION

I hereby certify as follows:

1. On November 7, 1997, I caused to be filed with the Clerk of the Tax Court an original and one (1) copy of the within Answer.

2. In addition, on that day, I served by first-class, United States mail, a copy of the within Answer on the following:

Charles M. Costenbader, Esq.
Stryker, Tams & Dill
Two Penn Plaza East
Newark, New Jersey 07105

Paul H. Frankel, Esq.
Morrison & Foerster
1290 Avenue of the Americas
New York, New York 10104

3. The within Answer was filed and served within sixty days of service of the Complaint on defendant.

4. There are no other proceedings either pending or contemplated with respect to the matter in controversy in this action and no other parties who should be joined in the action within the meaning of R. 4:5-1.

5. The foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are wilfully false, I am subject to punishment.

Patrick DeAlmeida
Deputy Attorney General

Dated: Trenton, New Jersey
November 7, 1997

McCARTER & ENGLISH, LLP
Charles M. Costenbader, Esq.
Four Gateway Center
100 Mulberry Street
Newark, New Jersey 07102

PAUL H. FRANKEL, ESQ.
c/o Morrison & Foerster LLP
1290 Avenue of the Americas
New York, NY 10104

Attorneys for Plaintiff

JOHN J. FARMER, JR.
ATTORNEY GENERAL OF
NEW JERSEY
Attorney for Defendant
Director, Division of Taxation
R.J. Hughes Justice Complex
25 Market Street
P.O. Box 106
Trenton, New Jersey 08625
By: Patrick DeAlmeida
Deputy Attorney General

TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC.,

Plaintiff,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant.

Civil Action

JOINT STIPULATION OF FACTS

The parties hereby stipulate to the following facts for the purposes of the issues pending in the above-entitled matter only. Entry into this Joint Stipulation of Facts does not constitute a waiver of any objections as to the relevancy of the stipulated facts contained therein.

1. The issue in this case is whether Lanco, Inc. ("Lanco") is subject to tax under the Corporation Business Tax ("CBT") Act and is required to file CBT returns for the period February 11, 1983 through the present ("the period in issue"). Unless otherwise specified, all statements below refer to the period in issue.

2. Attached hereto as Exhibit A is a copy of the Complaint that was timely filed by Lanco. Attached to the Complaint is a copy of the determination issued by the Division of

Taxation ("Division") to Lanco dated June 26, 1997, asserting that Lanco is required to file CBT returns for the period in issue (the "Subjectivity Notice"). Also attached to the Complaint is a copy of the New Jersey Schedule N (Nexus-Immune Activities Declaration) which was submitted by Lanco to the Division.

3. Attached hereto as Exhibit B is a copy of the Answer that was filed by the Director, Division of Taxation ("Director").

4. Lanco was incorporated in Delaware on December 15, 1982.

5. Lanco was formed to own, protect and license various trademarks, trade names and service marks (together, the "marks").

6. Lanco has registered all of its marks with the United States Patent and Trademark Office. Attached hereto as Exhibit C is an example of such a registration for one of the marks.

7. Lanco also registered its marks in numerous countries outside of the United States of America. Attached hereto as Exhibit D is a schedule of the dates that applications for some of such registrations were filed in other countries, copies of the registrations, and print-outs of the records maintained concerning the registrations.

8. No registration of any of the marks was ever obtained in the State of New Jersey by Lanco.

9. Lane Bryant, Inc. ("Lane Bryant") was incorporated in Delaware on April 26, 1982.

10. Lane Bryant is engaged in the nationwide retail sale of women's clothing and accessories.

11. Lanco and Lane Bryant are related by common ownership. Both Lanco and Lane Bryant are indirect subsidiaries of The Limited, Inc.

12. Pursuant to written agreement, Lanco licenses the use of its marks to Lane Bryant. Attached hereto as Exhibit E is a copy of the license agreement that is currently in effect.

13. Lanco receives royalty payments from Lane Bryant. The royalties are at arm's length rates.

14. Lane Bryant utilizes the marks in its business throughout the United States, including in New Jersey.

15. Lanco conducts all of its licensing activities from outside of New Jersey.

16. Lanco maintains no bank account, certificate of deposit or other financial accounts or safe deposit boxes at a banking institution within the State of New Jersey.

17. Lanco holds no interests in real property located in the State of New Jersey.

18. Lanco does not own any interest in tangible personal property located in the State of New Jersey.

19. Lanco has never maintained an office in the State of New Jersey. Originally, from 1983 through 1988, its offices were at 2625 Concord Pike, Wilmington, Delaware. Beginning January 9, 1989, Lanco's office was located at 1404 Foulk Road, Foulkstone Plaza, Wilmington, Delaware. From 1990 through the present, Lanco has had its office at 1105 North Market Street, Suite 902, Wilmington, Delaware 19899-8985.

20. Lanco has no officers or employees performing work for it in the State of New Jersey.

21. Lanco's Board of Directors has never held any meetings in the State of New Jersey. Lanco's shareholders have never held any meetings in the State of New Jersey.

22. Lanco has no agents in the State of New Jersey.

23. Lanco has never organized or sponsored any meetings in the State of New Jersey.

24. Lanco has purchased no goods or services from a contractor, subcontractor or vendor located in the State of New Jersey.

25. All of Lanco's activities concerning the protection of its marks occur outside New Jersey.

26. Attached as Exhibit F is Plaintiff's Response to Defendant's First Supplemental Interrogatories.

McCARTER & ENGLISH, LLP

Paul H Frankel

PAUL H. FRANKEL
Attorney for Plaintiff
c/o Morrison & Foerster LLP
1290 Avenue of the Americas
New York, NY 10104
(212) 468-8000

By: Charles M. Costenbader

CHARLES M. COSTENBADER
McCarter & English, LLP
Attorneys for Plaintiff
Four Gateway Center
100 Mulberry Street
Newark, NJ 07102
(973) 622-4444

Dated: October 4, 1999

JOHN J. FARMER, JR.
Attorney General of New Jersey

By: Patrick DeAlmeida

Patrick DeAlmeida
Deputy Attorney General
Attorney for Defendant
Director, Division of Taxation
R.J. Hughes Justice Complex
25 Market Street
P.O. Box 106
Trenton, NJ 08620
(609) 984-0183

Dated: Oct. 5, 1999

EXHIBIT A

STRYKER, TAMS & DILL LLP
Two Penn Plaza East
Newark, New Jersey 07105
(973) 491–9500

PAUL H. FRANKEL
c/o MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, New York 10104
(212) 468–8000

Attorneys for Plaintiff
Lanco, Inc.

LANCO, INC., a Delaware corporation, Plaintiff, -vs.- DIRECTOR, DIVISION OF TAXATION, Defendant.	TAX COURT OF NEW JERSEY DOCKET NO. Civil Action COMPLAINT (Corporation Business Tax)

Plaintiff, LANCO, INC. ("Lanco"), a Delaware corporation, seeking review and reversal of the determination made by the Director of the Division of Taxation ("Director") by a letter dated June 26, 1997 (the "Subjectivity Notice") (a true copy of which is annexed hereto as Exhibit A) that Lanco is required to file Corporation Business Tax ("CBT") returns from February 11, 1983 through the present, respectfully says:

Party Plaintiff

1. Unless specified otherwise, all allegations set forth herein shall refer to the period February 11, 1983 through the present ("the period at issue").

2. Lanco is a corporation organized under the laws of the State of Delaware, currently having its principal office at 1105 North Market Street, Suite 902, Wilmington, Delaware 19899–8985.

3. Lanco was formed to acquire and protect certain trademarks and service marks. These marks are utilized by Lane Bryant, Inc. ("Lane Bryant") in connection with nationwide retail sales, primarily of clothing and accessories.

4. Lanco actively protects its trademarks and service marks from infringement. Lanco has retained trademark counsel to assist it in protecting its valuable trademarks.

5. Lanco has taken numerous actions to protect its rights in its marks in the United States as well as in foreign jurisdictions, including registration of its marks with the United States Patent and Trademark Office and in numerous foreign countries as well as the filing of notices of opposition to the registration of similar marks when appropriate.

6. Lanco does not have any offices or employees in New Jersey. Lanco maintains no accounts in any banks, brokerage houses, or other financial institutions in New Jersey.

7. Lanco does not hold a certificate, registration, license, or authorization issued by any New Jersey department or agency authorizing it to engage in business activity within the State.

8. Lanco does not employ or own real property, tangible personal property or intangible personal property in New Jersey.

9. Lanco disputes all of the filing requirements and the resulting liabilities set forth in the Subjectivity Notice.

<u>New Jersey Activities</u>

10. Lanco licenses the use of trademarks and service marks to Lane Bryant. A portion of the royalty fees earned by Lanco is derived from the licensing of trademarks and service marks

used by Lane Bryant in New Jersey. Lane Bryant utilizes the trademarks and service marks in connection with the sale of clothing and accessories in New Jersey.

11. During the period at issue, Lanco conducted its licensing activities from outside New Jersey.

12. Lanco submitted a New Jersey Schedule N (Nexus-Immune Activity Declaration) (a true copy of which is annexed hereto as Exhibit B) which it received from the Division of Taxation ("Division").

13. After a review of information submitted by Lanco, the Division, by the Subjectivity Notice, determined that Lanco was purportedly required to file CBT returns for the period at issue.

14. The Subjectivity Notice constitutes a final determination of the Director.

15. The amount in controversy, exclusive of penalties and interest, exceeds $2,000.00.

First Claim for Relief

16. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

17. Lanco was not subject to the tax under the CBT Act and is not required to file CBT returns for the period at issue since it did not engage in sufficient business activities in New Jersey under N.J.S.A. 54:10A–2.

Second Claim for Relief

18. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

19. Lanco is engaged in interstate commerce.

20. Any determination that Lanco is required to file CBT returns for the period at issue and pay CBT taxes on its apportioned Entire Net Income under the CBT Act when Lanco did not have a "substantial nexus" or substantial physical presence in New Jersey effects a discriminatory and impermissible burden upon interstate commerce in violation of the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3, and is therefore invalid and unenforceable as to Lanco.

Third Claim for Relief

21. Lanco realleges and repeats the allegations of paragraphs 1 through 15.

22. Any determination that Lanco is required to file CBT returns for the period at issue effects an arbitrary and unreasonable deprivation of property in violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution and of Article I, paragraph 1 of the New Jersey Constitution (1947).

WHEREFORE, Plaintiff Lanco demands judgment as follows:

A. That the determination that Lanco is required to file CBT returns for the taxable period February 11, 1983 through the present be reversed and set aside; that Lanco has not engaged in sufficient activities in New Jersey to be subject to taxation under the CBT Act.

B. That to the extent that the CBT Act is construed to require Lanco to file CBT returns for the period at issue, such CBT Act be declared null and void and unenforceable as against Lanco since such Act as so construed violates (i) the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3; and (ii) the Due Process

Clause of the Fourteenth Amendment of the United States Constitution and Article I, paragraph 1 of the New Jersey Constitution (1947).

C. That such other and further relief as the Court may deem just and appropriate be granted.

STRYKER, TAMS & DILL

BY: Charles M. Costenbader
Charles M. Costenbader

Paul H. Frankel
Paul H. Frankel

Attorneys for Plaintiff
Lanco, Inc.

Dated: September 8, 1997

Of Counsel:

HOLLIS L. HYANS, ESQ.
CRAIG B. FIELDS, ESQ.
MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, New York 10104
(212) 468-8000

Exhibit A

State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF TAXATION
CN 269
TRENTON NJ 08646-0269

CHRISTINE TODD WHITMAN
Governor

BRIAN W. CLYMER
State Treasurer
In reply respond to:

June 26, 1997

John Ristoro
Office Audit E
Phone: (609) 984-6429
Fax: (609) 633-2681

LANCO INC.
1105 N. MARKET STREET
PO BOX 8985, SUITE 1300
WILMINGTON DE 19899-8985
ATTN: EDWARD JONES, SECRETARY

RE: LANCO INC.
FID# 510-267-535/000

Dear Mr. Jones:

I have received your completed New Jersey Schedule N.

Based on your response to the questionnaire, the corporation is required to file a New Jersey Corporation Business Tax returns from 2/11/83 to the present.

In order to simplify the process of filing these returns, the Division requests the corporation to file complete 1994 through 1996 New Jersey Corporation Business Tax returns along with a complete copy of Federal Form 1120. In addition, the corporation may in lieu of filing complete New Jersey Corporation Business Tax returns, submit a schedule reporting the corporation's Federal taxable income (Line 28) for 1983 through 1993; based on the results of the completed 1994 through 1996 New Jersey Corporation Business Tax returns, the corporation can apply the average allocation factor of these years to the 1983 to 1994 years if this factor adequately represents the allocation factor of those years.

The requested information should be forwarded directly to this office within thirty (30) days from the date hereof. Should you have any questions please contact the undersigned.

Very truly yours,

John Ristoro,
Auditor

Exhibit B

SCHEDULE N
(2-96)

NE. JS-IMMUNE ACTIVITY DEC_ARATION

For taxable year beginning _____, 19___ and ending _____, 19___

CORPORATION NAME	FEDERAL ID NUMBER
Lanco, Inc.	51-0267535

Read the instructions on the reverse side before completing this schedule.

Did this corporation, during the period covered by this return, perform any of the following activities in New Jersey:

☐ Yes ☒ No (1) Own, lease or rent any real property in New Jersey?

☐ Yes ☒ No (2) Lease tangible property to others for use in New Jersey?

☐ Yes ☒ No (3) Own or lease vehicles registered in New Jersey which are provided to people who are not sales people?

☐ Yes ☒ No (4) Own, lease or rent any type of property located in New Jersey (consignments, inventory, drop shipments, c like transactions)?

☒ Yes ☐ No (5) License the use of any intangible rights from which royalties, licensing fees, etc., are derived for the use o these rights in New Jersey (for example without limitations, software licenses, trademarks)?

First date of activity in NJ: 2/11/83

☐ Yes ☒ No (6) Solicit sales in New Jersey for services through the use of employees, officers, agents and/or independen contractors or representatives?

☐ Yes ☒ No (7) Perform any type of service in New Jersey (other than solicitation) such as constructing, erecting, installing repairing, consulting, training, conducting seminars or meetings or administering credit investigations throug the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (8) Provide any technical assistance or expertise which is performed in New Jersey through the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (9) Perform any detail work in New Jersey without limitations such as taking inventory, stocking shelves, maintaining displays, arranging delivery through the use of employees, agents, sub-contractors and/or independent contractors or representatives?

☐ Yes ☒ No (10) Carry goods, merchandise, inventory, or other property into New Jersey for direct sale to customers in New Jersey?

☐ Yes ☒ No (11) Pick-up and/or replace damaged, returned or repossessed goods from New Jersey customers with company owned vehicles or through contract carriers?

☐ Yes ☒ No (12) Make pick-ups or deliveries to points in New Jersey with company owned vehicles or through contract carriers? **Transportation Companies Only.**

☐ Yes ☒ No (13) Provide any type of maintenance program which is performed in New Jersey by either this entity or an independent contractor?

☐ Yes ☒ No (14) Have sales representatives who have the authority to accept or approve sales orders from customers located in New Jersey in which acceptance/approval takes place in New Jersey and not from an out-of-state location?

☐ Yes ☒ No (15) Have employees, independent contractors or representatives with in-home offices in New Jersey for which they are reimbursed for expenses other than telephone or travel?

☐ Yes ☒ No (16) Serve as a general partner in a partnership doing business in New Jersey?

AFFIRMATION OF INFORMATION BY AN OFFICER / RESPONSIBLE INDIVIDUAL

I/We certify that this schedule, including any accompanying riders, is to the best of my knowledge a true, correct and complete report

Name Edward J. Jones Title Secretary

Edward J. Jones Date 6/10/97

CERTIFICATION PURSUANT TO RULE 4:5-1

Pursuant to R. 4:5-1, LANCO, INC. certify that the matter in controversy is not the subject of any other action pending in any court or arbitration proceeding and that no such proceeding is contemplated.

Charles M. Costenbader

Dated: September 8, 1997

CERTIFICATION OF SERVICE

The undersigned, an attorney-at-law of the State of New Jersey, hereby certifies as follows:

1. On September 8, 1997 I caused a copy of the within complaint to be personally served upon Peter Verniero, Attorney General of the State of New Jersey.

2. On September 8, 1997 I also caused a copy of the within Complaint to be personally served upon Richard D. Gardiner, Director, New Jersey Division of Taxation.

I certify that the foregoing statements made by me are true. I am aware that if these statements are willfully false, I am subject to punishment.

Charles M. Costenbader

Dated: September 8, 1997

EXHIBIT B

PETER VERNIERO
Attorney General of New Jersey
Attorney for Defendant
Director, Division of Taxation
R.J. Hughes Justice Complex
P.O. Box 106
Trenton, New Jersey 08625-0106

By: Patrick DeAlmeida
Deputy Attorney General
(609) 984-0183

TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC., a Delaware corporation, Plaintiff,	Civil Action
v.	ANSWER
DIRECTOR, DIVISION OF TAXATION, Defendant.	

Defendant Director, Division of Taxation, by way of the undersigned counsel, hereby responds to the allegations set forth in the Complaint, and by way of an Answer to said Complaint states:

STATE TAX INFORMATION SCHEDULE

1. Admitted.

2. Admitted.

3. Admitted.

4. Admitted.

5. Admitted.

6. Admitted.

7. Admitted.

8. Admitted.

Party Plaintiff

1. Defendant neither admits nor denies the allegations set forth in paragraph 1 of the Complaint, as said allegations do not call for a response from defendant.

2. Admitted.

3. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in the first sentence of paragraph 3 of the Complaint. Defendant admits the allegations set forth in the second sentence of paragraph 3 of the Complaint.

4. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 4 of the Complaint.

5. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 5 of the Complaint.

6. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 6 of the Complaint.

7. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 7 of the Complaint.

8. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 8 of the Complaint.

9. Admitted.

New Jersey Activities

10. Admitted.

11. Defendant lacks sufficient information or knowledge to either admit or deny the allegations set forth in paragraph 11 of the Complaint.

12. Admitted.

13. Admitted.

14. Admitted.

15. Admitted.

First Claim for Relief

16. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 15 of the Complaint as if fully set forth herein.

17. Denied.

Second Claim for Relief

18. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 17 of the Complaint as if fully set forth herein.

19. Admitted.

20. Denied.

Third Claim for Relief

21. Defendant repeats and realleges each response to the allegations set forth in paragraphs 1 through 20 of the Complaint as if fully set forth herein.

22. Denied.

WHEREFORE, defendant respectfully requests the following relief from the Court:

a) dismissal of the Complaint with prejudice;

b) the entry of judgment in favor of defendant and against plaintiff affirming the June 26, 1997 final determination of the Director, Division of Taxation.

FIRST AFFIRMATIVE DEFENSE

At all times and in all respects the Director has acted with respect to plaintiff in accordance with all controlling statutes and regulations.

SECOND AFFIRMATIVE DEFENSE

The Complaint fails to state a claim upon which relief can be granted.

THIRD AFFIRMATIVE DEFENSE

The June 26, 1997 final determination of the Director is sound in all respects and comports with all controlling statutes and regulations.

DESIGNATION OF TRIAL COUNSEL

Pursuant to R. 4:5-1(c) Deputy Attorney General Patrick DeAlmeida is hereby designated as trial counsel for defendant.

Respectfully submitted,

PETER VERNIERO
ATTORNEY GENERAL OF NEW JERSEY

By: Patrick DeAlmeida
Patrick DeAlmeida
Deputy Attorney General

DATED: Trenton, New Jersey
November 7, 1997

CERTIFICATION

I hereby certify as follows:

1. On November 7, 1997, I caused to be filed with the Clerk of the Tax Court an original and one (1) copy of the within Answer.

2. In addition, on that day, I served by first-class, United States mail, a copy of the within Answer on the following:

Charles M. Costenbader, Esq.
Stryker, Tams & Dill
Two Penn Plaza East
Newark, New Jersey 07105

Paul H. Frankel, Esq.
Morrison & Foerster
1290 Avenue of the Americas
New York, New York 10104

3. The within Answer was filed and served within sixty days of service of the Complaint on defendant.

4. There are no other proceedings either pending or contemplated with respect to the matter in controversy in this action and no other parties who should be joined in the action within the meaning of R. 4:5-1.

5. The foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are wilfully false, I am subject to punishment.

Patrick DeAlmeida
Deputy Attorney General

Dated: Trenton, New Jersey
November 7, 1997

EXHIBIT C

Int. Cl.: 42

Prior U.S. Cl.: 101

Reg. No. 1,363,867

United States Patent and Trademark Office

Registered Oct. 1, 1985

SERVICE MARK
PRINCIPAL REGISTER

LANE BRYANT

LANCO, INC. (DELAWARE CORPORATION)
2625 CONCORD PIKE
WILMINGTON, DE 19803

FOR: RETAIL WOMEN'S CLOTHING STORE SERVICES, IN CLASS 42 (U.S. CL. 101).
FIRST USE 0-0-1911; IN COMMERCE 0-0-1911.

OWNER OF U.S. REG. NOS. 633,237 AND 1,293,460.

SER. NO. 532,773, FILED 4-18-1985.

G. MAYERSCHOFF, EXAMINING ATTORNEY

EXHIBIT D

Country	Date of Application	Date of Registration
Benelux	December 20, 1986	February 9, 1987
China	February 3, 1986	October 30, 1986
Columbia	August 1, 1985	September 13, 1990
Greece	July 28, 1988	October 17, 1991
Guatemala (one class)	December 23, 1987	March 22, 1989
Guatemala (another class)	December 30, 1987	October 3, 1988
Haiti	July 10, 1985	December 27, 1985
Italy	July 1, 1988	October 29, 1990
Jamaica	August 2, 1985	February 5, 1992
Mauritius	April 15, 1987	November 6, 1987
Mexico	August 1, 1990	November 27, 1990
Philippines	August 10, 1988	December 2, 1991
South Korea	July 19, 1985	August 8, 1986
Thailand	July 22, 1988	May 15, 1989
Turkey	December 5, 1985	December 5, 1985
Uruguay	August 29, 1985	May 8, 1986

Date : 07/23/1993

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19801
Trademark-name	: LANE BRYANT
Country	: BENELUX
Class(es)	: 25,40,42
File number	: D/651
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 12/20/1986
Application number	:
Publication date	:
Registration date	: 02/09/1987
Registration number	: 427,266
Renewal date	: 02/09/1997
Tax date	:
Use date	:
Goods and services	:

Clothing, boots, shoes and slippers, in International Class 25;
Tailoring, in International Class 40; and
Fashion consultancy, fashion rentals, in International Class 42.

Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

BENELUX-MERKENBUREAU BUREAU BENELUX DES MARQUE

BEWIJS VAN INSCHRIJVING **CERTIFICAT D'ENREGISTREMENT**

's-Gravenhage, de / La Haye, le

15 09 1987

de Direkteur / le Directeur

Dr. L.J.M. van BAUW

00 500101 US 000017

01 427266 690963/09 02 1987, 10.00

02 09 02 1997

03 Lanco, Inc., een Delaware corporatie
04 2625 Concord Pike
05 Wilmington - Delaware 19803, Ver.St.v.Am.

06 Hogehilweg 3, 1101 CA Amsterdam-Zuidoost, Nederland.

08 LANE BRYANT

13 Kl 25 Kleding, laarzen, schoenen, slippers.
Kl 40 Kleermakerij.
Kl 42 Kledingadviezen, kledingverhuur.

14 25 40 42

99 PUBL: I 10 1987

Verklaring der codering

Volgorde van publikatie (voorafgegaan door codering):

01 Nummer van de inschrijving alsmede dagtekening (dag, uur en minuut) van het depot;
02 Datum waarop de geldigheidsduur van de inschrijving verstrijkt;
03 Naam van de deposant;
04 Adres (straat);
05 Plaats en land;
06 In voorkomend geval, vermelding van het correspondentieadres van de deposant;
08 Afbeelding van het woordmerk;
09 Afbeelding van het beeldmerk;
(Combinatie woordmerk/beeldmerk)
10 Afbeelding van het beeldmerk;
(Niet in combinatie met een woordmerk)
11 In voorkomend geval, vermelding van een collectief merk, afgekort COLL;
12 In voorkomend geval, de vermelding dat het merk of een deel van het merk driedimensionaal is en onder andere dat het bestaat uit de vorm van de waar of de verpakking; in voorkomend geval, vermelding van de kleur(en) indien deze als onderscheidend bestanddeel aangemerkt wordt (worden) alsmede in voorkomend geval, een beschrijving van de delen van het merk met de daarop betrekking hebbende kleuraanduiding; eveneens in voorkomend geval de vermelding van de klasse-aanduiding van de beeldelementen van het merk;
13 — Klasseaanduiding alsmede de opgave van waren en diensten waarvoor het merk is bestemd;
— voor de depots ex artikel 40: beroep op het bestaan van het verkregen recht voor de vermelde diensten;
14 Klasseopsomming (00 = tot en met);
15 — Voor de depots ex artikel 30:
Aard en tijdstip der feiten die het verkregen recht hebben doen ontstaan in België (B), in Nederland (N) en in Luxemburg (L) alsmede eventuele toevoeging van de aanduiding "voor een deel der waren" (deel van de eerder genoemde waren);
— Voor de depots ex artikel 40:
vermelding van het jaar van het eerste gebruik;
16 Nummer(s) en datum (data) van de voor B (België), N (Nederland) en L (Luxemburg) van kracht zijnde nationale of internationale depots of inschrijvingen (I is de internationale inschrijving), alsmede vermelding van het nummer van het basisdepot in B (België), N (Nederland) of L (Luxemburg); indien er achter een depot of inschrijving twee of meer data zijn vermeld dan is de laatste datum die waarop de bescherming van het depot (inschrijving) een aanvang nam;
17 In voorkomend geval, vermelding van het recht van voorrang als bedoeld in artikel 4 van het Verdrag van Parijs tot bescherming van de Industriële Eigendom.
18 Dagtekening van de vernieuwing;
19 In voorkomend geval de vermelding van de licenties.

99 Publikatiedatum van de inschrijving en van de vernieuwing.

Explication des codes

Ordre de la publication (précédé d'un code):

01 Numéro de l'enregistrement ainsi que la date (jour, heure et minute du dépôt;
02 Date d'échéance de la durée de protection de l'enregistrement;
03 Nom du déposant;
04 Adresse (rue);
05 Localité et pays;
06 Le cas échéant, l'indication de l'adresse postale du déposant;

08 La reproduction de la marque verbale;
09 La reproduction de la marque figurative;
(Combinaison marque verbale/marque figurative)
10 La reproduction de la marque figurative;
(Pas en combinaison avec une marque verbale)
11 Le cas échéant, l'indication qu'il s'agit d'une marque collective, en abrégé COLL;
12 Le cas échéant, la mention que la marque ou une partie de la marque est à trois dimensions, constituée entre autres par la forme du produit ou du conditionnement; le cas échéant, l'indication de la ou des couleur(s) si celle(s)-ci est (sont) revendiquée(s) à titre d'élément distinctif ainsi que, le cas échéant, une description des éléments de la marque avec l'indication des couleurs s'y rapportant; le cas échéant l'indication de la classification des éléments figuratifs de la marque;

13 — L'indication des classes ainsi que la liste des produits et des services que la marque est destinée à couvrir;
— pour les dépôts ex article 40: revendication de l'existence du droit acquis pour les services mentionnés;
14 Enumération des classes (00 = à);
15 — Pour les dépôts ex article 30:
La nature et le moment des faits qui ont donné naissance aux droits acquis en Belgique (B), aux Pays-Bas (N) et au Luxembourg (L) ainsi que l'adjonction éventuelle de l'indication "pour une partie des produits" (partie des produits nommés ci-dessus).
— Pour les dépôts ex article 40:
indication de l'année du premier usage.
16 Numéro(s) et date(s) des dépôts ou enregistrements nationaux ou internationaux en vigueur en Belgique (B), aux Pays-Bas (N) et au Luxembourg (L); ainsi que l'indication du numéro du dépôt de base en Belgique (B), aux Pays-Bas (N) et au Luxembourg (L); si un dépôt ou un enregistrement est suivi de deux ou de plusieurs dates, c'est la dernière date qui détermine le point de départ de la protection du dépôt/de l'enregistrement; (I = enregistrement international);

17 Les cas échéant, l'indication du droit de priorité visé à l'article 4 de la Convention de Paris pour la protection de la Propriété Industrielle

18 Date du renouvellement;
19 Le cas échéant, la mention des licences.

99 Date de publication d'enregistrement et de renouvellement.

Benelux trademarks

Use requirements

Benelux trademarks must be used on a commercial scale within the three years following the filing date and such use should not be interrupted for 5 years or longer.

Licensing

Trademark licences can only be invoked against third parties if recorded with the Benelux Trademarks Office. Licences not laid down in writing are null en void.

Assignment

Benelux trademarks may be freely assigned without equally transferring the business.
Only registered assignments may be invoked against third parties.

Explanation of the code figures appearing on the certificate

00	code indicating applicant, home country and agent
01	registration number ____ filing number/filing date & time
02	expiration date
03	applicant's name
04/05	address
06	address for service
08	trademark word
09/10	reproduction of design mark
11	COLL=collective mark
12	if applicable: indication 3-dimensional mark, colour description or device element – classification
13	description of goods/services
14	classes covered (00 means through)
17	convention priority claimed

Date : 07/20/1993

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19801
Trademark-name	: LANE BRYANT
Country	: CHINA (PEOPLE'S REPUBLIC OF)
Class(es)	: 53
File number	: D/651
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 02/03/1986
Application number	:
Publication date	:
Registration date	: 10/30/1986
Registration number	: 266,940
Renewal date	: 10/29/1996
Tax date	:
Use date	:
Goods and services	:
Clothing.	
Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

中华人民共和国

商标注册证

商标注册证 第266940号

商　　标　LANE BRYANT

LANE BRYANT

注　册　人　美国兰科有限公司

使用商品　第53类　衣服

有效期限　自 1986 年10月30日至1996年10月29日

1986 年10月30日

中华人民共和国国家工商行政管理局 商标局

变更注册事项

THE PEOPLE'S REPUBLIC OF CHINA
CERTIFICATE OF TRADEMARK REGISTRATION

No. 266940

Registered proprietor

Lanco, Inc.

Goods for which the trademark is used

Clothing.

In Class 53

Trade Mark LANE BRYANT

Duration of validity

From Oct. 30, 1986 to Oct. 29, 1996

Seal of State Administration for Industry & Commerce of the People's Republic of China

Oct. 30, 1986

Date : 05/30/1991

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1409 Foulk Road Wilmington, Delaware 19803
Trademark-name	: LANE BRYANT
Country	: COLOMBIA
Class(es)	: 25
File number	: D/65
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 08/01/1985
Application number	: 247,281
Registration date	: 09/13/1990
Registration number	: 131,286
Renewal date	: 09/13/1995
Tax date	:
Use date	:
Goods and services	:
Clothing, including boots, shoes and slippers.	
Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

Ramiro Castro Duque

REPUBLICA DE COLOMBIA

SUPERINTENDENCIA DE INDUSTRIA Y COMERCIO

DIVISION DE PROPIEDAD INDUSTRIAL

EXPEDIENTE No	247281	CERTIFICADO DE REGISTRO	131286
APODERADO	CASTRO DUQUE RAMIRO		
RESOLUCION No.	6378	FECHA	13 SET. 1990

POR LA CUAL SE CONCEDE EL REGISTRO DE UNA MARCA

El jefe de la División de PROPIEDAD INDUSTRIAL de la Superintendencia de Industria y Comercio: en ejercicio de las facultades legales y en especial las que le confiere el artículo 24 del Decreto Ley 149 de 1976, y

CONSIDERANDO:

Que la solicitud de Registro de MARCA contenida en las presentes diligencias, reune los requisitos previstos en la Decisión 85 de la Comisión del Acuerdo de Cartagena, (D. 1190/78)

RESUELVE:

ARTICULO PRIMERO: Concédese el Registro de la MARCA LANC [redacted]

A favor de: LANCO, INC.
Con domicilio en: WILMINGTON (DELAWARE) ESTADOS UNIDOS
Por el término de cinco (5) años, contados a partir de la fecha de la presente Resolución, para distinguir: ***Vestidos, con inclusion de botas, zapatos y zapatillas. Productos comprendidos en la clase 25a. del Decreto 755 de 1972.

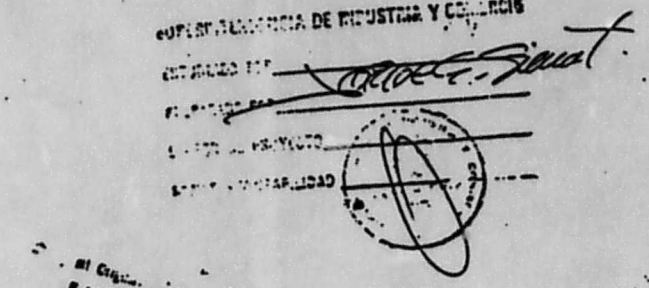
ARTICULO SEGUNDO: Previa la cancelación de los derechos que esta actuación causa, entréguese al titular el CERTIFICADO DE REGISTRO; háganse las anotaciones en los libros correspondientes y publíquese en la Gaceta de Propiedad Industrial. Contra esta Providencia proceden los recursos de Ley. Archívese el expediente.

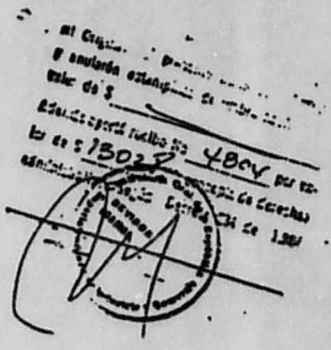
NOTIFIQUESE Y CUMPLASE:

El jefe de la División de Propiedad Industrial — El secretario de la División de Propiedad Industrial

INSCRITO AL FOLIO	171	DEL LIBRO	159 DE MARCAS

El secretario de la División de Propiedad Industrial


SUPERINTENDENCIA DE INDUSTRIA Y COMERCIO



Date : 12/06/1991

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1409 Foulk Road
Wilmington, Delaware 19803

Trademark-name : LANE BRYANT

Country : GREECE

Class(es) : 25

File number : D/65

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 07/28/1988
Application number : 89943

Registration date : 10/17/1991
Registration number : 89,943

Renewal date : 07/28/1998
Tax date :
Use date :

Goods and services :
Clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

Τόμος _____

ΕΛΛΗΝΙΚΗ ΔΗΜΟΚΡΑΤΙΑ

ΥΠΟΥΡΓΕΙΟ ΕΜΠΟΡΙΟΥ

ΤΜΗΜΑ ΚΑΤΑΘΕΣΕΩΣ ΣΗΜΑΤΩΝ

ΚΑΤΑΘΕΣΗ ΑΛΛΟΔΑΠΟΥ ΣΗΜΑΤΟΣ

Αριθμός Σήματος 89943

Χρονολογία 28 Ιουλίου 1988 Ώρα 11.35'

Συμβατική προτεραιότητα _____ Χώρα Η.Π.Α.

Δικαιούχος "LANCO, INC.", εταιρία που εδρεύει στο WILMINGTON της Πολιτείας DELAWARE (2625 CONCORD PIKE)

Πληρεξούσιος Δικηγόρος Ευαγγελία Παπά, Πανεπιστημίου 64

Αντίκλητος Ρένα Ραζή - Βαγιακάκου, " " " "

Προϊόντα για διάκριση Ρούχα, μπότες, παπούτσια και τσαντοφόλες.

Κλάσεις 25.-

Αριθμός διπλότυπου είσπραξης Δημόσιου Ταμείου 934994-95.991308.991310-11.966182.934997/1988

Αριθμός Απόφασης Διοικητικής Επιτροπής Σημάτων ΑΕΚΤΟ 395/1990

LANE BRYANT

Ο καταθέσας

Υπογραφή

Ο Τμηματάρχης

Υπογραφή

ΔΗΜΟΣΙΕΥΣΗ 7 Μαρτίου 1991 ΔΕΒΙ 2/1991

ΠΑΡΕΜΒΑΣΕΙΣ, ΕΝΔΙΚΑ ΜΕΣΑ ΑΠΟΦΑΣΕΙΣ

ΚΑΤΑΧΩΡΗΘΗΚΕ την 17 Οκτωβρίου 1991

Ο Τμηματάρχης

Υπογραφή 14.11.1991

Λήξης προστασίας 29 Ιουλίου 1998

ΜΕΤΑΒΟΛΕΣ ΚΑΙ ΠΑΡΑΤΑΣΕΙΣ ΠΡΟΣΤΑΣΙΑΣ

ΑΙΤΗΣΕΙΣ ΑΠΟΦΑΣΕΙΣ

ΑΙΤΗΣΕΙΣ ΑΝΤΙΡΡΑΣΩΝ ΠΡΟΣ
ΧΡΗΣΙΝ ΠΑΤΑΣΕΤΟΥ
Αριθ. 22 ... 19 91

ΠΑΡΑΤΗΡΗΣΕΙΣ

Date : 07/18/1993

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19801
Trademark-name	: LANE BRYANT
Country	: GUATEMALA
Class(es)	: 42
File number	: D/651
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 12/23/1987
Application number	:
Publication date	:
Registration date	: 03/22/1989
Registration number	: 57,697
Renewal date	: 03/21/1999
Tax date	:
Use date	:
Goods and services	:
Retail store services.	
Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

REPUBLICA DE GUATEMALA

CENTRO AMERICA

El Registrador de la Propiedad Industrial

CERTIFICA:

Que LANCO, INC.

de nacionalidad Estados Unidos con domicilio en 2625 Concord Pike, Wilmington, Delaware 19803, Estados Unidos es titular de la Marca de Servicios: "LANE BRYANT" denominada:

inscrita bajo el Número Cincuenta y siete mil seiscientos noventa y siete. (57697), folio ciento sesenta y siete. (67), tomo Ciento diecisiete. (127) de inscripciones, cuyo modelo está inserto, sellado a continuación.

REGISTRO DE LA PROPIEDAD INDUSTRIAL

BASADO EN LOS PRINCIPIOS DEL DERECHO REGISTRAL

MINISTERIO DE ECONOMIA

LANE BRYA

MINISTERIO DE ECONOMIA

y al número Nueve mil quinientos treinta y cuatro.

(9534), folio Ciento treinta y cuatro.

(134), tomo Treinta y dos (32) de modelos.

Ampara y distingue en la clase CUARENTA Y DOS (42):

SERVICIOS DE TIENDAS DE VENTAS AL POR MENOR. ----------

Reservas del uso del modelo:La casa solicitante, se reserva el uso exclusivo de la marca en cualesquiera tamaños, colores, tipos y formas de letras, fondos; disposiciones y combinaciones de colores y el derecho de aplicarla o fijarla a los servicios que ampara y a los recipientes que contienen los productos que ampara de la manera que estime más conveniente.----------

El distintivo fué inscrito con fecha veintidos de marzo de mil novecientos ochenta y nueve.

con vigencia por diez años, los que vencerán el veintiuno de marzo de mil novecientos noventa y nueve.

Para los efectos legales, se extiende el presente certificado de registro, en la ciudad de Guatemala, a veintidos de marzo de mil novecientos ochenta y nueve.

(Sello y firma del Registrador)

Date : 07/18/1993

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19801

Trademark-name : LANE BRYANT

Country : GUATEMALA

Class(es) : 25

File number : D/651

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 12/30/1987
Application number :

Publication date :

Registration date : 10/03/1988
Registration number : 55,863

Renewal date : 10/02/1998
Tax date :
Use date :

Goods and services :
Clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

REPUBLICA DE GUATEMALA

CENTRO AMERICA

El Registrador de la Propiedad Industrial

CERTIFICA:

Que LANCO INC.

de nacionalidad ESTADOUNIDENSE con domicilio en 2625 Concord Pike, Wilmington, Delaware, [illegible] Estados Unidos de América.

es titular de la marca Industrial-Comercial denominada "LANE BRYANT"

inscrita bajo el número cincuenta y cinco mil ochocientos setenta y tres (55,863), folio doscientos treinta y ocho (238), tomo ciento veintitrés (123) de inscripciones, cuyo modelo está inserto y sellado a continuación.

REGISTRO DE LA PROPIEDAD INDUSTRIA
BASADO EN LOS PRINCIPIOS DEL DERECHO REGISTRAL
MINISTERIO DE ECONOMIA

LANE BRYANT

y al número siete mil ochocientos c_incuenta y nueve

(7,859), folio doscientos cincuenta y nueve

(259), tomo VEINTISEIS (26) de modelos.

Ampara y distingue en la clase VEINTICINCO (25):

VESTIDOS, CON INCLUSION DE BOTAS, ZAPATOS Y ZAPATILLAS.----------

Reservas del uso del modelo: La casa solicitante se reserva el uso exclusivo de la marca en cualesquiera tamaños, colores, tipos y formas de letras, fondos; disposiciones y combinaciones de colores y el derecho de aplicarla o fijarla a los productos que ampara y a los recipientes que los contienen de la manera que la casa solicitante estime más conveniente.----------

El distintivo fué inscrito con fecha tres de octubre de mil novecientos ochenta y ocho.

con vigencia por diez años, los que vencerán el dos de octubre de mil novecientos noventa y ocho.

Para los efectos legales, se extiende el presente certificado de registro, en la ciudad de Guatemala, a cinco de octubre de mil novecientos ochenta y ocho.

MINISTERIO DE ECONOMIA

Lic. Jorge Rafael Recinos Acevedo
Registrador de la Propiedad Industrial
Ministerio de Economía

(Sello y firma del Registrador)

Date : 07/22/1993

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19801

Trademark-name : LANE BRYANT

Country : HAITI

Class(es) : 25

File number : D/651

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 07/10/1985
Application number :

Publication date :

Registration date : 12/27/1985
Registration number : 185/75

Renewal date : 12/27/1995
Tax date :
Use date :

Goods and services :
Articles of clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

REPUBLIQUE D'HAITI

MINISTERE
DU COMMERCE

SERVICE DES MARQUES DE FABRIQUE ET DE COMMERCE

(Loi du 17 Juillet 1954)

No 185/75.....
DUREE : 10 ans.....
Renouvellement du No.....
Date d'expiration. 27 .décembre .1995.....

A TOUS CEUX QUIL APPARTIENDRA

Il est certifié qu'aux termes de la Loi sur les Marques de Fabrique et de Commerce
LANCO, INC., société organisée et opérant sous le régime des lois de l'Etat de Delaware, E. U. A., ayant son siège social à 2625 Concord Pike, Wilmington, Delaware 19803, E. U. A., représentée par Mes. Jean P. Salès et Jean-Frédéric Salès, a

présenté une demande d'enregistrement de la marque : "LANE BRYANT"

Cette Marque consiste dans la dénomination ci-dessus, indépendamment des styles, couleurs et dimensions des caractères qui la composent.

Elle s'applique aux vêtements, y compris les bottes, les souliers et les pantoufles. (Classe 25)

Les formalités de la Loi ayant été remplies et aucune opposition n'ayant été reçue, la marque sus-mentionnée a été enregistrée au Ministère du Commerce le 27 décembre 1985

Le présent enregistrement confère au déposant le droit exclusif de possession et d'usage de la marque. Toute imitation, contrefaçon ou falsification sera punie conformément à la Loi.

Le Chef de Service des Marques de Fabrique et de Commerce
P. N. d'H. (illegible)

REPUBLIQUE D'HAITI

CHAMBRE DE COMMERCE D'HAITI

RECONNUE D'UTILITE PUBLIQUE

DECRET DU 18 JUIN 1964

No M.F.C.: A-7683.

A TOUS CEUX A QUI IL APPARTIENDRA

Il est certifié qu'aux termes de l'Art. 10 du décret du 18 Juin 1964

LANCO, INC, société organisée et opérant sous le régime des lois de l'Etat de Delaware, E.U.A., ayant son siège social à 2625 Concord Pike, Wilmington, Delaware 19803, E.U.A., représentée par Mes. Jean P. SALES et Jean-Frédéric SALES, a

présenté une demande d'enregistrement de la marque : "LANE BRYANT"

cette (marque) consiste dans la dénomination ci-dessus, indépendamment des styles, couleurs et dimensions des caractères qui la composent.

la marque ainsi décrite est la propriété de : LANCO, INC.

Elle s'applique aux vêtements, y compris les bottes, les souliers et les pantoufles.

Conformément au décret sus visé, il a été communiqué le Certificat du Département du Commerce et de l'Industrie. Aucune opposition n'ayant été reçue et la marque plus haut indiquée ayant été enregistrée à la Secrétairerie d'Etat du Commerce et de l'Industrie sous le No. - 185-Reg. 75 a été inscrite à la Chambre de Commerce d'Haiti, le 24 Février 1986 au No. M.F.C.: A-7683

M-9-85-0327—N.A. Théodore

La présente inscription confère le droit exclusif de possession et d'usage de la marque déposée à LANCO, INC.

Toute imitation, contrefaçon ou falsification sera punie conformément à la loi.

En foi de quoi le présent Certificat est délivré pour servir et valoir ce que de droit.

Fait à la Chambre de Commerce d'Haïti, ce 24 Février 1986

Chambre de Commerce d'Haïti

Fondée en 1907

Date : 01/13/1992

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1409 Foulk Road
Wilmington, Delaware 19803

Trademark-name : LANE BRYANT

Country : ITALY

Class(es) : 25

File number : D/65

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 07/01/1988
Application number : 22238 C88

Registration date : 10/29/1990
Registration number : 535,513

Renewal date : 07/01/2008
Tax date :
Use date : 10/29/1993

Goods and services :
Clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

MINISTERO DELL'INDUSTRIA DEL COMMERCIO E DELL'ARTIGIANATO

D.G.P.I. - UFFICIO CENTRALE BREVETTI

BREVETTO PER MARCHIO D'IMPRESA

Tipo PRIMO DEPOSITO

N. 0535513

Il presente brevetto viene concesso per il marchio d'impresa oggetto della domanda sotto specificata:

num. domanda	anno	U.P.I.C.A.	data pres. domanda
22238	1988	MILANO	01/07/1988

TITOLARE — LANCO INC.
WILMINGTON DELAWARE U.S.A.

RAPPR.TE — ING. BARZANO' & ZANARDO MILANO
S.P.A. G. ZANARDO R. GARAVAGLIA
S. ROGGERO F. SINISCALCO R.
APPOLONI ED ALTRI
VIA BORGONUOVO 10 MILANO

TITOLO — L'ESEMPLARE DEL MARCHIO E LE INDICAZIONI DELLE CLASSI SONO CONTENUTI NELLA DICHIARAZIONE DI PROTEZIONE ALLEGATA

CLASSI — 25.

TASSA — PAGATA PER VENTI ANNI

ROMA, 29/10/1990

IL DIRIGENTE
FIRMATO GIOVANNA MORELLI

CONSEGNATO IL
O FACENTE FUNZIONE.

DAL DIRETTORE UPICA DI MILANO
FIRMA

Da69

ING. BARZANO' & ZANARDO
MILANO S.p.A.

DICHIARAZIONE DI PROTEZIONE

a nome: LANCO, INC., di nazionalità statunitense, con sede in WILMINGTON, Delaware (U.S.A.), rappresentata dai sottoscritti mandatari della Ing. BARZANO' & ZANARDO MILANO S.p.A., con domicilio eletto in MILANO, Via Borgonuovo 10, per il marchio di impresa di primo deposito,

depositato il: -1 LUG. 1988 222380 C/88

Il marchio è costituito dalla dicitura:

LANE BRYANT

Il marchio sarà utilizzato per contraddistinguere i prodotti elencati al punto A) della presente dichiarazione.

Il marchio stesso verrà usato applicandolo sui prodotti, involucri, imballaggi, stampati, etichette, fascette, pubblicità, ecc., ed inoltre nella pubblicità radiofonica, cinematografica, televisiva e simili, in qualsiasi dimensione, colore o combinazione di colori e tipo di carattere, sia mediante impressione, rilievo o stampa, sia in ogni altro modo conveniente.

A) ELENCO PRODOTTI: " Articoli di abbigliamento, compresi stivali, scarpe e pantofole ". - Classe 25 -.

LANE BRYANT

p.p. LANCO, INC.

MANDATARI NOMINATI:
G.Zanardo - R.Garavaglia - S.Roggero - R.Appoloni,
F.Siniscalco - E.De Carli - A.Zappella - R.Coletti
(firma)

(per sé e per gli altri) Da70

Date : 04/21/1992

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1409 Foulk Road
Wilmington, Delaware 19803

Trademark-name : LANE BRYANT

Country : JAMAICA

Class(es) : 25

File number : D/65

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 08/02/1985
Application number : 25/936

Publication date : 12/31/1990

Registration date : 02/05/1992
Registration number : B22,857

Renewal date : 08/02/1992
Tax date :
Use date :

Goods and services :
Articles of clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

FORM No. 54

Certificate of Registration

JAM[illegible]
MARK[illegible]

LANE BRYANT

The Trade Mark shown above has been registered in Part B of the [illegible]egister in the name of—

LANCO, INC. a Corporation organised and exi ing under the laws of the State of Delaware, United States of Ame ca, located at 2625 Concord Pike, Wilmington, Delaware, United States of America, trading as Manufacturers and Merchants

in Class 25 Schedule IV under No. B22,857 as of the date 2nd August, 1985 in respect of

Articles of clothing, including boots, shoe and slippers

Sealed at my direction, this FIFTH day of FEBRUARY, 1992.

Office of the Registrar of Companies,
Trade Marks Branch,
11 King Street,
Kingston, Jamaica.

G. E. Edwards
Registrar of Companies

Date : 07/22/1993

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19801

Trademark-name : LANE BRYANT

Country : MAURITIUS

Class(es) :

File number : D/651

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 04/15/1987
Application number :

Publication date :

Registration date : 11/06/1987
Registration number : 41

Renewal date : 04/15/1994
Tax date :
Use date :

Goods and services :
Articles of clothing, including boots, shoes and slippers.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

SCOTT & CO LTD

4, Edith Cavell Street
P.O. Box 51, Port Louis, Mauritius
Cable: FINCOM — Telex: 4412 FINCOM IW — Tel 085051

TM/87/34

15 April 1987

The Comptroller of Customs
PORT LOUIS

Dear Sir

APPLICATION FOR REGISTRATION OF A TRADE MARK

In the name and on behalf of MESSRS LANCO, INC., a Delaware Corporation, of 2625 Concord Pike, Wilmington, Delaware 19803, United States of America, we beg to apply under section 9(a) of the Trade Mark Act in Mauritius, for the registration of the following Trade Mark:

which is to be used in respect of: "Articles of clothing, including boots, shoes and slippers".

Claim is made to use the Mark in any ; colour, size

Yours faithfully
SCOTT & CO LTD

Manager

I certify that the Trade Mark mentioned in the application overleaf and of which a facsimile has been deposited in my office was registered in Reg A/28 No. 41 folio 21 on the 15th day of the month of April 1987.

Received Rs 302.50 CB 5760 of 29.10.87

Comptroller of Customs

H M Customs
Port Louis
MAURITIUS.

Date: 6th November, 1987

Date : 10/13/1992

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19803
Trademark-name	: LANE BRYANT
Country	: MEXICO
Class(es)	: 25
File number	: D/65
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 08/01/1990
Application number	: 92,740
Publication date	:
Registration date	: 11/27/1990
Registration number	: 387,124
Renewal date	: 08/01/1995
Tax date	:
Use date	: 11/27/1993
Goods and services	:
Clothing.	
Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

SECRETARIA DE COMERCIO Y FOMENTO INDUSTRIAL

DIRECCION GENERAL DE DESARROLLO TECNOLOGICO

FECHA Y HORA DE PRESENTACION

92740

79926

SOLICITUD DE REGISTRO DE MARCA

1 - DATOS DE LA MARCA

TIPO DE MARCA: NOMINATIVA [X] INNOMINADA [ ] MIXTA [ ]

DENOMINACION LANE BRYANT

PRODUCTOS O SERVICIOS QUE PROTEGE VESTUARIO.

CLASE 025

1 PRODUCTO [ ] DE 2 A 10 PRODUCTOS [ ] TODA LA CLASE [X]

SI LA MARCA SE HA USADO, INDIQUE FECHA DE INICIO [ ] [ ] [ ] (DIA MES AÑO) NO SE HA USADO [X]

2 - DATOS DEL ESTABLECIMIENTO

TIPO: INDUSTRIAL [ ] COMERCIAL [X] SERVICIOS [ ]

UBICACION DEL ESTABLECIMIENTO 2625 CONCORD PIKE (DOMICILIO CALLE Y NUMERO)

19803 (C.P.) WILMINGTON, DELAWARE (POBLACION Y ESTADO)

(COLONIA) E.U.A. (PAIS) [US] (CLAVE)

UBICACION DEL ESTABLECIMIENTO (DOMICILIO CALLE Y NUMERO)

(COLONIA) (C.P.) (POBLACION Y ESTADO)

(PAIS) [ ] (CLAVE)

3 - RECLAMACION DE PRIORIDAD (SI LA HAY)

(PAIS) (FECHA DE PRESENTACION) (No. DE SERIE)

4 - SE CONCEDE PRIORIDAD

SI [ ] NO [ ] FECHA EN QUE SE CONCEDE [ ] [ ] [ ] (DIA MES AÑO)

NOMBRE Y FIRMA DE QUIEN CONCEDE LA PRIORIDAD

(NOMBRE) (FIRMA)

5 - DATOS DEL TITULAR

NOMBRE LANCO, INC. (CLAVE)

NORTEAMERICANA (NACIONALIDAD) [U S] (CLAVE) 2625 CONCORD PIKE (DOMICILIO CALLE Y NUMERO) (COLONIA)

19803 (C.P.) WILMINGTON, DELAWARE (POBLACION Y ESTADO) E.U.A. (PAIS) [US] (CLAVE)

6 - DATOS DEL APODERADO

NOMBRE LICS. GERARDO GOMEZ VEGA, ALEJANDRO ORTIGOZA, ROBERT YOUNG SR., MANUEL M. SOTO, MARIO PONCE V., IGNACIO SANDS G., HERIBERTO PEÑARIA M., ARTHUR ORTIGOZA GOYTIA (CLAVE)

Mexicana (NACIONALIDAD) [M X] (CLAVE) Hamburgo 260 (DOMICILIO CALLE Y NUMERO) Juárez (COLONIA)

06600 (C.P.) México, D.F. (POBLACION Y ESTADO) México (PAIS) [M X] (CLAVE)

NOTA: SE AUTORIZA LA LIBRE REPRODUCCION DE ESTA FORMA SIEMPRE Y CUANDO NO SE ALTERE EL DISEÑO 040-015

7 - DESCRIPCION Y RESERVAS

DESCRIPCION DE LA MARCA.- LA MARCA CONSISTE SUSTANCIALMENTE EN SU REPRESENTACION DETALLADA COMO APARECE EN LA ETIQUETA O EN EL ESPECIMEN DE LA MARCA

RESERVAS.- Del derecho exclusivo al uso de la denominación LANE BRYANT representada en cualquier tipo y tamaño de letras, así como del de aplicarla de cualquier manera que produzca la impresión visual representada en el facsímile anexo, para amparar los artículos señalados al dorso.

EXCLUSION DE LEYENDAS NO RESERVABLES

8 - ETIQUETA O ESPECIMEN DE LA MARCA

L A N E B R Y A N T

SECRETARIA DE COMERCIO
Y FOMENTO INDUSTRIAL
DIRECCION GENERAL DE
DESARROLLO TECNOLOGICO

9 - DOCUMENTOS ANEXOS

— DOCUMENTOS QUE EL INTERESADO DEBERA ANEXAR A LA SOLICITUD	PARA USO EXCLUSIVO DE LA D.G.I.M. y D.T. SI	NO
— 8 IMPRESIONES DE LA MARCA BLANCO Y NEGRO	X	
— 8 IMPRESIONES DE LA MARCA A COLORES (EN SU CASO)		X
— CARTA PODER (CUANDO NO SE TRAMITE POR EL INTERESADO)		X
— TESTIMONIO QUE COMPRUEBE LAS FACULTADES DEL REPRESENTANTE DEL TITULAR (CUYO ORIGINAL OBRA EN MARCA 330059	X	
(EN SU CASO) No REG. GRAL. DE PODERES		X

NOTA: SOLICITUD DE RE-REGISTRO VER ANEXO

México, D.F.
LUGAR

1 de agosto de 1990
FECHA

LIC. BERNARDO GOMEZ VEGA
NOMBRE

FIRMA

10-REGISTRO DE MARCA

FECHA LEGAL: 1 DE AGOSTO DE 1990

HORA: 14.15

NUMERO DE REGISTRO: 367124

LOS EFECTOS DE ESTE REGISTRO TIENEN UNA DURACION DE CINCO AÑOS CONTADOS A PARTIR DE LA FECHA LEGAL Y ES RENOVABLE DE ACUERDO A LAS DISPOSICIONES LEGALES APLICABLES

MEXICO, D.F. 27 DE NOVIEMBRE DE 1990

POR ACUERDO DEL C. SECRETARIO DE COMERCIO Y FOMENTO INDUSTRIAL, EL C. DIRECTOR GENERAL DE DESARROLLO TECNOLOGICO

SUFRAGIO EFECTIVO. NO REELECCION
EL DIRECTOR GENERAL

M. en C. ROBERTO GALLEGOS LUNA

CGR/hpp

Date : 07/09/1992

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19803

Trademark-name : LANE BRYANT

Country : PHILIPPINES

Class(es) : 42

File number : D/65

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 08/10/1988
Application number : 65,468

Publication date :

Registration date : 12/02/1991
Registration number : 51,821

Renewal date : 12/02/2011
Tax date :
Use date : 12/02/1996

Goods and services :
Retail women's clothing store services and mail order store services in the field of women's apparel.
* * *
Affidavits of use due 12/02/2001 and 12/02/2006.
* * *
Based on U.S. Registration Nos. 1,363,867 and 1,293,460.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

and Technology Transfer

DATE REGISTERED: DEC 02 1991 REGISTRATION NO: 51821

Principal Register

(~~TRADEMARK~~/SERVICE MARK/~~TRADE NAME~~)

MARK: LANE BRYANT Serial No.: 65468

Date Filed: August 10, 1988

LANE BRYANT

Goods: Retail women's clothing store services and mail order store services in the field of women's apparel.

Classes: 42

Applicant: LANCO, INC. Address: 2625 Concord Pike, Wilmington Delaware 19803, U.S.A.

Assignee: None Address: None

~~Priority~~/Reg. No.s: 1,363,867 / 1,293,460 - U.S.A. First use in the Philippines: None

October 1, 1985 & September 4, 1984

Disclaimer: None Claim of Color: None

Translation: None

Registered for a term of 20 years from: DEC 02 1991

Examiner: WILFREDO PULMANO Attorney/Agent: BITO, ET.AL.

ATTESTED:

IN WITNESS WHEREOF, I have hereunto affixed my hand and the seal of the Bureau of Patents, Trademarks and Technology Transfer at Makati, Metro Manila, Philippines, today, DEC 02 1991

IGNACIO S. BAPALO
Director

IMPORTANT REMINDER

TO AVOID CANCELLATION of this registration, the registrant SHALL FILE AN AFFIDAVIT OF USE or NON-USE within one year following the 5th, 10th, and 15th anniversary of the date of registration with the necessary fee as required by law.

AFFIDAVIT FILED	DATE	O.R. NO.	RECORDED by:
After the 5th Year Within the 6th Year			
After the 10th Year Within the 11th Year			
After the 15th Year Within the 16th Year			

Date : 07/21/1993

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19801

Trademark-name : LANE BRYANT

Country : SOUTH KOREA

Class(es) : 45

File number : D/651

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 07/19/1985
Application number :

Publication date :

Registration date : 08/08/1986
Registration number : 128,443

Renewal date : 08/07/1996
Tax date :
Use date :

Goods and services :
Dress coats, evening dresses, skirts, sweaters, white shirts, blouses, sport shirts, polo shirts, under shirts, pants, combination, chemise, slips, petticoats, corsets, brassieres, bathing suits, bathing caps, night wear, pajamas, negligees, nightgowns, sportswear, hosiery, stockings, gloves (including rubber gloves, rubber gloves for insulation and medical gloves), neckpieces, mufflers, scarves, neckerchiefs, shawls, stockings for sports, tights, hats and caps, necklaces, earrings, bracelets, brooch, rings, hair ribbons, buttons and handkerchiefs.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

TRANSLATION

CERTIFICATE OF TRADEMARK REGISTRATION

Trademark Registration No. 128443

Trademark Application No. 85-12174

Trademark Publication No. 86-4480

Owner : Lanco, Inc.
2625 Concord Pike, Wilmington, Delaware 19803,
U. S. A.

LANE BRYANT

Coverage: Class 45
Please see the attached sheet.

Date of Registration: August 8, 1986

This is to hereby certify that the above trademark has been officially recorded in the Trademark Register in accordance with Korean Trademark Law.

Dated this 8th day of August, 1986

Director-General of the Korean Patent Office (Sealed)

* Expiration Date is August 7, 1996.

Application for registration renewal can be made only within the year preceeding the date of the trademark right expiration.

Designated Goods: Class 45

Dress coats, evening dresses, skirts, sweaters, white shirts, blouses, sport shirts, polo shirts, under shirts, pants, combination, chemise, slips, petticoats, corsets, brassieres, bathing suits, bathing caps, night wear, pajamas, negligees, nightgowns, sports-wear, hosiery, stockings, gloves (including rubber gloves, rubber gloves for insulation and medical gloves), neckpieces, mufflers, scarves, neckerchiefs, shawls, stockings for sports, tights, hats and caps, necklaces, earrings, bracelets, brooch, rings, hair ribbons, buttons and handkerchiefs.

상 표 등 록 증

상표등록제 128443 호

19 85 년 상표등록출원 제 12174 호
19 86 년 상표등록출원공고제 4480 호

연합상표등록번호 미합중국델라웨어19803윌밍톤론코오드파크2625
상 표 권 자 탄코인코포레이티드

상표를 사용할 상품명 및 구분

제 045 류

예복 외 44 건

등 록 일 자 19 86 년 8 월 8 일

위는 상표법에 의하여 상표등록원부에 등록되었음을 증명함.

19 86 년 8 월 8 일

특 허 청

유 의 사 항

1. 권리내용의 확인

상표권의 내용은 상표등록원부를 열람하면 구체적으로 확인할 수 있읍니다.

2. 상표권의 존속기간

○상표권의 존속기간은 설정의 등록일로부터 10년간이며 존속기간 갱신등록출원에 의하여 10년간씩 갱신할 수 있읍니다.-

○상표권의 존속기간갱신등록출원은 상표권의 존속기간 만료전 1년내에 출원하여야 합니다.

*위의 사항은 관계법령의 개정으로 그 내용이 변경될 수도 있으니 불이익을 받는 일이 없도록 주의하시기 바랍니다.

Date : 07/20/1993

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19801
Trademark-name	: LANE BRYANT
Country	: THAILAND
Class(es)	: 38
File number	: D/651
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 07/22/1988
Application number	:
Publication date	:
Registration date	: 05/15/1989
Registration number	: 125,517
Renewal date	: 07/21/1998
Tax date	:
Use date	:
Goods and services	:

Articles of clothing including boots, shoes and slippers.

Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

TRANSLATION OF REGISTRATION CERTIFICATE

BANGKOK, THAILAND

T.M. Form No. 7 – Registration Number (a) 125517

CERTIFICATE OF TRADEMARK REGISTRATION

This Certificate is issued to Messrs. (b) LANCO, INC.,

as evidence that the Trademark referred to in Application Number 178823

which was advertised in the Trademark Journal Number 1145

on page 96, has been duly registered by us in Class No. 38,

in respect to the following goods namely: Articles of clothing including boots, shoes and slippers.

TRADEMARK OFFICE.

Date: May 15, 1989

(Signed by) Mr. Prakas Tenanon

Director General of
Department of Trademark Registration
(Seal of Thailand Trademark Office)

"LANE BRYANT"

(Appearing on the Reverse side of the document)

This certificate is valid for ten (10) years from the date of application, that is from the 22 day of July 1988, and may be renewed within three (3) months before maturity of each period of ten (10) years.

If any alteration or change be made in the ownership of this Trademark, or in the registered address, notice of such alteration or change must be submitted to the Registrar as soon as possible.

NOTE: If it is desired to learn whether any alteration or change has been made after the date of this certificate, please apply to the Registrar requesting an inspection of the Register, giving the following information along with the inquiry

(a) Serial number of the registration
(b) Name of Proprietor of the Trademark.

TRANSLATION MADE BY

Tilleke & Gibbins...

ADVOCATES & SOLICITORS (FOUNDED 1893)
TILLEKE & GIBBINS BUILDING
64/1 SOI TONSON
PLOENCHIT ROAD
BANGKOK 10330
THAILAND

ค.ม. ๗ เรื่องเลขที่ (ก) 125517

หนังสือคู่มือรับจดทะเบียน

หนังสือคู่มือนี้ให้ไว้แก่ (ข) แลนโค, อิ้งค์.,

เพื่อแสดงว่าเครื่องหมายการค้าที่อ้างถึงในคำขอจดทะเบียนหมายเลขที่ 178823 และที่ได้ประกาศในหนังสือจดหมายเหตุแสดงรายการเครื่องหมายการค้าเล่ม 1145 หน้า 96 นั้น ได้จดทะเบียนแล้วในจำพวก 38 สำหรับสินค้าที่ได้ระบุไว้คือ เครื่องนุ่งห่มและแก่งกาย รองเท้าหุ้มข้อเท้า รองเท้าและรองเท้าแตะ ซึ่งอยู่ในจำพวกนี้

กองสิทธิบัตรและเครื่องหมายการค้า

ออกให้ ณ วันที่ 15 พฤษภาคม พุทธศักราช ๒๕๓๒

(เริ่มนับอายุตั้งแต่วันที่ 22 กรกฎาคม 2531 หมดอายุวันที่ 21 กรกฎาคม 2541)

ลงลายมือชื่อ

(นายประกาศ [illegible])
รองอธิบดี ปฏิบัติราชการแทน

LANE BRYANT อธิบดีกรมทะเบียนการค้า

Date : 07/20/1993

PRINT-OUT OF RECORD

Owner : Lanco, Inc.
1105 North Market Street
Wilmington, Delaware 19801

Trademark-name : LANE BRYANT

Country : TURKEY

Class(es) :

File number : D/651

Union priority : country :
Union priority : number :
Union priority : date :

Application date : 12/05/1985
Application number :

Publication date :

Registration date : 12/05/1985
Registration number : 89,831

Renewal date : 12/05/1995
Tax date :
Use date :

Goods and services :
Women's, nurses and children's clothes and accessories, namely, suits, dresses, waists and skirts for outer and underwear, sweaters, hats, hosiery, shoes, belts, neckties, scarfs, shawls, fur coats, fur collars, fur muffs, gloves, corsets and brassieres.

Date of 1st use :
Declaration Section 8 :
Section 15 :
Disclaimer :
Registered User :
Comment :

T. C.
SANAYİ VE TİCARET BAKANLIĞI
Sınai Mülkiyet Dairesi Başkanlığı

MARKA TESCİL BELGESİ

Markanın Numarası : 089831
Çeşidi : Perdi

Lane Bryant

Marka Sahibinin Adı, Soyadı : LANCO, INC.,
Delaware Eyaleti kanunlarına tevfikan müessese
Tâbiyeti, İkametgahı : Amerika Birleşik Devletleri
Markanın Kullanılacağı Emtia : Delaware Eyaletinde , Wilmington Şehrinde, 2625 Concord Pike, Amerika Birleşik Devletleri

"Kadınların, hemşirelerin ve çocukların elbiseleri ve aksesuarlarından takım elbiseler, elbiseler, yelekler, ve dış ve iç etekler, sveterler, şapkalar, çoraplar, ayakkabılar, kemerler, kravatlar, atkılar, şallar, kürk paltolar, kürk yakalar, kürk kolluklar, eldivenler, korseler ve sütyenler."

551 sayılı Kanuna göre 5 Aralık 1985 tarihinden muteber olmak üzere on yıl müddetle tescil edilmiştir.

SANAYİ VE TİCARET BAKANI

Kâmil ŞENER
Müsteşar Muavini

DEVİR, LİSANS UNVAN VE EMTİA DEĞİŞİKLİĞİ, HACİZ,
TERKİN DEĞİŞİKLİĞİ VE DİĞER İŞLEMLER

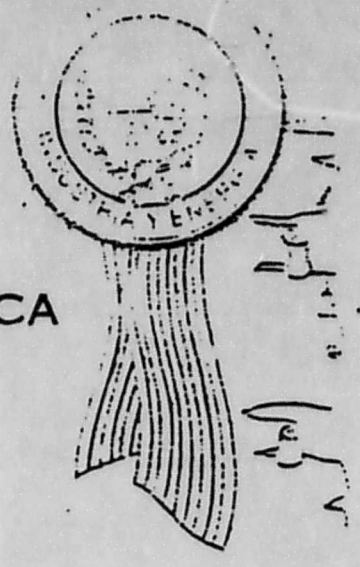
Date : 07/20/1993

PRINT-OUT OF RECORD

Owner	: Lanco, Inc. 1105 North Market Street Wilmington, Delaware 19801
Trademark-name	: LANE BRYANT
Country	: URUGUAY
Class(es)	: 25
File number	: D/651
Union priority : country	:
Union priority : number	:
Union priority : date	:
Application date	: 08/29/1985
Application number	:
Publication date	:
Registration date	: 05/08/1986
Registration number	: 207,495
Renewal date	: 05/08/1996
Tax date	:
Use date	:
Goods and services	:
Clothing, including boots, shoes and slippers.	
Date of 1st use	:
Declaration Section 8	:
Section 15	:
Disclaimer	:
Registered User	:
Comment	:

REPUBLICA O. DEL URUGUAY

TITULO DE MARCA



Nº 207.495

EL CENTRO NACIONAL DE LA PROPIEDAD INDUSTRIAL

C E R T I F I C A

que, cumplidas las formalidades establecidas por las disposiciones legales y reglamentarias vigentes y por resolución de 8 de mayo de 1986, se ha autorizado a favor de LANCO, INC., de los Estados Unidos de Norte América,

el registro de la marca "LANE BRYANT"

cuyos datos surgen de la hoja de descripción adjunta para distinguir la clase Int. 25.-

Y para constancia se extiende el presente Título en Montevideo, a los trece días del mes de noviembre de mil novecientos ochenta y siete.

nsm

MINISTERIO DE INDUSTRIA Y ENERGIA
CENTRO NACIONAL DE LA PROPIEDAD INDUSTRIAL

Dr. AGUSTIN J. PRAT GUTIERREZ
DIRECTOR
DIRECTOR DEL CENTRO NACIONAL
DE LA PROPIEDAD INDUSTRIAL

Da94

DESCRIPCION

207495

PRIMARIA	X	RENOVACION	

MINISTERIO DE INDUSTRIA Y ENERGIA
CENTRO NACIONAL DE LA PROPIEDAD INDUSTRIAL
URUGUAY

SOLICITANTE

Nombre: LANCO, INC., sociedad anónima de Delaware
Domicilio: 2625 Concord Pike, Wilmington, Delaware
Nacionalidad: Estado civil:
Cédula Identidad:
País: U.S.A.

PAIS	17.	FECHA DE SOLICITUD	29 de agosto de 1985.

CLASE (S) Int. 25.

MARCA

"LANE BRYANT"

DESCRIPCION DE ARTICULOS

Renovada con fecha

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EXHIBIT E

TRADEMARK PROTECTION AGREEMENT

THIS TRADEMARK PROTECTION AGREEMENT (the "Agreement") is made and entered into as of the 1st day of April, 1995, by and between LANCO, INC., a Delaware corporation ("Licensor"), and LANE BRYANT, INC., a Delaware corporation ("Licensee").

WITNESSETH:

WHEREAS, Licensor is the proprietor of the trademarks and service marks set forth on Exhibit A attached hereto (the "Marks"); and

WHEREAS, the parties hereto desire that Licensee have a non-exclusive right to use the Marks under the terms and conditions hereinafter set forth;

NOW THEREFORE, in consideration of the mutual covenants hereinafter set forth, the parties hereto, intending to be legally bound, hereby mutually covenant and agree as follows:

Section 1. Grant. Subject to the provisions of this Agreement, Licensor hereby grants to Licensee a non-exclusive right, permission and privilege to use, and Licensee hereby accepts such grant to use, the Marks worldwide in connection with the ownership and operation of stores ("Stores") and catalogues ("Catalogs") (collectively "Retailers") engaged in the sale of apparel and/or personal care products and accessories ("Merchandise").

1.1. Sublicenses. In addition to the other rights granted under this Agreement, Licensee may grant to World Financial Network National Bank (the "Bank") a non-exclusive right, permission and privilege to use the Marks in connection with the issuance of credit cards to Licensee's customers (the "Cardholders") for use in the purchase of Merchandise from the Retailers. The Bank may use the Marks on the credit cards, on agreements with the Cardholders, on bills and other correspondence sent to the Cardholders and in oral communications with or concerning the Cardholders.

1.2. Additional Sublicenses. In addition to the other rights granted under this agreement, Licensee hereby grants to Gryphon Development, Inc. ("Gryphon") a non-exclusive right, permission and privilege to use the Marks in connection with the manufacture and distribution of personal care products for Licensee. Gryphon may grant to others a non-exclusive limited right, permission and privilege to use the Marks solely in connection with the manufacture and distribution of Licensee's personal care products for Gryphon.

Section 2. Standard of Conduct. Licensee shall use the Marks only in accordance with the following terms and conditions:

2.1. Quality of Stores. Licensee shall use its best efforts, skill and diligence in the operation of its Stores and Catalogs, and shall regulate its employees so that they will be courteous and helpful to the public.

2.2. Quality of Distribution Facility. Licensee shall use its best efforts, skill and diligence in the operation of its distribution facility ("Distribution Facility) and Catalogs, and shall regulate its employees so that they will be courteous and helpful to the public.

2.3. Quality of Merchandise. Licensee shall use its best efforts, skill and diligence to insure that the quality of all Merchandise sold under or in connection with the Marks is not less than the standard of quality as has been customary for said Merchandise.

2.4.1. Reasonable Business Standards. Licensee shall operate its Stores and otherwise sell Merchandise in accordance with reasonable business standards and provide a standard of service not less than that standard of quality as has been customary for said services.

2.4.2. Licensee shall publish its Catalogs and otherwise sell Merchandise in accordance with reasonable business standards and provide a standard of service not less than that standard of quality as has been customary for said services.

2.5. Compliance with Law. Licensee shall conduct its business and use the Marks in accordance with all applicable governmental laws, ordinances, rules and regulations. Licensee shall not use or occupy, or permit the use or occupancy, of any of its Stores and/or Distribution Facilities contrary in any material respect to any applicable governmental law, ordinance, rule or regulation.

Section 3. Inspection and Reports.

3.1. Reports. Licensee shall make available its Distribution Facility for inspection by the Licensor and/or Licensor's representative and/or cause each of its Stores to be inspected at least once each year and shall cause approximately one-half of its Stores to be inspected on a semi-annual basis. Licensee shall submit to Licensor within 60 days after the end of Licensee's fiscal year a written statement certified by Licensee to be true and correct showing the following:

3.1.1. The addresses, store numbers or description of locations of its Stores inspected during such fiscal year;

3.1.2. That each such Store that was inspected complies in all material respects with this Agreement, or if the foregoing is untrue, Licensee shall state with particularity (a) the reason therefor and (b) recommendations of action to be taken to correct any deficiencies disclosed. In the event that Licensee does not receive written notice from Licensor concerning any such noncompliance within 30 days after the mailing of such written statement by Licensee to Licensor, Licensee shall promptly proceed, at its own cost and expense, to implement any such recommendations. In the event that Licensee receives a written notice from Licensor concerning any such noncompliance within such 30 days, Licensee shall promptly proceed, at its own cost and expense, to comply with the provisions of such written notice. Nothing herein shall be construed to prevent Licensee from proceeding, at its own cost and expense, to implement any of its recommendations within 30 days from the mailing of such written statement by Licensee to Licensor.

3.2. Licensee shall make available copies of all inspection reports to Licensor and/or Licensor's trademark counsel at their addresses as set forth in Section 12.5, or as otherwise directed by Licensor.

3.3. Inspection. Licensee shall permit an inspection of any of its Stores by Licensor or the authorized agents of Licensor in such manner and at such times so as not to interfere with Licensee's business.

Section 4. Submission of Advertising. Licensee shall make available to Licensor's trademark counsel at its address as set forth in Section 12.5 samples of all advertising, including each different linear promotional material, key sign, video or other literature, packages, labels and labeling prepared by or for Licensee which uses the Marks for its review and approval.

Section 5. Maintenance of Marks. If applicable law permits, at the request of Licensee, Licensor shall make application to register Licensee as a "Permitted User" or a "Registered User" of the Marks and, if necessary, Licensee will assist in such application under the conditions of this Agreement and to execute any such documents as may be necessary to implement such application. Licensor shall use reasonable efforts in good faith to register and maintain, or cause to be registered and maintained, the Marks in the United States of America and its possessions. At the request of Licensee, Licensor shall, at its own expense, use reasonable efforts in

good faith to register and maintain, or cause to be registered and maintained, the Marks in areas outside of the United States of America and its possessions.

Section 6. Royalties.

6.1. Royalty Rate. Licensee shall pay Licensor a royalty at the rate of 5.5% of the Net Sales (as hereinafter defined) of its Retailers using the Marks.

6.2. Net Sales. "Net Sales" shall mean gross revenues of all of Licensee's Retailers using the Marks, and gross revenues from the sale of Merchandise under the Marks other than through Retailers, whether such sales be evidenced by cash, check, credit, charge account, exchange or otherwise but shall exclude:

6.2.1. sales of Merchandise for which cash has been refunded, provided that such sales shall have previously been included in Net Sales;

6.2.2. sales of Merchandise where such Merchandise is subsequently returned for exchange, provided that (a) the sale of such returned Merchandise shall have previously been included in Net Sales, and (b) the sales price of Merchandise delivered in exchange for the Merchandise returned shall be included in Net Sales;

6.2.3. the amount of any sales tax imposed by any federal, state, municipal or other governmental authority directly on sales and collected from customers, provided that the amount thereof is added to the selling price or absorbed therein, and actually paid by Licensee to such governmental authority;

6.2.4. insurance proceeds from casualty, theft or other loss;

6.2.5. proceeds of sales of fixtures or other equipment not in the ordinary course of Licensee's business; and

6.2.6. employees' discounts.

6.3. Time of Payments. All royalty payments shall be due and payable in semi-annual installments in arrears on or before the 20th day of March and September following the sixth month period for which such royalty payment accrues.

6.4. Place of Payments. All royalty payments shall be payable, without notice or demand, to Licensor at its address as set forth in Section 12.5, or to such other

party or address as to which Licensor has given written notice to Licensee pursuant to Section 12.5.

6.5. Semi-Annual Statements. At the time of each royalty payment, Licensee's representative will submit a certification to the chief financial officer of Licensor. Such certification will state that the amount of the Net Sales for the preceding six fiscal months are true and correct. Such certification shall be submitted to Licensor's representative by March 30 following a March 20 payment date and by September 30 following a September 20 payment date.

6.6. Adjustments. In the event that (a) during any fiscal year of Licensee, there are more than 52 weeks, or (b) Licensee changes its fiscal year, appropriate adjustments to the provisions of this Section 6 shall be made.

6.7. Books and Records. Licensee covenants and agrees to keep at its principal office, for a period of not less than five years following the end of the fiscal year to which they pertain, books and records in accordance with generally accepted accounting principles in which shall be recorded Net Sales. The books and records shall include all federal, state and local tax returns of Licensee relating to the operation of its Retailers, and such other records which would normally be examined by an independent certified public accountant pursuant to generally accepted auditing standards in performing an audit of Net Sales. Licensor and its authorized representatives shall have the right, at Licensor's expense, after delivering 10 days' prior written notice to Licensee, to examine and copy such books and records during regular business hours, but not more than once in any fiscal year. Licensor covenants and agrees to use its best efforts to keep confidential all information obtained from such examination, and not to make use of such information until it shall have become public, except in connection with this Agreement and with its accountants and attorneys, subject, however, to Licensor's obligations under law or pursuant to subpoenas or other process to make such information available.

6.8. Audit. The acceptance by Licensor of payments of royalty shall be without prejudice to Licensor's right to an examination of Licensee's books and records of Net Sales in order to verify such revenues. Licensor may cause, at any reasonable time and upon 10 days' prior written notice to Licensee, a complete audit to be made of Licensee's books and records relating to calculation of the Net Sales for the period covered by any statement issued by Licensee, by an independent certified public accounting firm of national reputation, but not more than once in any fiscal year. Licensee shall promptly remit any deficiency in royalty established by such audit. The

cost of the audit shall be paid for by Licensor; provided, however, if such audit discloses that the actual Net Sales exceed those reported by 5% or more, Licensee shall pay the cost of the audit. If such audit discloses that Licensee has overpaid royalty, the amount of such overpayment shall be credited to the next maturing installment or installments of royalty. Any dispute between Licensor and Licensee concerning any discrepancy between the amount of Net Sales established by such audit and the amount of Net Sales reported by Licensee shall be subject to arbitration in accordance with Section 12.10.

6.9. Sublicense Fees. In addition to all other payments herein, Licensee shall pay to Licensor a royalty at a percentage of Net Sales of any and all sales of Merchandise made by a sublicensee to any party other than Licensee when such Net Sales are in excess of $1 million with respect to each New Line Of Business (as hereinafter defined), which is the same as the then existing percentage of Net Sales in this Agreement for sales made by the Retailers.

6.10. New Line of Business. "New Line of Business" shall mean each separate business venture or agreement entered into between a sublicensee and any party other than Licensee with respect to distribution of Merchandise in channels of distribution outside of Retailers' regular channels of distribution, e.g., hotels, military exchanges and duty free shops.

Section 7. Indemnity. Licensor assumes no liability to Licensee or third parties with respect to the performance characteristics of Merchandise manufactured or sold by Licensee under the Marks and Licensee covenants and agrees to indemnify and defend Licensor and save it harmless from and against any and all claims, actions, damages, liabilities and expenses whatsoever in connection with loss of life, personal injury and/or damage to property arising from or out of the ownership or operation of the Retailers or the manufacture or sale of Merchandise under the Marks.

Section 8. Ownership of Mark. Licensee acknowledges Licensor's exclusive right, title and interest in and to the Marks and will not at any time do or cause to be done any act or thing contesting or in any way impairing or tending to impair any part of such right, title and interest.

Section 9. Termination. This Agreement shall remain in effect for a period of ten years, and thereafter shall be automatically renewed for successive yearly periods if neither of the parties has delivered a written notice of its intention to terminate this Agreement at least twelve months prior to the tenth year or at least 90 days prior to the anniversary date of

this Agreement after such tenth year; provided, however, that Licensor may terminate this Agreement upon the occurrence and continuance of any one or more of the following events:

9.1. Royalty Payments. The failure of Licensee to pay when due any royalty payment under this Agreement, and such failure shall continue for 30 days after receipt by Licensee of notice thereof from Licensor; or

9.2. Bankruptcy. Licensee shall (a) make an assignment for the benefit of, or enter into any composition or arrangement with, creditors; (b) apply for or consent (by admission of material allegations of a petition or otherwise) to the appointment of a receiver, custodian, trustee or liquidator of Licensee or of a material part of its properties, or authorize such application or consent, or proceedings seeking such appointment shall be commenced without such authorization, consent or application against Licensee and continue undismissed for 60 days; (c) authorize or file a voluntary petition in bankruptcy, suffer an order for relief under any federal bankruptcy law, or apply for or consent (by admission of material allegations of a petition or otherwise) to the application of any bankruptcy, reorganization, arrangement, readjustment of debt, insolvency, dissolution, liquidation or other similar law of any jurisdiction, or authorize such application or consent, or proceedings to such end shall be instituted against Licensee without such authorization, application or consent and be approved as properly instituted or remain undismissed for 60 days; (d) permit or suffer all or a material part of its properties to be sequestered, attached or subjected to a lien through any legal proceeding or distraint which is not vacated within 60 days from the date thereof; (e) generally not pay its debts as such debts become due; or (f) conceal, remove, or permit to be concealed or removed, a material part of its assets, with intent to hinder, delay or defraud its creditors or any of them, or make or suffer a transfer of a material part of its property to or for the benefit of a creditor at a time when other creditors similarly situated have not been paid.

Section 10. Results of Termination. In the event this Agreement is terminated pursuant to its terms, the grant to Licensee herein contained shall immediately terminate and Licensee shall have no further right to use the Marks. Licensee also agrees that in the event of such termination, it shall not use any similar trade name, trademark or service mark that may cause confusion in the mind of the public.

Section 11. Infringement.

11.1. Third Party. Licensee shall inform Licensor if Licensee becomes aware that any third party is

infringing upon the Marks. If Licensor becomes aware that any third party is infringing upon the Marks, Licensor shall promptly demand of the infringer that such infringement cease and shall promptly notify Licensee of such infringement. If such infringement continues, Licensor, at its expense, may take legal action to prevent continuance of such infringement and to collect damages on account thereof. Licensee shall cooperate in any legal action brought by Licensor including being joined as a party plaintiff along with Licensor in any claim or lawsuit brought to enforce the Marks. Any damages or settlements collected, after payment of all expenses incurred, shall belong to Licensor.

11.2. Suit Against a Party. In the event that either party to this Agreement is made a party to a legal or similar proceeding which is based in whole or in part on a claim that the use of the Marks or any of them infringes upon any other trademark or service mark, or infringes upon any trade name, Licensor at its own cost and expense, shall defend such claim. Each party shall cooperate in any legal action brought against the other party including being joined as a party defendant in any claim or lawsuit alleging that use of the Marks or any of them infringes upon any other trademark or service mark, or infringes upon any trade name.

Section 12. Miscellaneous.

12.1. Waiver. No purported waiver by Licensor of any default by Licensee of any term, covenant or condition contained herein shall be deemed to be a waiver of such term, covenant or condition unless the waiver is in writing and signed by Licensor. No such waiver shall in any event be deemed a waiver of any subsequent default under the same or any other term, covenant or condition contained herein. Licensor's acceptance of one or more royalty payments following a default hereunder by Licensee shall not be deemed a waiver of such default or any preceding or subsequent default by Licensee of any term, covenant or condition of this Agreement, other than the failure of Licensee to pay the particular royalty payment so accepted, regardless of Licensor's knowledge of such default at the time of such payment. The consent or approval by Licensor to or of any act by Licensee requiring consent or approval shall not be deemed to waive the requirement of Licensor's consent or approval to or of any subsequent or similar acts by Licensee.

12.2. Entire Agreement. This Agreement and the exhibit attached hereto set forth the entire understanding between Licensor and Licensee concerning the subject matter of this Agreement and incorporate all prior negotiations and understandings. There are no covenants, promises, agreements, conditions or understandings, either oral or written, between them relating to the subject matter of this Agreement other than

those set forth herein. No alteration, amendment, change or addition to this Agreement shall be binding upon Licensor or Licensee unless in writing and signed by the party to be charged.

12.3. No Partnership. Nothing contained in this Agreement shall be deemed or construed by the parties hereto or by any third person to create the relationship of principal and agent or of partnership or of joint venture.

12.4. Successors. Each and all of the provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto, and except as otherwise specifically provided in this Agreement, their respective successors and assigns; provided, however, that neither this Agreement, nor any rights herein granted to Licensee may be assigned, transferred or encumbered by Licensee.

12.5. Notices. Any consent, waiver, notice, demand, request or other instrument required or permitted to be given under this Agreement shall be deemed to have been properly given when delivered in person or sent by United States certified or registered mail, return receipt requested, postage prepaid, addressed:

If to Licensor:

Lanco, Inc.
1105 North Market Street, Suite 1210
Wilmington, Delaware 19801
Attn: Lewis S. Black, Jr.

If to Licensee:

Lane Bryant, Inc.
Five Limited Parkway East
Dept. #8000
Reynoldsburg, Ohio 43068
Attn: Samuel P. Fried, Esq.

If to Trademark Counsel:

Colucci & Umans
Manhattan Tower
101 East 52nd Street
New York, New York 10022
Attn.: Frank J. Colucci

Either party or trademark counsel may change its address for notices by notice in the manner set forth above.

12.6. Captions. The captions and section numbers appearing in this Agreement are inserted only as a

matter of convenience. They do not define, limit, construe or describe the scope or intent of the provisions of this Agreement.

12.7. Partial Invalidity. If any term, covenant or condition of this Agreement or the application thereof to any person, firm or corporation, or circumstance, shall be invalid or unenforceable, the remainder of this Agreement, or the application of such term, covenant or condition to persons, firms or corporations, or circumstances, other than those as to which it is held invalid, shall both be unaffected thereby and each term, covenant or condition of this Agreement shall be valid and be enforced to the fullest extent permitted by law.

12.8. Governing Law. This Agreement shall be governed and construed exclusively by the provisions hereof and in accordance with the laws of the State of Delaware applicable to agreements to be performed in the State of Delaware.

12.9. Counterparts. This Agreement may be executed in counterparts, each of which when executed by Licensor and Licensee shall be deemed an original and all of which together shall be deemed the same Agreement.

12.10. Arbitration. Any controversy or claim arising out of or relating to this Agreement or the breach of any term or provision hereof, shall be settled by arbitration in the City of Wilmington, State of Delaware, in accordance with the Rules of the American Arbitration Association and judgment upon the award rendered by the Arbitrator(s) may be entered in any Court having jurisdiction thereof. The Arbitrator(s) sitting in any controversy shall have no power to alter or modify any express provision of this Agreement, or to make any award which by the terms effects any such alternation or modification.

12.11. Amendments to Add or Delete Marks. In the event that Licensor and Licensee agree from time to time to amend this Agreement for the purpose of adding Marks to or deleting Marks from the attached Exhibit A, such amendments shall be deemed approved, adopted and legally binding on the parties hereto if an amended Exhibit A is attached to this Agreement, setting forth a list of all Marks that Licensor and Licensee intend to be the subject of this Agreement, provided that any such amended Exhibit A shall be executed and dated by an authorized officer of each of Licensor and Licensee. The execution of any amended Exhibit A shall have the effect of terminating any previously effective Exhibit A.

The parties hereto have caused this Agreement to be executed in Wilmington, Delaware, by their duly authorized

officers as of the day and year first above written.

LANCO, INC.

By _____

LANE BRYANT, INC.

By _____

0653a

EXHIBIT A

Trademark/Service Mark	Registration No.
LANE BRYANT	1,293,460
LANE BRYANT	1,363,867
LANE BRYANT	633,237
LB	1,211,680
LB & Design	1,765,089
LB FOR SHORT	1,210,665
LB FOR SHORT	1,724,383
L.B.T.'s	829,133
LB & Design	1,890,565

Application	Serial No.
LANE BRYANT - WHAT REAL WOMEN WEAR	74/705,103

EXHIBIT F

CHARLES M. COSTENBADER, ESQ.
McCarter & English, LLP
Four Gateway Center
100 Mulberry Street
Newark, New Jersey 07102

PAUL H. FRANKEL, ESQ.
c/o Morrison & Foerster LLP
1290 Avenue of the Americas
New York, NY 10104

TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC.,

Plaintiff,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant.

Civil Action

RESPONSE TO DEFENDANT'S FIRST SUPPLEMENTAL INTERROGATORIES

TO: JOHN J. FARMER, JR.
ATTORNEY GENERAL OF NEW JERSEY
Attorney for Defendant
Director, Division of Taxation
R. J. Hughes Justice Complex
25 Market Street
P.O. Box 106
Trenton, New Jersey 08625

By: Patrick DeAlmeida
Deputy Attorney General
(609) 984-0183

DEFINITIONS

A. "Address" means the present or last known street name and number, city or town, state, zip code and telephone number.

B. "And" and "or" as used herein shall have the same meaning, that is, the disjunctive meaning of "or." The listing of terms separated by commas, semi-colons, the word "and" or the word "or" shall be deemed to require a response to each and every term listed.

C. "Answer" means the Answer which was filed in this action on behalf of defendant. The term "Answer" specifically includes all denominated Affirmative Defenses, Denials and Counterclaims.

D. "Communication(s)" means any meeting, conversation, discussion, correspondence, message or other occurrence whereby thoughts, opinions or data were transmitted between two or more persons.

E. "Complaint" means the complaint in this action filed by plaintiff.

F. "Describe," "set forth" and "state" all mean to state the substance of the event, circumstances, facts, communications, representation, conversation, meeting, transaction, occasion or other occurrence in question; the date, time, place and identity of all persons present thereat or participating therein; that which each such person said and did; the approximate duration of such occurrence; the method or means of communications employed; the identity of all documents relating thereto; and the identity of all persons having knowledge of such occurrence; as well as the date and means when and whereby such knowledge was first acquired, setting forth the underlying facts rather than ultimate conclusions.

G. "Document" or "documents" means the original and any identical or non-identical copy, regardless of origin or location, of any written, reported, filmed, magnetically stored, or graphic matter, or record of any type or description, whether produced, reproduced or producible on paper, cards, tapes, film, electronic facsimile, computer storage devices, or any other media, including but not limited to memoranda, notes, minutes, records, photographs, computer

programs, correspondence, telegrams, diaries, bookkeeping entries, specifications, source code, object code, flow charts, financial statement, charts, studies, reports, graphs, statements, notebooks, handwritten notes, applications, feasibility studies, agreements, books, pamphlets, periodicals, appointment calendars, notes, records and recordings of oral conversations, work papers, and also including but not limited to, originals and all copies which are different in any way from the originals, whether by interlineation, receipt stamp, notation, indication of copy sent or received, or otherwise, and drafts, which are in the possession, custody or control of the present or former agent, representative, employees, or attorneys of plaintiff, or all persons acting on plaintiff's behalf, including documents at any time in the possession, custody or control of such individuals or entities who are known by plaintiff to exist. Include also any catalog, brochure or other data compilations from which information can be obtained and translated if necessary, or any other written, recorded, stored, transcribed, punched, taped, filed or graphic matter however produced or reproduced, to which plaintiff has or has had access.

H. "Identify" or "identification" mean, when used in reference to:

1. A natural person, his or her:

   a. full name;

   b. present or last known home address (including name and number, city or town, state, zip code and telephone number);

   c. present or last known business address (including street name and number, city or town, state, zip code, and telephone number);

   d. present or last known occupation, position, business affiliation and job description;

e. occupation, position, business affiliation and job description at the time relevant to the particular interrogatory being answered.

2. A company, corporation, association, partnership of legal entity other than a natural person:

a. its full name;

b. a description of the type of organization or entity;

c. the full address (including street name and number, city or town, state, zip code and telephone number) of its principal place of business;

d. the jurisdiction of incorporation or organization.

3. a document:

a. its description (for example, letter, memorandum, report);

b. its title (e.g., letter, memorandum, telegram, chart, etc.);

c. its date;

d. the number of pages thereof;

e. its subject;

f. the identity of its author, signatory or signatories, and any person who participated in its preparation;

g. the identity of its addressee or recipient;

h. the identity of each person to whom copies were sent and each person by whom copies were received;

i. its present location; and

j. the identity of its present custodian. (If any such document was, but is no longer, in the possession of or subject to the control of plaintiff, state what disposition was made of it and when).

4. an oral communication or statement:

a. the date and time when it occurred;

b. the place where it occurred;

c. the complete substance of the communication;

d. the identity of each person: (i) to whom such communication was made; (ii) by whom such communication was made; and (iii) who was present when such communication was made;

e. if by telephone: (i) the identity of each person participating in the telephone call; (ii) the identity of the person who made each telephone call; and (iii) the place where each person participating in the telephone call was located;

f. the identity of all documents memorializing, referred to or relating in any way to the subject of the communication.

I. "Oral communication(s)" means any verbal conversation or other statement from one person to another, including, but not limited to, an interview, discussion, conference, conversation, meeting or telephone conversation.

J. "Person" means a natural person, firm, proprietorship, association, partnership, corporation or any other type of organization or entity.

K. "Years at issue" means the two fiscal years ended January 31, 1998 and January 31, 1999, as agreed between counsel.

1. State the full name, present address, and relationship to plaintiff of the individual providing answers to these Interrogatories.

RESPONSE: Timothy B. Lyons
Vice President, Treasurer
Lanco, Inc.
1105 N. Market Street
Wilmington, Delaware 19899

2. Please identify plaintiff's state of incorporation and the date on which plaintiff was incorporated.

RESPONSE: Plaintiff was incorporated in Delaware on December 15, 1982.

3. Please identify all parents, subsidiaries and affiliates of plaintiff, along with each such entity's state of incorporation, existing during the period 1983 to the present.

RESPONSE: For the years in issue, Plaintiff's direct parent was Womanco, Inc. ("Womanco"). Womanco's parent was The Limited, Inc. ("The Limited"). Plaintiff had no subsidiaries.

The Limited, Plaintiff's ultimate parent, had many other direct and indirect subsidiaries. Womanco also had other direct and indirect subsidiaries, including Lane Bryant, Inc. ("Lane Bryant"), which was a direct subsidiary of Womanco and was a party to a licensing agreement with Plaintiff.

The Limited, Womanco, and Lane Bryant were all incorporated in the state of Delaware.

4. Please explain fully plaintiff's relationship to each entity identified in response to the previous Interrogatory.

See response to Interrogatory No. 3.

5. Please state whether plaintiff maintained any bank account(s), certificates of deposit, other financial accounts or safe deposit boxes at a banking institution within the State of New Jersey during the period 1983 to present. If so, please specify the type and location of each such account.

RESPONSE: Plaintiff did not maintain any such account, certificate or safe deposit box.

6. Please state whether plaintiff held an interest of any type in real property located in the State of New Jersey during the period 1983 to the present. If so, please identify the location of said real property and the nature and duration of plaintiff's interest.

RESPONSE: Plaintiff did not hold any such interest.

7. Please state whether plaintiff had an ownership interest in tangible personal property located in New Jersey during the period 1983 to present.

RESPONSE: Plaintiff did not have any such interest.

8. If the answer to the previous Interrogatory is in the affirmative, please identify each such item of tangible personal property, the nature of plaintiff's interest in each such item, the time period that each such item was located in New Jersey, and the uses to which each such item was put.

RESPONSE: N/A

9. Please identify each place of business and/or office maintained by plaintiff or agents of plaintiff inside or outside of New Jersey to accomplish plaintiff's business purposes during the period 1983 to the present.

RESPONSE: Plaintiff has never maintained a place of business or office or agents inside New Jersey. Plaintiff's office outside New Jersey was maintained in Wilmington, Delaware, and Plaintiff did not maintain any other place of business or office outside New Jersey.

10. For each place of business or office identified in response to the previous Interrogatory, specify its address and the time period in which it was used to further plaintiff's business purposes.

RESPONSE: From 1983 through 1988, Plaintiff's office was at 2625 Concord Pike, Wilmington, Delaware 19803. From 1988 through 1990, Plaintiff's office was at 1403 Foulk Road, Suite 102, Wilmington, Delaware 19803. From 1990 through the present, Plaintiff's office was and is at 1105 N. Market Street, Wilmington, Delaware 19899.

11. For each place of business or office identified in response to the Interrogatory No. 9, provide the total number of persons performing work for plaintiff at said place of business during the period 1983 to present, and the relationship that each such person had to plaintiff.

RESPONSE: By agreement between Plaintiff's counsel and Defendant's counsel, this Interrogatory is deemed limited to any place of business or office inside New Jersey. Plaintiff had no such place of business or office.

12. For each place of business or office identified in response to the Interrogatory No. 9, state whether any other entity or person utilized said place of business, identify each such entity or person, and describe the business conducted at said places of business by each such entity or person.

RESPONSE: By agreement between Plaintiff's counsel and Defendant's counsel, this Interrogatory is deemed limited to any place of business or office inside New Jersey. Plaintiff had no such place of business or office.

13. Please identify the location of plaintiff's corporate headquarters during the period 1983 to present.

RESPONSE: Please see response to Interrogatory No. 10.

14. Identify all individuals serving permanently or temporarily as plaintiff's corporate officers during the period 1983 to present.

RESPONSE: Pursuant to agreement between Plaintiff's and Defendant's counsel, the response to this Interrogatory is limited to the years in issue. For those years, Plaintiff's officers were:

Kenneth B. Gilman	President, Assistant Secretary
Timothy B. Lyons	Vice President, Treasurer
Edward J. Jones	Secretary
Lewis S. Black, Jr.	Assistant Secretary
Roger P. Thompson	Assistant Secretary

15. Please indicate whether the officers identified in response to the previous Interrogatory conducted corporate activities on behalf of plaintiff from the location(s) identified in response to Interrogatory No. 9 If any or all of the officers did not conduct their corporate activities on behalf of plaintiff from the location(s) identified in response to Interrogatory No. 9, please provide the name(s) of the officers and the address(es) for each location that the officers were situated and conducting corporate activities during the period 1983 to present.

RESPONSE: Plaintiff's officers conducted business at the offices identified in the response to Interrogatory No. 10. In addition, Mr. Black also conducted activities at his office, located at 1201 N. Market Street, Wilmington, Delaware.

16. Identify each of plaintiff's officers who served as employees or officers of any of plaintiff's parents, subsidiaries or affiliates during the period 1983 to present.

RESPONSE: Mr. Gilman and Mr. Lyons also served as employees and/or officers of the companies identified in response to Interrogatory No. 3. Mr. Jones, Mr. Black and Mr. Thompson served as officers of other corporations owned indirectly by The Limited. See response to Interrogatory No. 17 below.

17. For each individual identified in response to the previous Interrogatory, name the corporation in which that individual served an employee or officer, the title held by that individual, and the time period in which that individual was an officer of said corporation.

RESPONSE: Mr. Gilman served as President and Assistant Secretary of Womanco; Vice Chairman, Chief Administrative Officer, and Assistant Treasurer of The Limited; and Executive Vice President and Assistant Secretary of Lane Bryant. He was also an officer of other corporations owned directly or indirectly by The Limited. Mr. Lyons served as Vice President and Assistant Secretary of Womanco; Vice President - Taxes and Assistant Secretary of The Limited; and Vice President and Secretary of Lane

Bryant. Mr. Lyons was also an officer of other companies owned directly or indirectly by The Limited.

Mr. Gilman and Mr. Lyons were both employees of Limited Service Corporation, which was indirectly owned by The Limited.

Mr. Jones, Mr. Black and Mr. Thompson served as Secretary, Assistant Secretary, and Assistant Secretary, respectively, of certain other corporations owned indirectly by The Limited.

18. Identify every person employed by plaintiff who performed work for plaintiff in New Jersey during the period 1983 to present.

RESPONSE: None.

19. State whether plaintiff paid any New Jersey employment taxes, including but not limited to, New Jersey gross income tax withholding and New Jersey state unemployment tax during the period 1983 to present.

RESPONSE: Plaintiff did not pay any such taxes.

20. State whether any of plaintiff's officers or employees traveled to a New Jersey destination for any business purpose of plaintiff during the period 1983 to present.

RESPONSE: None of plaintiff's officer or employees traveled to a New Jersey destination for any business purpose during the period specified.

21. If the answer to the previous Interrogatory is in the affirmative, provide the date of each such trip, the destination, and the business purpose accomplished on each such trip.

RESPONSE: N/A

22. State whether plaintiff's Board of Directors, or any committee of plaintiff's Board of Directors, held any meetings in the State of New Jersey during the period 1983 to present.

RESPONSE: No such meetings were held.

23. If the answer to the previous Interrogatory is in the affirmative, please provide the date and location of each such meeting.

RESPONSE: N/A

24. Identify each individual and entity with offices in or doing business in New Jersey to whom plaintiff has granted the right to use a trademark and/or service mark owned by plaintiff during the period 1983 to present.

RESPONSE: Plaintiff has granted a license to use certain trademarks, tradenames and service marks (hereinafter referred to as the "trademarks") to Lane Bryant and certain of its subsidiaries.

25. Set forth the amount of each payment made to plaintiff during the period 1983 to present by each individual and entity identified in the previous Interrogatory, the date of each such payment, and the location of the account to which each such payment was sent.

RESPONSE: By agreement between counsel for Plaintiff and Defendant, no response is required to this Interrogatory at this time.

26. Describe in detail any policies, procedures, rules, regulations or manner of operation which plaintiff prescribed for or recommended to the individuals and entities who received the right through agreement with plaintiff to use in New Jersey a trademark and/or service mark owned by plaintiff during the period 1983 to present.

RESPONSE: Plaintiff required its licensee, Lane Bryant, to use the trademarks in a manner that would maintain their quality. Plaintiff's agreement with Lane Bryant was set forth in a written licensing agreement. Plaintiff's outside trademark counsel was responsible for assuring that the licensee adhered to its duty to use the trademarks properly.

27. State whether plaintiff provided training to the individuals and entities who through agreement with plaintiff secured the right to use in New Jersey a trademark and/or service mark owned by plaintiff during the period 1983 to the present. If so, please list the dates, places and purposes of any training provided by plaintiff.

RESPONSE: Plaintiff provided no training activities in New Jersey.

28. State whether plaintiff oversaw or consulted with the individuals and entities who through agreement with plaintiff secured the right to use in New Jersey a trademark and/or service mark owned by plaintiff. If so, please describe in detail the activities engaged in by plaintiff in performing such oversight or consultation.

RESPONSE: Plaintiff from time to time consulted with individuals at the corporate headquarters of its licensee, all of whom were located in Columbus, Ohio. Plaintiff did not oversee their activities. Such activities included efforts to ensure that the trademarks owned by Plaintiff were being properly used and protected by the licensee, and communications in connection with protection activities, including litigation, undertaken by trademark counsel. Trademark counsel regularly communicated with Plaintiff at its

Delaware office. All applications for registration of the trademarks in the United States are filed with the United States Patent and Trademark Office. No particular registration in the State of New Jersey was ever obtained.

29. During the period 1983 to the present, did plaintiff organize or sponsor any periodic meetings of the individuals and entities who through agreement with plaintiff secured the right to use in New Jersey a trademark and/or service mark owned by plaintiff. If yes, please set forth the date(s) and place(s) of such meetings, their purpose, and the names and positions of plaintiff's employees who attended each such meetings.

RESPONSE: Plaintiff did not organize or sponsor any such meetings.

30. Please identify any and all contractors, subcontractors, and vendors located in New Jersey who sold goods and/or services to plaintiff during the years at issue. Include a description of the goods received and/or services rendered from each contractor, subcontractor and/or vendor identified.

RESPONSE: No such contractors sold goods or services to plaintiff.

31. Describe in full plaintiff's activities designed and employed for the introduction, marketing and/or promotion of plaintiff's trademarks and service marks in New Jersey.

RESPONSE: Plaintiff engaged in no such activities particularly directed toward New Jersey.

32. Describe fully all steps taken by plaintiff to protect its trademarks and/or service marks in New Jersey.

RESPONSE: Plaintiff engaged in no protection activities in New Jersey or particularly directed at New Jersey. Plaintiff's outside trademark counsel engaged in protection activities, such as registering the trademarks with the U.S. Patent and Trademark Office, registering the marks in numerous foreign jurisdictions, and pursuing legal proceedings such as oppositions and lawsuits.

CERTIFICATION
IN LIEU OF OATH OR AFFIDAVIT

I hereby certify that the foregoing responses to Defendant's Initial Interrogatories made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment for contempt of court.

Timothy Blyzou

Dated:

NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE
TAX COURT COMMITTEE ON OPINIONS

TAX COURT OF NEW JERSEY

DOCKET NO. 005329-97

LANCO, INC.	:	
Plaintiff,	:	
v.	:	OPINION
DIRECTOR, DIVISION OF TAXATION,	:	
Defendant.	:	

Decided: October 23, 2003

Paul H. Frankel, Hollis L. Hyans, Craig B. Fields, of Counsel, and
Amy F. Nogid, of Counsel, for Plaintiff
(Morrison & Foerster LLP, attorneys).
Charles M. Costenbader, of Counsel, for Plaintiff
(McCarter & English, LLP, attorneys).

Patrick DeAlmeida, for Defendant
(Peter C. Harvey, Attorney General of New Jersey).

Charles H. Friedrich, of Counsel, for Amicus Curiae New Jersey State Chamber of Commerce
(Stryker, Tams & Dill LLP, attorneys).

PIZZUTO, J.T.C.

This case presents the question of whether New Jersey may constitutionally subject a foreign corporation to the Corporation Business Tax (N.J.S.A. 54:10A-1 et seq., "the CBT"), where the corporation has no physical presence in the state and derives income from a New Jersey source only

pursuant to a license agreement with another corporation that conducts a retail business here.

Plaintiff Lanco, Inc., ("Lanco") is a Delaware corporation that owns certain intangible property (trademarks, trade names and service marks). The parties have stipulated that Lanco has no offices, employees, or real or tangible property in New Jersey. Lanco licenses Lane Bryant, Inc., ("Lane Bryant") to utilize the intangible property in the conduct of Lane Bryant's retail operations, including those in New Jersey, and in return receives royalty payments from Lane Bryant. Lanco and Lane Bryant are affiliated corporations, but the common ownership is not material to the constitutional issue concerning the determination by the defendant, Director of the Division of Taxation ("Director"), that activity under the license agreement makes Lanco subject to taxation in New Jersey. It is the determination that Lanco is obliged to file under the CBT, rather than the calculation of tax claimed to be due, that is contested.[1]

State taxation of entities engaged in interstate commerce must comport with the Due Process and Commerce Clauses of the United States Constitution. In the leading case of Complete Auto Transit v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), the Supreme Court articulated the standard to determine whether, in the absence of Congressional action (when the clause is considered "dormant"), a particular instance of state taxation of interstate commerce is permitted under the Commerce Clause. U.S. Const. art. I, § 8, cl. 3. The Court formulated a four-part test that permits taxation "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 U.S. at 279.

[1] The original determination required filings beginning in 1983. During the pendency of the action, however, the parties have stipulated that issues concerning certain reporting periods have been resolved and that the claims in this action are amended to address only the year ending January 31, 1998. The court has allowed the amendment.

Until the decision in Quill Corp. v. North Dakota, 504 U.S. 298,112 S.Ct. 1904,119 L.Ed.2d 91 (1992), it was generally considered that the requirement of the Due Process Clause, U.S. Const. Amend. XIV, § 1, that an entity have certain minimum contacts with a taxing jurisdiction to support the imposition of a tax was not different from the substantial nexus component of the Commerce Clause standard. In Quill, however, the Supreme Court uncoupled the Due Process Clause analysis from the nexus test under the Commerce Clause. Quill concerned the use tax collection obligation[2] of a mail-order vendor of office supplies that had no retail outlets or sales force in North Dakota and that shipped its products into that state by common carrier. The Court addressed the continuing vitality of its decision in National Bellas Hess Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), which had held that a mail-order vendor may not constitutionally be required to collect from its customers a use tax imposed by the state within which its product is delivered, unless the vendor has a physical presence, more than de minimis, in that state. The presence may be associated with activities totally unrelated to the sale. Thus, the presence of offices handling advertisements in a publication will support the imposition of a use tax collection responsibility for items sold by the publisher. Nat'l Geographic Soc. v. Cal. Bd. of Equalization, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). Moreover, the physical presence requirement may be satisfied by independent contractors who solicit sales, assist retailers or service the product sold. See Scripto, Inc. v. Carson, 362 U.S. 207, S.Ct. 619, 4 L.Ed.2d. 660 (1960).

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[2] States that impose a sales tax on retail transactions occurring within the state typically also impose a "compensating" use tax on the use of property whose sale in the jurisdiction would be taxable, when a sales tax has not been collected. See N.J.S.A. 54:32B-6. The litigation concerning mail-order vendors deals with the use tax collection obligation, rather than with the liability of the vendors to income taxation by jurisdictions into which they sell, because Congress has immunized mail-order vendors, among others, from income taxation by those jurisdictions. P.L. 86-272 (1959), codified at 15 USCA §§ 381 to 384. This statute was enacted in response to the Supreme Court's decision in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959), permitting appropriately apportioned state taxation of activities exclusively in furtherance of interstate commerce.

Quill determined that the Bellas Hess result remained sound, but as a matter of Commerce Clause jurisprudence only and not as a requirement of the Due Process Clause. Recognizing that a quarter-century of adjudication since Bellas Hess had produced a conception of due process in terms of minimum contacts, reasonable notice and basic fairness, the court concluded that North Dakota's assertion of an obligation on the part of Quill to collect use tax comported with due process. The majority (Justice Stevens joined by Chief Justice Rehnquist and Justices Blackmun, O'Connor and Souter) found, however, that the Commerce Clause requirement of substantial nexus embodied other constitutional considerations:

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills.
> ....Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause. [504 U.S. at 312-13.]

The determination that physical presence remains a requirement under the Commerce Clause for the imposition of a use tax collection responsibility rests to a significant extent on stare decisis principles. The majority opinion observed that "the Bellas Hess rule has engendered substantial reliance and has become part of the basic framework of a sizable industry." 504 U.S. at 317.

Moreover, it noted that the "underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." Id. at 318 (footnote omitted). Nevertheless, the decision does not simply reflect deference to precedent and recognition of Congressional authority. The majority clearly undertook an analysis of the physical presence requirement on its own merits. It concluded "[w]hile contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, Bellas Hess is not inconsistent with Complete Auto and our recent cases." Id. at 311.

The opinions of the other Justices underscore that the majority found continuing value in the requirement of physical presence for constitutional exercise of State taxing power under the Commerce Clause. Justice White concurred with the majority's due process analysis and would have applied the same standard for the substantial nexus inquiry under the Commerce Clause. He would have overruled Bellas Hess and given it "the complete burial it justly deserves." Id. at 322 (White, J., concurring in part, dissenting in part). Justice Scalia, joined by Justices Kennedy and Thomas, concurred in the result, but expressly noted that he "would not revisit the merits of that holding, but would adhere to it on the basis of stare decisis." Id. at 320 (Scalia, J., concurring).

The decisive question in this case is whether the physical presence requirement confirmed in Quill under the Commerce Clause applies simply to the use tax collection obligation directly at issue in that case, or whether it is also a necessary element of substantial nexus for the imposition of a state income or franchise tax. The Quill majority opinion does not give an unambiguous answer to this question. In at least two places, the opinion observes that in cases concerning other types of taxes the Supreme Court has not articulated a physical presence requirement. 504 U.S. at 314, 317.

The opinion acknowledges, however, that the Commerce Clause precedents considered by the North Dakota Supreme Court in sustaining a collection obligation for Quill involved businesses that were physically present in the taxing state. Id. at 314. Those cases were therefore, the court noted, consistent with Bellas Hess.

This question has been addressed both in litigation and in academic discussion subsequent to Quill. The earliest decision of a state court of last resort is Geoffrey, Inc. v. South Carolina Tax Com'n, 313 S.C. 15, 437 S.E. 2d 13 (1993), cert. den. 510 U.S. 992, 114 S.Ct. 550, 126 L.Ed.2d 451 (1993). The Geoffrey fact pattern is materially indistinguishable from this case. Geoffrey, Inc., a wholly owned subsidiary of Toys R Us, Inc., was a Delaware corporation without property or employees in South Carolina. It owned trademarks and trade names that it licensed Toys R Us to use in that state. Toys R Us made royalty payments to Geoffrey and deducted those payments from income in determining its South Carolina income tax obligation. The South Carolina tax authorities initially disallowed the deduction, but eventually contended that Geoffrey was independently subject to taxation, notwithstanding that Geoffrey had no physical presence in the state. The South Carolina Supreme Court sustained this contention, commenting in the course of its decision that "[t]he net effect of this corporate structure has been the production of 'nowhere' income that escapes all state taxation." 437 S.E. 2d 17, n.1.

The thesis that Geoffrey is correctly decided is comprehensively developed in two articles by Michael T. Fatale, a tax attorney with the Massachusetts Department of Revenue: Geoffrey Sidesteps Quill: Constitutional Nexus, Intangible Property and the State Taxation of Income, 23 Hofstra L. Rev 407 (1994) and State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard, 54 Tax Law. 105 (2000). The interpretation of Quill adopted in Geoffrey

and advanced by the cited articles is a necessary component of the Director's argument in this case. It considers that Quill merely establishes a safe harbor with respect to the use tax collection obligation for vendors that do not have a physical presence in a state where their products are delivered. In other words, if a vendor does no more than solicit orders from outside the state and ship goods into the state by mail or common carrier, the vendor is not obliged to collect the state's use tax from its customers. Where the issue is not use tax collection, but liability for state taxation of income, it is argued that Quill permits a finding of liability by virtue of an intentional exploitation of the state's market without physical presence in the state.

This argument is not persuasive. In the first place, it does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant as to justify a different rule for each concerning physical presence as an element of Commerce Clause nexus. Next, the Supreme Court cases decided before Quill strongly suggest that physical presence is a necessary element of nexus for income taxation. Finally, other state court cases decided since Quill do not follow the Geoffrey rule.

As noted previously, the Supreme Court's decision in Quill to retain the physical presence requirement rested on more than the principles of stare decisis and the mail-order industry's reliance on the Bellas Hess rule. The Court spoke of the "benefits of a clear rule...[that] firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." 504 U.S. at 315. It is difficult to see distinctions that give virtue to physical presence as a necessary element of nexus in this area and not for purposes of income taxation. The Quill majority noted the discussion in Bellas Hess that potential imposition of sales taxes by more than 6000 jurisdictions raised a prospect of "many variations in rates of tax, in

allowable exemptions and in administrative and record-keeping requirements" and "a wealth of complicated obligations." 504 U.S. 313, n.6, quoting Bellas Hess, supra at 759-60. Even on the supposition that these complexities characterize use tax collection more than income tax liability, the record-keeping and classification tasks, considered complicated and onerous in 1967 when Bellas Hess was decided, are considerably less difficult under contemporary data-processing technology. See Quill, supra, 504 U.S. at 332 (White, J., concurring in part, dissenting in part). The use tax collection obligation does not, to put it plainly, seem significantly more burdensome than the liability to pay an income tax. If physical presence is a constitutional necessity for one, it is illogical that it should not be for both.

The conclusion that physical presence is necessary to support state taxation of income is fully consistent with and strongly suggested by the Commerce Clause cases decided before Quill. Complete Auto establishes a standard that can fairly be called a balancing test. It does not articulate the nexus component of the test in terms of physical presence, or any particular bright-line requirement. Nevertheless, the nexus question by its very nature is analyzed in terms of objective factors like presence. The Quill majority, moreover, noted that the precedents cited by the North Dakota Supreme Court concerned taxpayers physically present in the taxing state. In the use tax context, Quill establishes that physical presence, when coupled with the filling of orders from out-of-state, tips the balance in favor of the collection obligation. With respect to income taxation, the question seems to be the sufficiency of other factors beyond physical presence, which is taken as a given, to establish taxing jurisdiction.

In propounding the thesis that Commerce Clause nexus does not require some element of physical presence, the articles cited above acknowledge the absence of precedent at the Supreme

Court level sustaining imposition of an income tax on an entity without tangible property or other physical presence in the taxing jurisdiction. The earlier article approvingly analyzes the Geoffrey decision and argues for wide application of its reasoning. It proposes that the business-situs rule may be invoked to establish nexus for taxation on the basis of the use of intangible property in the taxing state. The business-situs rule, applied in several cases decided nearly a century ago, permits intangibles to be assigned a tax situs in a state where the owner is not physically present. The cases concerned ad valorem property taxation, and the issue was due process. The article claims support from only one income tax case decided by the United States Supreme Court, New York ex. rel. Whitney v. Graves, 299 U.S. 366, 57 S.Ct. 237, 81 L.Ed. 285 (1937). Whitney is also a due process case, in which New York was found to have jurisdiction to tax a Massachusetts resident on income from the sale of a right derived from a seat on the New York Stock Exchange.

The second article defends the proposition that the Quill requirement of physical presence applies only in the use tax collection context and discusses state court litigation subsequent to Quill. It demonstrates that there has been considerable activity, especially since the decision in Geoffrey. Nevertheless, South Carolina remains the only state which has found nexus without physical presence. The Geoffrey holding, of course, is binding precedent only in South Carolina. The Supreme Court's denial of certiorari does not address the merits of the decision. Hughes Tool Co. v. Trans World Airlines, Inc., 409 U.S. 363, 365, 93 S.Ct. 647, 34 L.Ed.2d 577 (1973). See also Ponte v. Real, 471 U.S. 491, 502, 105 S.Ct. 2192, 85 L.Ed.2d 553 (1985) (Stevens, J., concurring in part). In its discussion of the Commerce Clause, Geoffrey recites the four-part test of Complete Auto. Then, the opinion summarily concludes, in a footnote, that in Quill the Supreme Court "revisited the physical presence requirement of Bellas Hess and while reaffirming its validity as to sales and use

taxes, noted that the physical presence requirement had not been extended to other types of taxes." 437 S.E.2d at 23, n.4. The opinion goes on to declare that "[i]t is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus." Id. at 23. In support of the proposition, it cites a New Mexico state court decision and the U.S. Supreme Court decision in International Harvester Co. v. Wisconsin Dep't of Taxation, 322 U.S. 435, 441-42, 64 S.Ct. 1060, 88 L.Ed. 1373 (1944).

The International Harvester decision concerned a due process challenge by a foreign corporation doing business in Wisconsin to a state statute imposing a tax on that portion of dividends distributed by both domestic and foreign corporations as was derived from income earned in Wisconsin. The tax was imposed on the corporation, which was required to deduct the amount of the imposition from the dividends distributed to individual shareholders, who thus bore the burden of the tax. The Supreme Court upheld the tax, concluding that "a state has constitutional power to make a levy upon a corporation, measured by so much of its earnings from within the state as it distributes in dividends, and to make the taxable event the corporation's relinquishment of the earnings to its stockholders." 322 U.S. 441. In these circumstances, the Court declared "[p]ersonal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them." Id. The broad proposition which Geoffrey takes from International Harvester that "a state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are within the protection of the State and entitled to the numerous other benefits which it confers" is in the nature of dictum. 437 S.E.2d 23.

The only other decision cited in the Commerce Clause section of Geoffrey is Curry v. McCanless, 307 U.S. 357, 59 S.Ct. 900, 83 L.Ed. 1339 (1939). This case concluded that due process permits an inheritance or succession tax to be imposed, with respect to a decedent's disposition of intangible assets held in trust, by both the decedent's state of domicile and the state where the trustee is found. Neither Curry v. McCanless nor International Harvester directly addressed the Commerce Clause and in each case physical presence, in the one instance of the trustee and in the other of the corporation, was an essential factor in the finding of jurisdiction to tax. The authorities cited by the South Carolina Court do not support its conclusion that Commerce Clause nexus may be found absent physical presence ascribable to a taxpayer.

The question of the necessity of physical presence for Commerce Clause nexus has been addressed in other state court decisions after Quill and Geoffrey. None of them find nexus absent physical presence. J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. App. 1999), moreover, clearly rejects the reasoning of Geoffrey. The Tennessee court concluded that income realized by a Delaware banking corporation from credit card activity in Tennessee was not subject to Tennessee's franchise and excise taxes. The court observed that it could find no basis to differentiate between the use collection obligation addressed in Quill and the taxes imposed by Tennessee. Without specifically addressing Geoffrey, the decision found that under Quill physical presence is necessary for a finding of Commerce Clause nexus.

In another case, on facts like those in Geoffrey and the instant matter, the Maryland Court of Appeals reversed the holding of the Maryland Tax Court that a Delaware corporation, affiliated with a local retailer, is not subject to taxation where its only contact with Maryland is a license agreement with the retailer. Comptroller of the Treasury v. SYL Inc., 375 Md. 78, 825 A.2d 399 (2003). In

doing so, the Court did not find that the license of intangible property for use within a state, without more, establishes Commerce Clause nexus for taxation of the licensor by the state within which the property is used. Rather, it concluded that the licensing corporation had no economic substance as a separate business entity, apart from the licensee. Although the court cited Geoffrey favorably, it also invoked the decision in Syms Corp. v. Comm'r. of Revenue, 436 Mass. 505, 765 N.E.2d 758 (2002), in which the deduction of royalty payments to an affiliated corporation was disallowed in the computation of a retailer's taxable income because the payments resulted from a "sham transaction." The Maryland decision is not, therefore, an unqualified adoption of Geoffrey, and it does not support the Division's contention in this matter.

Other decisions taking note of Geoffrey do not directly address the question of whether physical presence is required to establish nexus. Truck Renting and Leasing Assn., Inc. v. Comm'r of Revenue, 433 Mass. 733, 746 N.E. 2d 143 (2001), sustains the imposition of the Massachusetts corporate excise tax to a foreign corporation that entered into lease agreements under which its trucks were operated in Massachusetts by the lessees. Although the issue of nexus without physical presence is noted in passing, the decision turns on the anticipated presence and use of the lessor's tangible property in the state. Couchot v. State Lottery Comm'n., 74 Ohio St. 417, 659 N.E.2d. 1225 (1996), holds a non-resident liable for state income tax on Ohio lottery winnings. Citing Geoffrey, the court considered that the physical presence requirement of Quill was inapplicable in the case. Nevertheless, the decision notes that the taxpayer was physically present in Ohio in both purchasing and redeeming the winning lottery ticket. General Motors Corp. v. City of Seattle, 107 Wash.App. 42, 25 P.3d 1022 (2001) rev. den. 145 Wash.2d 1014, 35 P.3d 381 (2001), cert. den. 525 U.S. 1056, 122 S.Ct. 1915, 152 L.Ed.2d 815 (2002), concerns a local business and occupation tax, to which

General Motors and Chrysler Corporations were found subject because, among other factors, their sales, service and parts representatives made regular visits to Seattle dealerships. In its discussion of Quill and Geoffrey, the court distinguished the tax at issue from both sales and use taxes and corporate franchise taxes and concluded that "[w]e decline to extend Quill's physical presence requirement in this context." 25 P.2d. at 1022. It is clear, however, that the automobile manufacturers had a physical presence in the taxing jurisdiction. Finally, in Acme Royalty Co. v. Director of Revenue, 96 S.W.3d. 72 (Mo. 2002) the Missouri Supreme Court, in a 4-3 decision interpreting state law, found that the state's corporate income tax statute did not reach income received by foreign corporations from licenses of trademarks, trade names and patents to related corporations operating in Missouri. The dissenting judges, invoking Geoffrey with respect to federal constitutional questions, would have found the corporations subject to tax.

This analysis leads to the conclusion that the physical presence of the taxpayer or its employee(s), agent(s), or tangible property in a jurisdiction has been and remains a necessary element for a finding of substantial nexus under the Commerce Clause of the United States Constitution. This constitutional issue must be reached, although Lanco advances an alternative argument that subjecting it to tax on the basis of its license agreement with Lane Bryant is not consistent with the terms of the New Jersey Corporation Business Tax Act (N.J.S.A. 54:10-A et seq.) The statutory argument fails because the CBT statute is clearly intended to reach foreign corporations engaged in business activities within the state to the full extent that is constitutionally permissible. Roadway Express, Inc. v. Dir., Division of Taxation, 50 N.J. 471, 483 (1967) appeal dism, 390 U.S. 745, 88 S.Ct. 1443, 20 L.Ed.2d 276 (1968).

The dispositive conclusion under the Commerce Clause also renders unnecessary extended discussion of other questions presented and expert testimony produced. Some discussion of those matters, however, is useful for an understanding of this decision. Lanco has argued, in particular, that not only the Commerce Clause, but also the Due Process Clause immunizes it from taxation in New Jersey. Yet it is impossible to conclude that its agreement with Lane Bryant does not satisfy the Quill due process standard in that Lanco has purposefully availed itself of the benefits of an economic market in New Jersey. See Quill, 504 U.S. at 307-08. Similarly, any contention that other elements of the four-part Complete Auto test are not satisfied is without merit. Since this case concerns not an assessment, but a determination of responsibility to file, the fair apportionment element of the Complete Auto test is not raised as an issue. The remaining elements concern discrimination and fair relation to benefits provided by the state. It is beyond question that the state seeks to tax license income of both domestic and foreign corporations and among the latter class to tax both those physically present and those not. There is simply no distinction made upon which a discrimination claim can be founded. As to fair relationship to services, it is clear that Lanco's intangibles are utilized in the conduct of Lane Bryant's retail business. Although it is not physically present in the state, Lanco clearly enjoys the same benefits provided to Lane Bryant.

Both parties presented testimony of economic experts. David Wildasin, Professor of Economics at Vanderbilt University testified as part of plaintiff's case. He concluded that it is undesirable on economic grounds for states to tax the income of corporations that have no physical presence in the taxing state. He considered it important that states have revenue mechanisms enabling them to tax entities that impose costs on the states to provide public services. In Wildasin's view, businesses that are physically present impose such costs, while those without physical presence

do not. A licensor of intangibles like Lanco receives, the expert acknowledged, an indirect benefit from the state in which its licensee conducts business, but that benefit does not support taxation. Taxation based upon indirect benefit, in his opinion, would produce adverse consequences in the form of multiple taxation, discouragement of commerce, export of tax burden, and potentially disparate taxation of separate economic sectors; while taxation based on physical presence would have no adverse consequences.

Defendant presented the testimony of James Kearl, Professor of Economics at Brigham Young University. He observed that there is no necessary relationship between the magnitude of the costs imposed on a state by a given taxpayer's activity in the state and the amount of revenue collected from that taxpayer. He considered that Lanco's licensure of intangibles for use in New Jersey imposes costs on the state because it generates economic activity that increases the demand for public services; and he further considered that Lanco benefits from this activity, since it receives fees that increase with sales. Kearl concluded that the imposition of a corporate income tax on a licensor like Lanco is warranted by economic factors and that it would produce no substantial distortions of economic behavior. He regarded broadening the tax base to include entities without physical presence in the state as permitting the lowering of the tax rate and the reduction of the overall impact of the corporation tax on economic incentives and behavior.

Plaintiff also offered the testimony of Richard D. Pomp, Professor of Law at the University of Connecticut. Pomp is one of the leading academic authorities in state and local taxation and was qualified as an expert in tax policy. As such, he enumerated six principles of tax policy that he regarded as representing the values inherent in the commerce clause: desirability of a clear or "bright-line" test, consistency with settled expectations, reduction of litigation and promotion of

interstate investment, non-discriminatory treatment of the service sector, avoidance of multiple taxation, and efficiency of administration. He concluded that a requirement for physical presence as an element of Commerce Clause nexus advances each of these principles to a greater extent than a rule establishing nexus on the basis of use of intangible property. Pomp also found no reason to distinguish between the use tax collection obligation, directly involved in Quill, and the obligation to pay the corporate tax at issue here in terms of considerations relating to nexus. Finally, he described how the method of combined reporting for corporate taxation would permit taxation of income received by a foreign corporation for use of intangible property in the taxing state by a related corporation, even under a nexus rule requiring physical presence, and he endorsed combined reporting as sound tax policy.[3]

Economic and tax policy considerations are unquestionably valid material for the Supreme Court to consider in its task of constitutional adjudication. Those considerations are also appropriately addressed by the Legislature when it formulates the statutory scheme of taxation. Expert testimony does not, however, bear upon the question of whether the requirement of physical presence for Commerce Clause nexus is, following Quill, applicable beyond the use tax collection situation. That is a question of the interpretation of case law. Once it is determined that the precedents continue to require physical presence for nexus, there is no further question in this case for expert testimony to address.

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[3] Combined reporting is distinguished from separate-entity reporting. Under the latter, each corporation or other business entity reports only its own income, while under the former a combined report is submitted for a parent corporation and all its subsidiaries that disregards inter-company transactions. In either system, all income of any unitary business conducted in whole or in part within the State is reported, and the taxable portion is determined by an apportionment formula. See Pomp & Oldman, State & Local Taxation, 10-29 to 10-36 (3d ed. 2000). Allied Signal Inc., v. Director, Div. of Taxation, 504 U.S. 768, 112 S.Ct. 2251, 119 L.Ed.2d 533 (1992) discusses the unitary business concept in its application to New Jersey as a separate-entity jurisdiction.

A question of retroactivity has also been raised in the amicus curiae brief filed by the New Jersey Chamber of Commerce. It is argued that the regulation adopted by the Director expanding the definition of doing business under the Corporation Business Tax (under which the determination at issue was made) should be applied only prospectively. The regulation, amending N.J.A.C. 18:7-1.9 to include the licensure of trademarks to retailers operating in New Jersey was adopted in 1996. 28 N.J.R. 4795(a). It is unquestionably the Director's response to the question of the necessity of physical presence for nexus in light of Quill and Geoffrey. This decision concludes that physical presence is a necessary element for Commerce Clause nexus after Quill. Moreover, the tax period that remains in dispute between the parties begins after the effective date of the amendment. The retroactivity question is therefore moot.

Nevertheless, if physical presence were no longer a necessary element for nexus, retroactive application of a rule permitting a finding of nexus without physical presence would appear problematical. Regulations interpreting the terms of a tax statute do not by their own force impose taxes, and by their nature they are ordinarily retroactive to the statute's effective date. Sharps, Pixley, Inc. v. Director, Div. of Taxation, 16 N.J. Tax, 626, 640 (Tax 1997); General Bldg. Prod. Corp. v. Director, Div. of Taxation, 14 N. J. Tax 232, 247 (Tax 1994) aff'd, 15 N.J. Tax 213 (App. Div. 1995). Where, however, a tax regulation is premised on a perceived change in federal constitutional law, the same considerations do not necessarily apply. New Jersey has settled precedent, antedating Quill and Geoffrey, that bases nexus on physical presence. Avco Financial Services Consumer Discount Company, One, Inc. v. Director, Div. of Taxation, 100 N.J. 27, 38 (1985) (finding "substantial physical presence"); Chemical Realty Corp. v. Director, Div. of Taxation, 5 N.J. Tax 581, 612 (Tax 1983), aff'd 6 N.J. 448 (App. 1984). A finding of nexus without

physical presence would clearly reflect a change in applicable law. In these circumstances, this court could reasonably conclude that the novelty of the change and the reliance interests of taxpayers under the former interpretation justify confining the new rule to application only after the effective date of the amendment to the regulation. Cf. State Troopers Fraternal Ass'n of N.J., Inc. v. State, 149 N.J. 38 (1997).

It is appropriate to note, in addition, certain considerations that arise from the particular facts of this case. The plaintiff, while not physically present in the state, does have a direct long-term contractual relationship with a related entity clearly doing business in New Jersey. The case does not therefore concern isolated transactions, indirect connections or distant actors who cannot anticipate where the products of their effort, tangible or intangible, may come to be employed. If physical presence were not a requirement, nexus might be found in the circumstances of this case, but not necessarily in cases where there is no direct contractual relationship between the producer of property and its user in this state. There are other factors besides physical presence that can limit nexus findings and prevent taxation of remote parties. Certainly the due process standards of notice and fair warning will continue to hold. This decision concludes, however, that physical presence continues to be a requirement of the Commerce Clause.

This case and Geoffrey, as well as certain decisions in other states dealing with the necessity of physical presence for nexus, concern corporations organized to hold intangible property used in a retail or other business by an affiliated corporation. They are usually incorporated in jurisdictions that do not tax them on the receipt of license or royalty income from the operating company, which takes a deduction from its own income for the royalty payment as an ordinary business expense. The result is that the single enterprise which includes the two corporations receives income, not taxable

under traditional nexus rules in any jurisdiction, which the Geoffrey court characterized as "nowhere income." Among the reasons, and perhaps the decisive reason, for placing ownership of intangibles in a separate corporation, is the avoidance of taxation. Michael A. Lisi, Practicing Law Institute, Intracorporate Licensing: A Domestic Trademark Holding Company Example, (PLI Order No. G4-4033, Mar. 1998).

Legitimate means to minimize taxation are, of course the prerogative of any business and perhaps the dictate of market-place competition. It is a familiar principle that a taxpayer is bound by its choice among different structures or transactions and must pay more tax, if it has chosen one means rather than another that would accomplish the same result with lower tax consequences. General Trading Co. v. Director, Div. of Taxation, 83 N.J. 122 (1980). The taxing authority is similarly bound where the taxpayer has chosen shrewdly.

This decision determines that the state may not assert nexus, absent physical presence, against a corporation that receives income from the use of trademarks or other intangibles employed in a New Jersey business conducted by an affiliated corporation. The particular technique of tax avoidance can, however, be addressed by other measures. Certain jurisdictions require combined reporting by all corporate components of an enterprise engaged in a unitary business conducted in part within the taxing state. Combined reporting would, as Professor Pomp noted, return to taxable income the royalty payment received by the holding company. Other jurisdictions have elected to disallow the deduction by the operating company. New Jersey is not a combined reporting jurisdiction, but a recent amendment to the CBT disallows deductions for royalty payments made to a related entity for use of intangible property, as those terms are defined in the statute. N.J.S.A. 54:10A– 4.4. (enacted as L. 2002, c. 40, sec. 33, effective July 2, 2002). This opinion, of course,

does not address the interpretation of the amendment in any particular factual situation. In circumstances when the amendment does apply, however, jurisdiction to tax the company receiving royalty income from use of its intangibles in New Jersey is not essential to capture that income in this state's tax base.

In conclusion, since it has been determined that physical presence is a necessary element of Commerce Clause nexus for taxation, judgment shall be entered in favor of plaintiff Lanco invalidating the Director's determination that it is subject to the New Jersey Corporation Business Tax.

FILED IN CHAMBERS

JAN 0 8 2003

PETER D. PIZZUTO, J.T.C.

A TRUE COPY

PETER D. PIZZUTO, J.T.C.
Tax Court of New Jersey

PETER C. HARVEY
ATTORNEY GENERAL OF NEW JERSEY
Attorney for Defendant
Director, Division of Taxation
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P.O. Box 106
Trenton, New Jersey 08625
By: Patrick DeAlmeida
Deputy Attorney General
(609) 292-8576

TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC., Plaintiff, v. DIRECTOR, DIVISION OF TAXATION, Defendant.	Civil Action **CONSENT ORDER AND JUDGMENT**

THIS MATTER having come before the Court on a complaint filed by Plaintiff, Lanco, Inc., by and through its attorneys, Morrison & Foerster LLP (Paul H. Frankel, Esq., Hollis L. Hyans, Esq., appearing and Craig B. Fields, Esq., and Amy F. Nogid, of counsel) and McCarter & English LLP (Charles M. Costenbader, Esq. appearing), challenging the issuance of a subjectivity notice by Defendant and the assertion by the Defendant, Director, Division of Taxation (by and through his attorney, the Attorney General of New Jersey, Patrick DeAlmeida, Deputy Attorney General appearing) that Plaintiff, which has no physical presence in New Jersey, has nexus to New Jersey and is subject to the imposition of the New Jersey Corporate Business Tax by Defendant;

IT IS on this 9th day of January, 2003;

ORDERED and ADJUDGED that, pursuant to and for the reasons set forth in this Court's written opinion dated October 23, 2003, judgment be and hereby is entered in favor of Plaintiff, since it does not have a taxable nexus in the State which would subject it to New Jersey's Corporate Business Tax;

FURTHER ORDERED that a copy of this Order be served upon the Defendant by the Plaintiff within 7 days after its execution.

Peter D. Pizzuto

Honorable Peter D. Pizzuto, J.T.C.

We, the undersigned, hereby consent to the form and entry of the above Consent Order and Judgment.

Attorneys for the Plaintiff
MORRISON & FOERSTER LLP

Paul H Frankel

By: Paul H. Frankel

Attorney for Defendant
PETER C. HARVEY
Attorney General of New Jersey

By: Patrick DeAlmeida
Deputy Attorney General

McCARTER & ENGLISH LLP

Charles Costenbader

By: Charles M. Costenbader
For the Firm

541549

NOTICE OF APPEAL

SUPERIOR COURT OF NEW JERSEY - APPELLATE DIVISION

TITLE IN FULL (AS CAPTIONED BELOW):

Lanco, Inc.,
Plaintiff-Respondent,

v.

Director, Division of Taxation,
Defendant-Appellant.

ATTORNEY OR PRO SE LITIGANT

NAME Patrick DeAlmeida, DAG

ADDRESS R.J. Hughes Justice Complex
P.O. Box 112, Trenton, NJ 08625

TELEPHONE NO. (609) 292-8576

ATTORNEY FOR Director, Division of Taxation

ON APPEAL FROM:

Tax Court of New Jersey

TRIAL COURT OR STATE AGENCY

Docket No. 005329-1997

TRIAL COURT OR AGENCY NUMBER

Hon. Peter D. Pizzuto, J.T.C.

TRIAL COURT JUDGE

CIVIL [x] CRIMINAL [] JUVENILE []

NOTICE IS HEREBY GIVEN THAT the Director, Division of Taxation, APPEALS TO THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION, FROM THE JUDGMENT [x] ORDER [x] STATE AGENCY DECISION [] ENTERED IN THE ACTION ON 01/09/04
DATE

IF NOT APPEALING THE ENTIRE JUDGEMENT, ORDER OR AGENCY DECISION, SPECIFY WHAT PARTS OR PARAGRAPHS ARE BEING APPEALED.

HAVE ALL ISSUES AS TO ALL PARTIES BEEN DISPOSED OF IN THE ACTION IN THE TRIAL COURT OR AGENCY? (IN CONSOLIDATED ACTIONS, ALL ISSUES AS TO ALL PARTIES IN ALL ACTIONS MUST HAVE BEEN DISPOSED OF.)

YES [x] NO []

IF NOT, HAS THE ORDER BEEN CERTIFIED AS FINAL PURSUANT TO R.4:42-2? YES [] NO []

IN CRIMINAL, QUASI-CRIMINAL AND JUVENILE ACTIONS:

GIVE A CONCISE STATEMENT OF THE OFFENSE AND OF THE JUDGMENT, DATE ENTERED AND ANY SENTENCE OR DISPOSITION IMPOSED.

IS DEFENDANT INCARCERATED? YES [] NO []

WAS BAIL GRANTED OR THE SENTENCE OR DISPOSITION STAYED? YES [] NO []

IF IN CUSTODY, GIVE THE PLACE OF CONFINEMENT.

ATTACH ADDITIONAL SHEETS IF NECESSARY

NOTICE OF APPEAL AND ANNEXED CASE INFORMATION STATEMENT HAVE BEEN SERVED ON:

TRIAL COURT JUDGE Hon. Peter D. Pizzuto, J.T.C. 02/20/04

TRIAL COURT CLERK Diane L. Ailey, Tax Court Administrator 02/20/04

ATTORNEY GENERAL OR ATTORNEY FOR OTHER GOVERNMENTAL BODY PURSUANT TO R.2:5-1(a),(e) or (h) _____

OTHER PARTIES:

NAME AND DESIGNATION	ATTORNEY NAME, ADDRESS AND TELEPHONE NO.	DATE OF SERVICE
Lanco, Inc., Plaintiff	Charles M. Costenbader, Esq. McCarter & English, LLP Four Gateway Center 100 Mulberry Street Newark, NJ 07101-0652 (973) 622-4444	02/20/04
	Paul H. Frankel, Esq. Morrison & Foerster, LLP 1290 Avenue of the Americas New York, NY 10104-0050 (212) 468-8000	02/20/04
New Jersey State Chamber of Commerce Amicus Curiae	Charles H. Friedrich, Esq. Stryker, Tams & Dill, LLP Two Penn Plaza East Newark, NJ 07105 (973) 491-9500	02/20/04

ANNEXED TRANSCRIPT REQUEST FORM HAS BEEN SERVED ON:

NAME	DATE OF SERVICE	AMOUNT OF DEPOSIT
COURT REPORTER'S SUPERVISOR, CLERK OF COURT OR AGENCY		
COURT REPORTER		

EXEMPT FROM ANNEXING THE TRANSCRIPT REQUEST FORM DUE TO THE FOLLOWING:

[] NO VERBATIM RECORD.

[x] TRANSCRIPT IN POSSESSION OF ATTORNEY OR PRO SE LITIGANT. (FOUR COPIES, ALONG WITH THE COMPUTER DISKETTE FROM THE TRANSCRIPT PREPARER, MUST BE SUBMITTED.) LIST THE DATE(S) OF THE TRIAL OR HEARING.

11/30/99; 05/15/00

[] MOTION FOR ABBREVIATION OF TRANSCRIPT FILED WITH THE COURT OR AGENCY BELOW.

[] MOTION FOR FREE TRANSCRIPT FILED WITH THE COURT BELOW.

I CERTIFY THAT THE FOREGOING STATEMENTS ARE TRUE TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF. I ALSO CERTIFY THAT, UNLESS EXEMPT, THE FILING FEE REQUIRED BY N.J.S.A. 22A:2 HAS BEEN PAID.

2/20/04
DATE

Patricia DiAlmeida
SIGNATURE OF ATTORNEY OR PRO SE LITIGANT

AD-9(Elec)
4/01

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TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

---------- x

LANCO, INC. :

Plaintiff, :

v. :

DIRECTOR, DIVISION OF TAXATION, :

Defendant. :

---------- x

Civil Action

JOINT STIPULATION

WHEREAS the Defendant, Director, Division of Taxation (the "Division") issued a determination to Plaintiff, Lanco, Inc. ("Lanco") dated June 26, 1997, asserting that Lanco is subject to the Corporation Business Tax ("CBT") and is required to file CBT returns for the

period February 11, 1983, through the present (hereinafter referred to as the "original years in issue"); and

WHEREAS Lanco commenced this action by timely filing a Complaint requesting a declaration that it does not have nexus to New Jersey and is not subject to the CBT and is not required to file CBT returns for the period February 11, 1983, through the present; and

WHEREAS the Division filed an Answer to the Complaint; and

WHEREAS a hearing was held, a Stipulation of Facts was entered into by the parties and post-hearing briefs were submitted to this Court by the parties; and

WHEREAS oral argument was heard by this Court on December 18, 2000, but the Court's decision remains pending; and

WHEREAS Lanco and the Division have entered into a Closing Agreement which was approved by the Division on June 12, 2002, whereby the parties agreed to a resolution of the issues raised herein covering the portion of the original years in issue, but not covering the fiscal year ended January 31, 1998, leaving that year to be resolved by this Court;

NOW, THEREFORE, IT IS HEREBY STIPULATED AND AGREED by and between the parties as follows:

a. The Complaint and Answer and all other filings should be deemed amended to reflect that the only year that is at issue in this action is the fiscal year ended January 31, 1998; and

b. The undersigned hereby consent to the form and content of this Joint Stipulation.

McCarter & English, LLP

By: _____
Charles M. Costenbader
For the Firm

_____
Paul H. Frankel
Attorneys for Plaintiff

DATED: August 9, 2002

David Samson
Attorney General of New Jersey

By: _____
Patrick DeAlmeida
Deputy Attorney General
Attorney for Defendant

DATED: August 10, 2002

Of Counsel:

Paul H. Frankel
Hollis L. Hyans
Amy F. Nogid
c/o Morrison & Foerster LLP

A-3285-03T1

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3285-03T1

LANCO, INC.

Plaintiff-Respondent,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Appellant.

Civil Action

ON APPEAL FROM A FINAL JUDGMENT
OF THE TAX COURT OF NEW JERSEY

DOCKET NO. 005329-1[illegible]
Sat Below:
Hon. Peter D. Pizzuto

SUPPLEMENTAL APPENDIX OF PLAINTIFF-RESPONDENT LANCO, INC.

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Craig B. Fields
Amy F. Nogid
Charles M. Costenbader
On the Brief

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November 21, 1991; PETITION FOR CERTIORARI FILED AUGUST 2,1991; CERTIORARI GRANTED OCTOBER 7, 1991

On Writ of Certiorari to the Supreme Court of the State ofNorth Dakota

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether the North Dakota Supreme Court is obligated to follow the longstanding precedent of National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), in a case that is factually indistinguishable from Bellas Hess?

OPINIONS BELOW

The opinion of the Supreme Court of the State of North Dakota is reported at 470 N.W.2d 203 (1991), and is reprinted in the Appendix to the Petition for Writ of Certiorari (hereinafter referred to as "Pet. App.") A1-A36.

The Memorandum Opinion of Judge Graff of the District Court for the South Central Judicial District, County of Burleigh, State of North Dakota, was issued on May 15, 1990 (N. Dakota State Tax Reporter (CCH) P200-376) and is reprinted at Pet. App. A38-A42.

JURISDICTION

This action was brought by the State of North Dakota ("North Dakota") against Quill Corporation ("Quill") n1 for taxes alleged to be due under the North Dakota Sales and Use Tax Act, as amended (Sections 57-40.2-01(6) and (7),

N.D. Cent. Code (Supp. 1989) and regulations promulgated thereunder. (N.D. Admin. Code § 81-04.1-01-03.1 (1987).) (Joint Appendix, "J.A." 3, 6.)

n1 Pursuant to Supreme Court Rule 29.1, the Court is advised that Quill is neither the parent nor the subsidiary of any other company.

The Supreme Court of North Dakota entered judgment on May 7, 1991 and no rehearing was requested. Petitioner timely filed its Petition for Writ of Certiorari under 28 U.S.C. § 1257(a), invoking the jurisdiction of this Court to review the judgment of the North Dakota Supreme Court.

On October 7, 1991, this Court granted a writ of certiorari limited to Question 1 presented by the petition. (J.A. 52.)

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the following constitutional, statutory and regulatory provisions:

U.S. Const. art. I, § 8, cl. 3

U.S. Const. art. VI, PP2 and 3

U.S. Const. amend. XIV, § 1

N.D. Cent. Code § 57-40.2-01(6) and (7) (Supp. 1989)

N.D. Admin. Code § 81-04.1-01-03.1 (1987)

The text of these provisions and related sections of the North Dakota Sales and Use Tax Acts are reproduced in Pet. App. A46-A57.

STATEMENT OF THE CASE

North Dakota enacted legislation which required Quill to register under the North Dakota Sales and Use Tax Acts as a "retailer" maintaining a place of business in North Dakota and to obtain a North Dakota sales and use tax permit to collect and remit North Dakota use taxes on sales made by mail and telephone to North Dakota customers, even though Quill had no physical presence and conducted no local activity in North Dakota. (J.A. 3-7.)

The North Dakota Use Tax.

In 1987 North Dakota enacted legislation expanding the reach of the North Dakota sales/use tax laws to:

every person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable optic, microwave, or other communication system. n2

n2 The definition of "retailer" under Section 57-40.2-01(6), N.D. Cent. Code (Supp. 1989) was amended in 1987. The definition of "[r]etailer maintaining a place of business in this state" was also amended to include substantially the same activities as defined above. N.D. Cent. Code § 57-40.2-01(7) (Supp. 1989) (Pet. App. A47-A48).

North Dakota's Administrative Code § 81-04.1-01-03.1 defines the term "regular or systematic solicitation" to include three or more separate mailings of any advertisement during a specified twelve month period. (Pet. App. A56.) The 1987 statute requires any out-of-state vendor who satisfies this statutory definition to register as a "retailer" under the North Dakota sales/use tax acts, to obtain a North Dakota sales/use tax registration permit, and to be subject to North

Dakota use tax collection obligations and all other regulatory provisions under the North Dakota sales and use tax acts including remitting the tax whether or not it is actually collected. These burdens are imposed even though the out-of-state vendor maintains no property and conducts no localized business activity within the state. (Pet. App. A47-A57.) n3

n3 Prior to 1987, the terms "retailer" and "retailer maintaining a place of business in [North Dakota]" were applied only to persons having a "physical presence" in the state such as an office, distribution house, sales house, warehouse, salesperson or agent. N.D. Cent. Code § 57-40.2-01(6) and (7) (prior to 1987 amendments). North Dakota did not require registration and did not impose use tax collection or payment obligations on out-of-state mail order vendors absent a physical presence in the state. (Pet. App. A58-A66.)

Quill's Business.

Quill is a national mail order vendor selling office supplies, stationery and office equipment. Quill is incorporated in Delaware and maintains its principal place of business in Lincolnshire, Illinois. (J.A. 28.) Quill's only offices, warehouses and employees are located in Illinois, California and Georgia. Quill is authorized to transact business only in those states. (J.A. 29.)

Quill solicits sales through catalogs and advertising flyers mailed to customers throughout the United States, including customers located in North Dakota. (J.A. 29.) Twice a year Quill mails catalogs from Illinois to a list of approximately 2,300 customers located in North Dakota. (R. 95.) During the year, Quill also mails out and encloses with merchandise smaller intermediate sales books and flyers. (R. 95.) Quill receives orders from customers by mail and telephone (including fax, telecopy, telex and electronic mail n4) at its Illinois, California and Georgia locations. (J.A. 29.) All communications with customers in connection with their orders is conducted from Illinois, California and Georgia. (J.A. 29.) Quill ships merchandise to fill orders by United States mail or common carrier from locations outside North Dakota. (J.A. 29.)

n4 Electronic mail is a term to describe computer communication via telephone.

Quill has no physical presence in North Dakota. Quill does not own any real or personal tangible property in North Dakota and does not maintain any office, distribution point, sales house, warehouse or other place of business in North Dakota. (J.A. 31.) Quill does not have any agent, salesman, employee, representative, independent contractor, canvasser, solicitor or other person of any kind soliciting sales or otherwise acting on its behalf in North Dakota. (J.A. 31.) Quill does not store inventory or merchandise in North Dakota and does not retain any security interest in merchandise sold to North Dakota customers. (J.A. 31.) Quill does not have any telephone listing, toll-free telephone line, "800" number or WATS line in North Dakota. (J.A. 32.) Quill does not have a bank account in North Dakota. (J.A. 30.) Quill does not advertise by radio or television media in North Dakota, nor does it advertise in newspapers distributed in North Dakota or on billboards located in the state. (J.A. 32.) Quill does not solicit by means of telegraphy, cable, optic, microwave, or similar communication system located in North Dakota. (J.A. 32.)

Proceedings Below.

North Dakota filed this action on July 7, 1989 and requested that the court: (i) declare Quill a "retailer maintaining a place of business in [North Dakota]"; (ii) "require Quill to obtain a North Dakota sales and use tax permit"; and (iii) order Quill to pay all North Dakota use taxes (plus interest and penalties) due from July 1, 1987. (J.A. 5-6.) Quill defended against this action on the grounds that it violated the due process and commerce clauses of the U.S. Constitution as established by this Court's decision in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). Quill also sought reimbursement of attorneys' fees and costs pursuant to 42 U.S.C. §§ 1983 and 1988.

On cross-motions for summary judgment, the district court held for Quill. (Pet. App. A38.) The court declared that the 1987 amendments to the North Dakota Tax Law, Sections 57-40.2-01(6) and (7), violated the due process and commerce clauses of the United States Constitution and declared those amendments invalid as applied to Quill. (Pet.

App. A42.) The district court found that Quill's contacts with North Dakota were factually indistinguishable from the contacts of the mail order company addressed by this Court in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). (Pet. App. A40.) The district judge specifically emphasized that the state failed to present any facts that demonstrated that Quill benefited from protection of the local government. (Pet. App. A41.) Without analysis, the court denied Quill's request for reimbursement of attorneys' fees and costs pursuant to 42 U.S.C. §§ 1983 and 1988. (Pet. App. A42.)

The state appealed to the North Dakota Supreme Court which reversed. n5 The supreme court refused to follow the constitutional standards established in Bellas Hess. It concluded that those standards were "obsolescent precedent." (Quill, Pet. App. A10.) The court also concluded that the existence of an organized market for Quill's products in North Dakota satisfied the nexus considerations in this case. (Quill, Pet. App. A8, A25.) The North Dakota Supreme Court held Quill liable for North Dakota use taxes on sales made by Quill into North Dakota commencing July 1, 1987. (Pet. App. A36, A37.) Request for this Court's review followed.

n5 Quill cross-appealed that portion of the final judgment whereby the district court dismissed Quill's counterclaim for reimbursement of attorneys' fees and other costs under 42 U.S.C. §§ 1983 and 1988.

SUMMARY OF THE ARGUMENT

The great purpose of the commerce clause is to promote and protect an area of free trade among the states. A key element of the protection given to the national economy by the commerce clause is the prohibition of state taxation on activities insufficiently related to the state. The decisions of this Court under the commerce and due process clauses have established and repeatedly recognized that a state cannot impose tax obligations on an out-of-state vendor unless the vendor has a "substantial nexus" with the taxing jurisdiction. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977); National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756, 758 (1967).

When determining whether there is sufficient "nexus" to require an out-of-state vendor to collect state taxes, this Court has weighed the resulting burden on the vendor against the extent of the vendor's contacts, if any, with the taxing state. The controlling question has been whether the tax obligations sought to be imposed have a proper relation to the benefits of local government conferred upon the out-of-state vendor by the taxing state. (Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940); Complete Auto Transit, 430 U.S. 274.) To require out-of-state vendors, who do no more than communicate with customers by mail or common carrier, to collect sales and use taxes owed by customers in numerous states would subject those vendors to fundamentally unfair burdens obstructing interstate commerce. Bellas Hess, 386 U.S. 753 (1967).

For nearly twenty-five years, this Court's leading decision defining nexus required in the context of collecting state use taxes on interstate mail order sales has been Bellas Hess. There, this Court ruled that states could not impose use tax collection and payment obligations on out-of-state mail order vendors who maintained no physical presence within the taxing state. 386 U.S. at 758. This Court found the requirement of physical presence to rest upon principles essential to the overriding national policy of preserving open interstate markets. 386 U.S. at 759-60. The Court reasoned that without a clear workable standard, companies such as mail order vendors would be subject to state tax obligations based on an uncertain standard of whether the mail order company "regularly and continuously engaged in the 'exploitation of the consumer market'" in the state. 386 U.S. at 762 (Fortas, J., dissenting). Without a clear standard, out-of-state vendors who owned no property and conducted no local activities in the taxing state, would be subject to a "virtual welter of complicated obligations to local jurisdictions" which would impose unjustifiable local burdens on interstate commerce. 386 U.S. at 759-60.

Bellas Hess followed a line of decisions that for over twenty-five years required physical presence within a state before tax obligations could be imposed. This principle, followed in Bellas Hess and its progeny, has been imbedded in business and state tax administrative practices and has been a workable standard for twenty-five years.

In 1987 North Dakota urged Congress to enact federal legislation to permit North Dakota and other states to impose sales and use taxes on mail order sales in certain situations. (Pet. App. A58.) Simultaneous with its petition to Congress, North Dakota enacted state legislation that would enable it to collect taxes if permitted by Congress. (Pet. App. A47,

A56, A60.) Congress considered but never enacted federal legislation to authorize the states to tax out-of-state vendors who did not conduct a local business or maintain property in the taxing state. The strong congressional reluctance to expand the states' taxing powers was and continues to be based on the conflict between: (i) the constitutional need to eliminate cumulative, substantial and discriminatory burdens on the interstate business of out-of-state mail order vendors, and (ii) the state and local governments' inability to get together to eliminate those burdens.

The statute and regulations enacted by North Dakota in 1987 require every out-of-state vendor who mails three or more advertisements into North Dakota during a twelve-month period to register as a "retailer maintaining a place of business" in North Dakota and be subject to all provisions of North Dakota law applicable to local vendors operating local establishments within the state. The North Dakota statute ignores Bellas Hess and the constitutional principle that a state may not impose tax burdens on an out-of-state business unless that business has a local presence in the state to justify sharing the costs of government.

The North Dakota Supreme Court upheld the constitutionality of the North Dakota use tax law as applied to Quill, even though the lower court concluded that Quill did not meet the Bellas Hess "physical presence" test. (Pet. App. A40.) The Supreme Court explicitly based its decision on its conclusion that Bellas Hess is "obsolescent precedent." (Pet. App. A10.) The court opined that "the foundational basis of Bellas Hess has been eroded and that the Supreme Court would so conclude." (Pet. App. A13.)

The North Dakota Supreme Court cited no decision of this Court questioning the continued validity of Bellas Hess. Instead, the court followed Justice Fortas' dissenting opinion in Bellas Hess, labeling it the "ubiquitous presence" test. (Pet. App. A8, A29.) The court advanced no new analysis to justify its refusal to follow this Court's precedent. The facts relied upon by the court below do not bear upon the constitutional protections afforded by the commerce and due process clauses. The North Dakota Supreme Court ignores fifty years of jurisprudence and misapplies this Court's holding in Complete Auto Transit. The court also ignores the tremendous burdens that will be imposed upon mail order vendors if the "business presence" standard is abandoned for an amorphous "ubiquitous presence" test.

Adoption of North Dakota's test on a nationwide basis will expose all mail order vendors to economic chaos, especially if states are allowed retroactively to apply this new standard to vendors who cannot collect use taxes on prior sales. This Court should not countenance the weakening of constitutional protections of interstate commerce. Reliance upon the existing standard set forth in Bellas Hess has afforded a workable rule for more than twenty-five years. Any realignment of commerce clause applications is more suitably undertaken by Congress.

ARGUMENT

I. THE NORTH DAKOTA SUPREME COURT ERRONEOUSLY REFUSED TO APPLY BELLAS HESS IN A CASE THAT IS FACTUALLY INDISTINGUISHABLE.

This case presents the question whether the North Dakota Supreme Court was justified in refusing to apply the "physical presence" standard articulated in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967).

A. The Fundamental Purpose of the Commerce Clause is to Promote and Protect an Area of Free Trade.

A primary effect of the commerce and due process clauses has been to secure a unified, national market unimpeded by state-imposed burdens and restraints against trade across state lines. It has long been recognized by this Court that the fundamental purpose of the commerce clause was to promote and protect an area of free trade among the several states. In Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977), this Court said:

As in Great A&P Tea Co. v. Cottrell, 424 U.S. 366 (1976), we begin with the principle that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." McLeod v. J. E. Dilworth Co., 322 U.S. 327, 330 (1944). It is now established beyond dispute that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States.

Boston Stock Exchange, 429 U.S. at 328.

In American Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987), this Court described free interstate trade as the "central" purpose of the commerce clause. 483 U.S. at 280. Of all of this Court's statements regarding the commerce clause, Justice Jackson's is perhaps the most eloquent. In H. P. Hood & Sons v. Dumond, 336 U.S. 525 (1949), he stated:

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

Hood & Sons, 336 U.S. at 539.

A key element of the protection given to the national economy by the commerce clause is the prohibition of state tax on activities insufficiently related to the taxing state. The decisions of this Court under the due process and commerce clauses have established and repeatedly recognized that a state cannot impose tax obligations on an out-of-state vendor unless the vendor has a "substantial nexus" with that taxing state. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). In Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981), this Court explained:

[I]nterstate business must have a substantial nexus with the State before any tax may be levied on it. See National Bellas Hess, Inc. v. Illinois Revenue Dept., 386 U.S. 753 (1967).

Quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938), the Court also stated:

[t]he measure of tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a "just share of state tax burden."

Commonwealth Edison Co. v. Montana, 453 U.S. at 626 (Emphasis added).

For nearly a quarter of a century, this Court's leading decision defining the required nexus in the context of mail order sales has been National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). There, this Court ruled that states could not impose use tax collection and payment obligations on out-of-state mail order vendors that maintained no physical presence within the taxing state:

In order to uphold the power of Illinois to impose use tax burdens on National [Bellas Hess] in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order 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 as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.

Bellas Hess, 386 U.S. at 758.

The court found the requirement of physical presence to rest upon principles essential to the overriding national policy of preserving open interstate markets. The Court reasoned that, without this distinction, companies such as mail order sellers would be subject to a "virtual welter of complicated obligations to local jurisdictions" which would impose "unjustifiable local entanglements" on interstate commerce. Bellas Hess, 386 U.S. at 759-60.

Recently, in Dennis v. Higgins, 111 S. Ct. 865 (1991), this Court recognized that the right of merchants to engage in interstate trade free of such "local entanglements" is a "right" and "privilege" secured by the Constitution. The Court said:

The Court has often described the Commerce Clause as conferring a "right" to engage in interstate trade free from restrictive state regulation. In Crutcher v. Kentucky, 141 U.S. 47 (1891), in which the Court struck down a license requirement imposed on certain out-of-state companies, the Court stated: "To carry on interstate commerce is not a franchise or a privilege granted by the State; it is a right which every citizen of the United States is entitled to exercise under the Constitution and laws of the United States." Id., at 57. Similarly, Western Union Telegraph Co. v. Kansas ex

rel. Coleman, 216 U.S. 1, 26 (1910), referred to "the substantial rights of those engaged in interstate commerce." And Garrity v. New Jersey, 385 U.S. 493, 500 (1967), declared that engaging in interstate commerce is a "righ[t] of constitutional stature."

Dennis v. Higgins, 111 S. Ct. at 871 (1991).

It is the right to market its goods in the fifty states which Quill defends in this case.

Marketing consists initially of making the market aware of a merchant's products. In this case, marketing involves the use of catalogs directed to customers by the U.S. mail. North Dakota urges this Court to concede that any method regularly used to advertise and market goods to citizens within a state supports a finding of nexus, subjecting the out-of-state vendor to a host of tax and regulatory provisions under state law. (Quill, Pet. App. A29.) North Dakota would extend its tax laws to:

every person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable optic, microwave, or other communication system.

Section 57-40.2-01(6), N.D. Cent. Code (Supp. 1989). See also Section 57-40.2-01(7), N.D. Cent. Code (Supp. 1989) (Pet. App. A47-A48.)

B. North Dakota's Holding is Contrary to Fifty Years of Jurisprudence Interpreting the Commerce and Due Process Clauses.

The consequences of North Dakota's argument are dramatic. It eviscerates both the first and fourth prongs of the Complete Auto Transit test (Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977), discussed infra, pp. 29-30). It also overturns the precedents of this Court established during the last fifty years, precedents which mandate a physical presence to support a finding of tax nexus. See infra pp. 27-32.

Local marketing activities conducted by vendors with a physical presence (retail outlets and sales personnel) in a state, clearly invoke the taxing power exercised by that state because that physical presence within the state "bears fiscal relationship to protection, opportunities and benefits given by the state" to those vendors. Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940). Out-of-state vendors who merely send advertising into interstate markets, whose sole connection with the state is through common carrier and United States mail, do not bear a similar relationship with the state or derive the same benefits as do local retailers with a physical presence in the state. As noted by this Court, "it is difficult to conceive of commercial transactions more exclusively interstate in character" than mail order transactions that justify protection from state tax obligations. Bellas Hess, 386 U.S. at 759-60; Miller Bros. Co. v. Maryland, 347 U.S. 340, 347 (1954).

Jurisdiction to Tax Requires Physical Presence in the Taxing State

In each of the tax decisions culminating with Bellas Hess, tax nexus was found to exist only when physical presence in the taxing jurisdiction was established. These decisions have consistently identified the significant difference between vendors which maintain outlets, property, salesmen or representatives within a state and out-of-state vendors whose communications and contacts with customers are limited to mail, telephone and common carrier conducted in an interstate business.

In 1941 this Court required the mail order operations of Sears, Roebuck & Co. to collect use tax on sales to local customers because Sears maintained local retail stores conducting a related business in the taxing state. Stressing the importance of the local retail outlets which enjoyed the protection and services of the taxing state, this Court said:

Since Iowa has extended to it that privilege, Iowa can exact this burden [of collecting the use tax] as a price of enjoying the full benefits flowing from its Iowa business.

Nelson v. Sears, 312 U.S. 359, 364 (1941) (Bracketed material added).

The Court then contrasted the benefits given retailers with a physical presence to those who have none:

But those other concerns [exclusively out-of-state mail order vendors] are not doing business in the state as foreign corporations. Hence, unlike respondent [Sears] they are not receiving benefits from Iowa for which it has the power to exact a price.

Nelson v. Sears, 312 U.S. at 365 (Bracketed material added.) n6

n6 This Court has never modified this basic principle that jurisdiction to tax requires some presence -- in person or through tangible property or representatives -- within the taxing state. In General Trading Co. v. State Tax Com., 322 U.S. 335 (1944) and Scripto, Inc. v. Carson, 362 U.S. 207 (1960), the Court sustained imposition of tax liability where sales were solicited by employees and by independent contractors within the taxing state. In these cases, the Court emphasized the importance of the "local function of solicitation" and upheld the tax obligation because of the physical presence of sales representatives carrying on the vendor's business within the state. Scripto, 362 U.S. at 211. See also Nelson v. Montgomery Ward & Co., 312 U.S. 373, 375 (1941) (local retail outlets located in state); General Trading Co. v. State Tax Com., 322 U.S. 335, 337 (1944) (local agents located in state); Standard Pressed Steel Co. v. Washington, 419 U.S. 560, 561-62 (1975) and Tyler Pipe Industries, Inc. v. Washington, 483 U.S. 232, 249 (1987) (employees and representatives located in state); National Geographic Society v. California, 430 U.S. 551, 556 (1977) (offices and employees located in state); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 276 (1977); and Good's Furniture House, Inc. v. Iowa State Board of Tax, 382 N.W.2d 145, 146-47 (Iowa), cert. denied, 479 U.S. 817 (1986) (in both cases trucks and employees located in state).

In 1954 this Court specifically rejected Maryland's effort to predicate jurisdiction to compel an out-of-state vendor to collect local use tax upon a finding of regular, continuous advertising, when the vendor maintained no local stores or local solicitors within the state. Miller Brothers maintained a Delaware furniture store and advertised its merchandise almost daily in newspapers and over radio stations which consistently reached Maryland customers. Miller Bros., 347 U.S. at 349 (1954). Miller Brothers also mailed advertising flyers to Maryland customers four times a year, regularly sold furniture to Maryland customers for use in Maryland and made regular deliveries into Maryland using its own trucks driven by its own employees. This Court held that in the absence of a physical presence in Maryland, Miller Brothers could not constitutionally be required to collect the Maryland use tax on its sales. The Miller Bros. decision gave effect to the Court's earlier statement in Sears that out-of-state mail order vendors could not be required to collect state use taxes when the vendors had neither outlets nor solicitors within the taxing state, even though the vendors regularly solicited orders through the interstate dissemination of general advertising.

Bellas Hess

Thirteen years later in Bellas Hess, this Court reviewed Illinois' effort to avoid the nexus standard applied in Miller Bros. Illinois argued that it could require use tax collection by an out-of-state vendor whose contacts with Illinois consisted primarily of the regular and systematic mailing of catalogs and advertising flyers to Illinois residents and the regular delivery of ordered goods via mail or common carrier. It failed. Bellas Hess, 386 U.S. at 754-55, 758. Bellas Hess owned no tangible property, real or personal, in Illinois. It did, however, conduct a sizeable mail order operation (approximately $60 million in total annual sales) with a significant level of both sales and advertising in Illinois. n7 Considering whether the activities of Bellas Hess were sufficient to support Illinois' claims of nexus (to support imposition of tax collection duties), this Court again analyzed the applicable commerce and due process clause considerations. n8 It again concluded that when a vendor's only contacts with a state are by mail and common carrier, the state has no basis to require the vendor to collect use tax on mail order sales made to that state's residents and Illinois' efforts violated both the due process clause of the fourteenth amendment and the commerce clause.

n7 Bellas Hess sold approximately $2.1 million of merchandise into Illinois over a 15-month period, mailed semi-annual catalogs listing over 4,000 products to over 5 million customers, and sent advertising flyers to an even larger list of customers. Bellas Hess, 386 U.S. at 761. (Fortas, J., dissenting.) Bellas Hess sold a substantial part of its merchandise on credit payment plans, accepted checks drawn on Illinois banks, and sold goods C.O.D. Id. The company provided merchandise guarantees to its customers, allowing returns, exchanges or refunds. It solicited names

of potential new customers from existing customers and accepted orders by telephone. Bellas Hess, 386 U.S. at 761 n.2; Affidavit of Thomas J. Curry, J.A. 49-50. See National Bellas Hess 1967 Catalog, Spring and Summer ed., Bellas Hess, Record on Appeal (O.T. 1966, No. 241); National Bellas Hess Spring 1970 catalog, reproduced in the Quill Record on Appeal Ex. I-2 (separately bound).

n8 Tax nexus criteria under the due process and commerce clauses are similar. Bellas Hess, 386 U.S. at 756; Trinova Corp. v. Mich. Dept. of Treasury, 111 S. Ct. 818, 828-29 (1991). Due process requires that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," Bellas Hess, 386 U.S. at 756, and the commerce clause requires that the tax "[be] applied to an activity with a substantial nexus with the taxing State, . . . not discriminate against interstate commerce, and [be] fairly related to the services provided by the State." Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

In Bellas Hess, this Court applied an established and ascertainable tax nexus test that keyed on whether a vendor maintains a physical presence (retail outlets, solicitors or property) within the taxing state. The Court reviewed over twenty-five years of jurisprudence and observed:

But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail.

Bellas Hess, 386 U.S. at 758. (Emphasis added.)

The Court considered and rejected Illinois' argument that maintenance of an economic marketplace justified the imposition of tax collection obligations. Justice Fortas' dissenting opinion, considered by the North Dakota court as prescient (Quill, Pet. App. A8), urged this Court to abolish the "physical presence" test. (386 U.S. at 762.) Justice Fortas was persuaded that the political structure inherent in the marketplace, when combined with successful marketing, created an obligation upon a vendor to collect tax without regard to its physical presence in the political (taxing) jurisdiction. This same argument has now been adopted and labeled by the North Dakota court as its "ubiquitous presence" test. (Quill, Pet. App. A29.)

In reviewing the expansive application of the Illinois law advocated by the state in Bellas Hess, this Court recognized that the statute would impose tax collection liabilities on all regular advertisers without regard to the magnitude of their sales activity. The argument advanced by Illinois counsel (but rejected by this Court) in Bellas Hess demonstrates that the test Illinois sought to impose was the same test articulated in Justice Fortas' dissenting opinion and is the same test that the North Dakota court here labels as the "ubiquitous presence" test:

[T]he rule that I would suggest should be distilled from the cases of this Court is a rule which businessmen should well understand, and that is simply when a business is successfully in a state from a business point of view that that should be equated with presence from a legal point of view.

Transcript of Oral Argument, p. 33, Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967) (O.T. 1966 No. 241), reproduced in Appendix 1 to Petitioner's Brief.

The standard espoused by Illinois and subsequently embraced by Justice Fortas and the North Dakota Supreme Court is not functional and in reality provides no test at all. It renders nugatory the commerce clause and due process protections heretofore established by this Court and would reverse the decision of this Court in Bellas Hess.

Quill is Factually Indistinguishable from Bellas Hess

Quill and Bellas Hess have a unique likeness on the level of sales, n9 on the level of advertising flyers, n10 and on commercial law applications. n11 The North Dakota District Court Judge found that Quill's relationship to North Dakota was "very similar" to the relationship of Bellas Hess to Illinois. (Pet. App. A40.)

n9 In fact, more sales were at issue in Bellas Hess than in Quill. Bellas Hess' sales to Illinois residents in the fifteen-month period at issue in that case totalled $2,174,744. Bellas Hess, 386 U.S. at 761 (Fortas, J., dissenting). Quill's sales

to North Dakota residents in the twenty-four month period involved in this litigation totalled $1,849,305. (R. 92.) Thus Quill's annual sales were approximately half of Bellas Hess' annual sales. To allow for inflation, if Bellas Hess' annual 1961 Illinois sales are converted to 1989 dollars (using the Consumer Price Index), Bellas Hess would have sold approximately $9 million into Illinois, more than nine times the amount of Quill's annual sales into North Dakota. (R. 282-283.)

n10 More advertising flyers were mailed by Bellas Hess into Illinois than Quill mailed into North Dakota. Bellas Hess mailed to its customers over 5 million semi-annual catalogs listing over 4,000 products. Bellas Hess also mailed a substantially larger number of advertising flyers to customers. If Bellas Hess catalogs were distributed on the same ratio as its sales, the company would have mailed in excess of 289,000 catalogs to Illinois customers annually, not counting advertising flyers mailed separately and catalogs included with customer orders. (Compare R. 281 with R. 95.)

n11 Bellas Hess offered "charge account" services, shipped merchandise C.O.D. and sold merchandise with guarantees of customer satisfaction. Bellas Hess, 386 U.S. at 761. (J.A. 49.)

North Dakota's "Ubiquitous Presence" Test

The North Dakota Supreme Court also acknowledged that Bellas Hess was directly on point. (Quill, Pet. App. A5.) However, its finding of jurisdiction to tax Quill rested upon its determination that application of the commerce and due process clauses now allows a "ubiquitous presence" analysis (rather than a "physical presence" analysis) when ascertaining taxable nexus. The court below argued that "the foundational basis of Bellas Hess had been eroded" (Quill, Pet. App. A13); it then adopted as the basis for its opinion a "ubiquitous presence" test, incorporating the test articulated by Justice Fortas in his dissent in the Bellas Hess case. The court below stated:

We conclude that Quill's asserted lack of physical presence is not fatal to the State's attempt to require Quill to collect and remit use tax on its sales into North Dakota . . . [W]e conclude that the concept of nexus encompasses more than mere physical presence within the state . . .

(Quill, Pet. App. A25.)

More precisely stated, the court concludes that the concept of nexus encompasses less than "physical presence." In support, the court enlists reference to the "tremendous social, economic, commercial and legal innovations" that have occurred during the intervening years since 1967. (Quill, Pet. App. A8, A10.) However, the North Dakota Supreme Court fails to explain how these "tremendous" innovations impact upon this Court's constitutional analysis in Bellas Hess. The court below looks at the same "benefits" considered by this Court in 1967, but in the context of communication technology in the 1990s. The court recites Quill's activities in a context that demonstrates a more efficient marketplace exists today than in 1967, but the court fails to identify how that efficiency obligates Quill to collect North Dakota use taxes:

Quill's activities directed toward North Dakota consumers clearly establish a substantial [ubiquitous] "presence" within the State. To iterate Quill's activities, it has 3,500 active customers in North Dakota, and its annual sales of nearly $1,000,000 make it the sixth largest seller of office supplies in the State. It annually mails over 60 different catalogs and flyers to its North Dakota customers, accounting for 230,000 separate pieces of mail. Quill also has a "help line" for consumers to call if they have questions or problems with merchandise ordered from Quill, and specialized service representatives are available [in Illinois] to assist with custom printing orders or to answer questions about computers available from Quill. Quill has availed itself of modern technology to engage in an extensive, continuous, and intentional solicitation and exploitation of the State's consumer market and had thereby established an ubiquitous presence in the State.

(Quill, Pet. App. A29); compare with Bellas Hess, 386 U.S. at 760-63. (Emphasis and bracketed material added.)

The dispute is not with Quill's activities, but with the court's substitution of a "ubiquitous presence" test n12 for this Court's "physical presence" test. Use of the "ubiquitous presence" test to establish tax nexus is both unsupportable and inapposite under constitutional precedent interpreting commerce and due process clause protections afforded out-of-state firms conducting a general interstate business. The 1987 amendments to the North Dakota tax law and the North

Dakota Supreme Court's "ubiquitous presence" test impose North Dakota tax liability upon any vendor or advertiser making more than three solicitations per year, without regard to the magnitude of the market or the amount of merchandise sold.

n12 Presumably the court was referring to the commonly understood meaning of the term "ubiquitous," that is "existing or being everywhere at the same time." Webster's Third New International Dictionary, Unabridged (1981), Merriam-Webster. Black's Law Dictionary defines the term "ubiquity" in a similar manner: "omnipresence; presence in several places, or in all places, at one time." Black's Law Dictionary (6th ed. 1990).

The arguments urged by the North Dakota Supreme Court were considered and rejected by this Court in Bellas Hess, 386 U.S. at 760-762 (Fortas, J., dissenting). This Court reviewed the factual predicates needed for tax nexus and unequivocally rejected Justice Fortas' argument that economic benefits derived through "systematic, continuous solicitation and exploitation" of a state's market (i.e., a "ubiquitous" presence without physical presence) satisfied the constitutional requirements for tax nexus. Bellas Hess, 386 U.S. at 758.

North Dakota provides no new insights to justify adoption of this amorphous "ubiquitous presence" test previously repudiated in Bellas Hess. The North Dakota Court merely refocuses the arguments rejected in Bellas Hess by pointing to: (i) the increased size of the industry (which the North Dakota court found to be "the greatest change in mail order since 1967") (Quill, Pet. App. A12); (ii) the new technology for ordering goods including "toll-free telephone lines, fax orders, and direct computer ordering" and the new methods for delivering merchandise, including "advances in the parcel delivery industry . . . including overnight delivery" (Quill, Pet. App. A12); and (iii) the service of North Dakota in disposing of the "solid waste" created by catalogs sent to North Dakota residents. (Quill, Pet. App. A34.)

The Size of the Mail Order Industry is not Constitutionally Significant

The court below observes that during the quarter-century which has passed since Bellas Hess, "'mail order' has grown from a relatively inconsequential market niche into a goliath." n13 (Quill, Pet. App. A11.) The court makes no effort to, nor can it, explain how the volume of sales of the mail order industry has any relevance to whether Quill has nexus to North Dakota. n14 Neither the size of the market nor the percentage of market penetration is of constitutional significance. It is the physical nexus of the vendor to the market state which determine tax burdens. 386 U.S. at 758. If the North Dakota ruling is affirmed, every company whose activities are limited to solicitation, without actual physical presence, will lose the constitutional protections heretofore afforded, regardless of their size.

n13 Contrary to the speculations of the court below, this Court was fully aware that the sizable number of mail order sales at issue in Bellas Hess in 1967 would increase in the coming years (Bellas Hess, 386 U.S. at 764), but the potential magnitude of that future growth did not impact this Court's constitutional analysis.

n14 The North Dakota court's emphasis on the "sheer volume" of mail order sales ignores the fact that Bellas Hess sold nearly twice as much merchandise into Illinois than Quill sold into North Dakota. See note 9 supra. The court also ignores the fact that more than 94% of mail order firms have annual sales of less than $12.5 million. Collection of State Sales and Use Taxes by Out-of-State Vendors: Hearing on S.639 and S.1099 for the Subcomm. on Taxation and Debt Mgmt. of the Senate Comm. on Finance, 100th Cong., 1st Sess. (1987), 15-16 (testimony of Governor George Sinner of North Dakota). Direct Marketing Association, the largest trade association representing mail order businesses, reports that 85% of its 3500 members have annual national sales of less than $10 million; 62% report annual sales of less than $3 million. (Brief of Amicus Curiae Direct Marketing Association at 1.)

In sum, the North Dakota court has in this case decided that any successful mail order vendor will be required to collect a tax for North Dakota without regard to any other activity occurring in the state, other than the fact that there has been solicitation and sales. This holding has given an entirely new, unprecedented and unsupported meaning to both the commerce and due process clauses of the Constitution.

New Technology Does Not Support Abandonment of Accepted Constitutional Criteria

Without meaningful analysis the North Dakota Supreme Court also urges that technological advances in communications in the last two decades support the abandonment of accepted constitutional criteria. The economic market (the existing national marketplace) is obviously larger in 1991 than it was in 1967. There have been and will continue to be significant improvements in communication capabilities among the vendors and vendees who comprise the marketplace. But draftsmen of the constitution had the foresight to appreciate that those markets should remain accessible and unencumbered in order to foster the economic well-being of all citizens, regardless of the technology used. The maintenance of a geographical market (e.g., North Dakota residents) has never been perceived as a governmental service sufficient to justify the imposition of a tax. H. P. Hood & Sons v. Dumond, 336 U.S. 525, 539 (1949); National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 759-60 (1967); Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 328 (1977).

In the mail order business, markets exist wherever residents reside. Given the nature of our inherent political structure, residents reside in a state. Given the need to finance state governments, states levy taxes on residents and on non-residents who have some connection ("physical presence/nexus") with the state. But non-residents are otherwise protected from taxation by the many states under both the commerce and due process clauses to the constitution unless they physically enter the taxing jurisdiction. Bellas Hess, 386 U.S. at 758 (1967); Miller Bros., 347 U.S. at 347 (1954); Sears, 312 U.S. at 364 (1941). This Court has never held that constitutional protections historically afforded are dependent upon the efficiencies of the vendor. n15

n15 See, e.g., Hunt v. Washington, 432 U.S. 333, 351 (1977).

The statute that the North Dakota court upheld permits North Dakota to tax any mail order vendor without regard to whether the vendor takes advantage of the technological advances of the past thirty years. North Dakota would deny the commerce clause and due process protections to all vendors who market in that state by mail or common carrier. The court's argument that telephonic and related communication improvements have rendered this Court's decision in Bellas Hess "obsolescent precedent" (Quill, Pet. App. A10) has overwhelming significance when considered in the context of existing and anticipated technological changes.

North Dakota's Reliance Upon Waste Disposal To Establish Tax Nexus Is Misplaced

The North Dakota Supreme Court also urges that Quill should be obligated to collect North Dakota use tax because (i) Quill mails catalogs into North Dakota, and (ii) catalogs ultimately may be disposed of in landfills located in North Dakota. (Quill, Pet. App. A34.) While the level of awareness of environmental concerns has increased, the argument of the court below precisely follows Illinois' attempt to establish nexus in Bellas Hess. In 1967 Illinois argued before this Court that Bellas Hess' "catalogs and advertising flyers . . . are found within the State" and, thus, support a finding of nexus with Illinois to require collection of Illinois use tax on merchandise sold to Illinois customers. n16 This Court rejected that argument, pointing out that mere "communicat[ion] with customers in the State by mail or common carrier as part of a general interstate business" does not establish the necessary physical presence for imposition of use tax collection obligations. Bellas Hess, 386 U.S at 758. Catalogs sent by Bellas Hess into Illinois obviously ended up in Illinois landfills, but this Court did not find that fact to be constitutionally significant. n17 The North Dakota court fails to address the issue of how this fact now obtains greater significance in the context of North Dakota. The argument of the North Dakota court adds nothing new to the issue previously considered by this Court in Bellas Hess. n18

n16 Brief for Appellee at 15-16, Bellas Hess, 386 U.S. 753 (O.T. 1966, No. 241).

n17 In fact, more catalogs and advertising flyers were mailed annually by Bellas Hess into Illinois than Quill mailed annually into North Dakota. See note 10, supra.

n18 See also SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 671 (1991), cert. denied, 111 S. Ct. 2839 (1991); and Wisconsin v. J. C. Penney, 323 N.W.2d 168, 170 (Wisc. App. 1982); Mart Realty, Inc. v. Norberg, 303 A.2d 361, 363 (RI 1973); Hoffman-LaRoche, Inc. v. Porterfield, 243 N.E.2d 72, 75 (Ohio 1968) (all holding that advertising material, once mailed, becomes the property of the recipient).

The Law Has Not Changed; This Court Has Consistently Applied the Holding in Bellas Hess

In Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), Justice Clark reviewed this Court's prior decisions regarding unconstitutional state taxes. While conceding that those decisions were sometimes confusing and inconsistent he stated: "From the quagmire there emerge, however, some firm peaks of decision which remain unquestioned." 358 U.S. at 458. For the last quarter century, this Court's decision in Bellas Hess has been one of those "firm peaks of decision". n19

n19 Bellas Hess has been cited by this Court and by lower state and federal courts in approximately 75 cases decided over the last quarter-century. See Pet. App. A76 and Appendix 4.

This Court has consistently applied Bellas Hess and has never held that communicating with customers by mail or telephone is sufficient to provide tax nexus. Contrary to the North Dakota Supreme Court's suggestion (Quill, Pet. App. A15-A16), this Court did not abandon the nexus standard set forth in Bellas Hess when deciding National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977). In National Geographic, the vendor maintained two offices and up to eight employees in California to solicit advertising for its magazine. National Geographic, 430 U.S. at 552, 555-56; 547 P.2d at 458, 459 (Cal. 1976). National Geographic also operated a mail order business from its facilities located in the District of Columbia and Maryland. California sought to require National Geographic to collect use tax from mail order sales of merchandise to California residents. The California Supreme Court agreed and stated:

Where an out-of-state seller conducts a substantial mail order business with residents of a state . . . the slightest presence within such taxing state independent of any connection through interstate commerce will permit the state constitutionally to impose on the seller the duty of collecting the use tax from such mail order purchasers and the liability for failure to do so.

National Geographic, 430 U.S. at 555-56 quoting National Geographic, 547 P.2d 458, 462 (Cal. 1976) (Emphasis added by the Court).

While upholding California's claim, this Court specifically rejected California's "slightest presence" test, stating:

[N]ot every out-of-state seller may constitutionally be made liable for payment of the use tax on merchandise sold to purchasers in the [taxing] State.

National Geographic, 430 U.S. at 555.

Our affirmance of the California Supreme court is not to be understood as implying agreement with that court's "slightest presence" standard of Constitutional nexus . . . Our affirmance . . . rests upon our conclusion that appellant's maintenance of the two offices in California and activities there adequately establish a relationship or "nexus" between the Society and the State . . .

National Geographic, 430 U.S. at 556.

As in Bellas Hess, this Court focused on the physical presence of National Geographic in California, not the "economic benefits" derived from the state or the "slightest presence" theory advanced by the California court. National Geographic, 430 U.S. at 556-57. This is emphasized by the Court's reiteration in National Geographic of the holding in Bellas Hess:

The Court's opinion [in Bellas Hess] carefully underscored, however, the 'sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within [the taxing] State and those like National [Bellas Hess] who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. Id. at 758. Appellant [National Geographic] Society clearly fall into the former category.

National Geographic, 430 U.S. at 559 (emphasis added).

The North Dakota Supreme Court's contention that Bellas Hess was eroded by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), is also wrong. (Quill, Pet. App. A13-A14.) The court correctly recognized that Complete Auto sets forth the relevant tests for analyzing whether a state's tax violates the commerce clause. The first prong of the Complete Auto test requires a finding of an "activity with a substantial nexus with the taxing State." Complete Auto, 430 U.S. at 279. Far from abandoning Bellas Hess, this Court's later decisions make it abundantly clear that Bellas Hess is not only entirely consistent with Complete Auto, but is the touchstone of the first prong of Complete Auto. As this Court stated in Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981):

Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied on it. See National Bellas Hess, Inc. v. Illinois Revenue Dept., 386 U.S. 753 (1967).

Commonwealth Edison, 453 U.S. at 626 (emphasis in original).

Far from being rejected, the Bellas Hess decision was directly incorporated into the Complete Auto commerce clause test. n20 In fact, it is the North Dakota "ubiquitous presence" standard that is inconsistent with this Court's pronouncements in National Geographic and Complete Auto. Both of these cases require a "physical presence" to sustain a finding of "substantial nexus" with the taxing state, before tax liability may be imposed on the out-of-state business. In both National Geographic and Complete Auto, the "physical presence/substantial nexus" requirement was satisfied by officers, employees, substantial tangible personal property and localized business activities occurring within the taxing state. North Dakota's "ubiquitous presence" test thus ignores the first and fourth prongs of the Complete Auto Transit test by discarding the requirements that "the tax [be] applied to an activity with a substantial nexus with the taxing state" and that "[the tax be] fairly related to the services provided by the state." Complete Auto, 430 U.S. at 279. At the very least, under this Court's holdings the interstate business must have a physical presence with the taxing state before any tax may be levied on it. Commonwealth Edison, 453 U.S. at 626. North Dakota's "ubiquitous presence" test fails to incorporate this crucial element of physical presence and is constitutionally deficient under this Court's existing precedent.

n20 This Court's decisions in Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue, 483 U.S. 232 (1987) and Standard Pressed Steel v. Washington Dept. of Revenue, 419 U.S. 560 (1975), do not support the North Dakota Court's refusal to follow Bellas Hess. In both cases this Court focused on the substantial in-state activities of the taxpayers to uphold a finding of tax nexus. Standard Pressed Steel had one full-time employee and a group of other employees that regularly visited with the company's principal customer in Washington. 419 U.S. at 561. Tyler Pipe had independent sales representatives who acted daily on behalf of Tyler Pipe in calling on its customers and in soliciting orders in Washington. 483 U.S. at 249.

The continuing validity of Bellas Hess was again recognized by this Court in Goldberg v. Sweet, 488 U.S. 252 (1989). In Goldberg, this Court was called upon to decide whether an Illinois tax on interstate telecommunications violated the commerce clause. In deciding that issue, Bellas Hess was cited as relevant authority when this Court expressed doubts "that termination of an interstate telephone call, by itself" provided sufficient nexus for a state to tax that telephone call. n21 Goldberg v. Sweet, 488 U.S. at 263. This Court's statement in Goldberg is consistent with the holding in Bellas Hess that vendors who "do no more than communicate with customers" in the taxing state are constitutionally protected from use tax collection duties. Bellas Hess, 386 U.S. at 758.

n21 All parties in Goldberg v. Sweet conceded that the "substantial nexus" test of Complete Auto had been satisfied because each party owned property located in Illinois. 488 U.S. at 256 n.6, 258 n.9, 260.

In D. H. Holmes Co. v. McNamara, 486 U.S. 24 (1988), this Court implicitly reaffirmed its Bellas Hess holding. In D. H. Holmes, the Court addressed an attempt by Louisiana to impose use tax liability on D. H. Holmes, a Louisiana retailer, for catalogs it had printed out of state and shipped to Louisiana. D. H. Holmes maintained its principal place of business in New Orleans, operated 13 stores there and employed approximately 5,000 workers in Louisiana. 486 U.S. at

26-27. D. H. Holmes argued that it should be treated like the mail order company in Bellas Hess, "apparently view[ing] its catalog distribution as analogous to the mail order solicitation in National Bellas Hess." D.H. Holmes, 486 U.S. at 33. Chief Justice Rehnquist, in a unanimous decision, restated with approval this Court's holding in Bellas Hess and distinguished D. H. Holmes on the ground that the retailer was clearly physically present in Louisiana.

The conclusion that Bellas Hess is not "obsolescent" law is demonstrated not only by this Court's own decisions, but also by the overwhelming number of lower federal and state courts that have acknowledged the continuing vitality and usefulness of the Bellas Hess "physical presence" standard. n22 Recognizing the fact that Bellas Hess controls the constitutionality of states' attempts to tax out-of-state mail order houses, courts have applied Bellas Hess to invalidate states' imposition of use tax collection obligations on businesses which lack a physical presence in the state. Two state supreme courts have invalidated their states' attempts to impose use tax collection duties on businesses that do not have a physical presence in the state (SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (Conn.), cert. denied 111 S. Ct. 2839 (1991); Cally Curtis Co. v. Groppo, 572 A.2d 302 (Conn.), cert. denied, 111 S. Ct. 77 (1990); Bloomingdale's By Mail Ltd. v. Dept. of Revenue, 591 A.2d 1047 (Pa. 1991), aff'g 567 A.2d 773 (Pa. Commw. Ct. 1989) (per curiam) cert. applied for sub nom Penn. v. Bloomingdale's By Mail Ltd., No. 91-383) and a federal district court invalidated California's attempt to impose use tax collection obligations on direct marketing companies with no physical presence in that state. Direct Marketing Ass'n v. Bennett, No. Civ. S-88-1067 (E.D. Cal. July 12, 1991) (1991 U.S. Dist. LEXIS 10736). See also L. L. Bean, Inc. v. Commonwealth of Pennsylvania, 516 A.2d 820 (Pa. Commw. Ct. 1986); Book-of-the-Month Club, Inc. v. Porterfield, 268 N.E.2d 272, 274 (Ohio 1971).

n22 Federal and state cases citing Bellas Hess are listed at Pet. App. A76. Appendix 4 contains a partial listing and summary of these cases. See also Tribe, American Constitutional Law at 450, 460 (2d ed. 1988).

The "physical presence" standard articulated in Bellas Hess is the only appropriate test for application by lower courts reviewing the availability of commerce and due process protections to national marketers. n23 North Dakota's determination that this Court's decisions in this area have been made "obsolescent precedent" by the passage of time completely misses the mark and abandons a reliable standard under which businesses can predictably operate. n24

n23 The physical presence test as articulated in Bellas Hess is also consistent with this Court's decisions that prohibit states from requiring a foreign corporation to qualify to do business unless the corporation conducts intrastate, localized business activities. See Allenberg Cotton Co. v. Pittman, 419 U.S. 20, 33 (1974).

n24 The North Dakota Supreme Court has also failed to give the appropriate deference to this Court's decisions, which violates the doctrine of federal supremacy. See Quill's Petition for Writ of Certiorari at 17-22.

The Standards for Personal Jurisdiction and Tax Nexus Differ.

The North Dakota Supreme Court's reliance on Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985), and other personal jurisdiction cases to establish tax nexus is misplaced. The North Dakota Supreme Court fails to note that this Court in Bellas Hess refused to adopt a tax standard fashioned from personal jurisdiction cases. In Bellas Hess, the State of Illinois urged this Court to adopt the "economic benefits" test that had already been applied in the personal jurisdiction cases for at least seventeen years. Appellee's Brief at 32-34, National Bellas Hess (O.T. 1966, No. 241). This Court declined to adopt that test to establish tax nexus and held in Bellas Hess that even continuous and systematic solicitation by mail would not create tax nexus as long as the taxpayer did not maintain a physical presence in the state. This Court has consistently distinguished between these two standards, tax nexus and personal jurisdiction. See Travelers' Health Assoc. v. Virginia, 339 U.S. 643, 653-54 (1950) (Douglas, J., concurring):

It is the nature of the state's action that determines the kind or degree of activity in the state necessary for satisfying the requirements of due process.

* * *

The requirements of due process may demand more or less minimal contacts . . . depending on what the pinch of the decision is or what [a state] requires of the foreign corporation.

The North Dakota Supreme Court confuses the differing standards between personal jurisdiction and tax nexus, and restates an argument rejected by this Court in Bellas Hess. The North Dakota court improperly substitutes its "ubiquitous presence" test -- a standard which is ultimately no greater than that imposed in the personal jurisdiction cases; a standard that this Court refused to apply to determine tax nexus when deciding Bellas Hess.

II. NATIONWIDE APPLICATION OF THE NORTH DAKOTA RULING RESULTS IN CUMULATIVE AND DISCRIMINATORY BURDENS ON OUT-OF-STATE MAIL ORDER VENDORS.

This Court has the benefit of careful congressional investigations of the impact of sales and use tax laws as applied to interstate commerce. n25 Congress is well aware of the claims of the state taxing authorities. It has studied and has attempted to resolve the various complex problems associated with the imposition of tax burdens on out-of-state vendors. In recent years numerous bills have been introduced to achieve at the federal level the goal that North Dakota seeks here. n26

n25 Congress is fully aware of the Bellas Hess rule and over the years has considered legislation urged by the states to change that rule. Congress authorized hearings and studies to evaluate imposing state sales/use tax collection obligations on out-of-state vendors who did not maintain a physical presence within the taxing state. Legislation proposing a uniform federal response to state imposition of sales/use tax obligations has been introduced numerous times. Congress has declined to enact such legislation without state and local government agreement as to uniformity in application.

H.R. 2230 ("Equity in Interstate Competition Act of 1989"), 101st Cong., 1st Sess. (1989); S.480 ("Equity in Interstate Competition Act of 1989"), 101st Cong., 1st Sess. (1989) (requiring uniform local tax for application and setting minimum jurisdictional standards nationally ($12.5 million) and by state ($500,000)); S.2368, 100th Cong., 2nd Sess. (1988) (setting annual sales minimum for jurisdiction at $15 million nationally or $750,000 by state and providing variable local sales tax component); H.R.3521, 100th Cong., 1st Sess. (1987); H.R.1891, 100th Cong., 2nd Sess. (1987); H.R.1242, 100th Cong., 1st Sess. (1987) (establishing $5 million national annual sales minimum and requiring uniform local rate throughout the state); S.1099, 100th Cong., 1st Sess. (1987) (stating minimum jurisdictional standards including annual sales nationally of $12.5 million and providing local sales tax component); S.639, 100th Cong., 1st Sess. (1987). Hearings have also been held to evaluate a federal solution. Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R.1242, H.R.1891 and H.R.3521 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 100th Cong., 2d Sess. (1988) ["Hearings on H.R.1242, H.R. 1891 and H.R.3521"]; Collection of State Sales and Use Taxes by Out-of-State Vendors: Hearings Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance to Consider S.639 and related S.1099, the Equity in Interstate Competition Act of 1987, 100th Cong., 1st Sess. (1987) ["Hearings on S.639 and S.1099"].

n26 See note 25. Bills were introduced and considered in earlier years. See H.R.3549, 99th Cong., 1st Sess. (1985); S.1510, 99th Cong., 1st Sess. (1985); S.983, 96th Cong., 1st Sess. (1979); S.2173, 95th Cong., 1st Sess. (1977); S.2811, 93rd Cong., 1st Sess. (1973); S.2092, 93rd Cong., 1st Sess. (1973); S.282, 93rd Cong., 1st Sess. (1973); H.R.11798, 89th Cong., 1st Sess. (1965); introduced October 22, 1965 by Rep. Willis (ten companion bills with substantially similar text were also introduced by other representatives).

Hearings have been conducted on many of the bills: See note 25; see also, Interstate Sales Tax Collection Act of 1987: Hearing on H.R. 1242 before the Subcomm. on Select Revenue Measures for the House Comm. on Ways and Means, 100th Cong., 1st Sess. (1987) ["Hearing on H.R. 1242"]; State Taxation of Interstate Commerce: Hearing on S.1510 before the Subcomm. on Taxation and Debt Mgmt. of the Senate Comm. on Finance, 99th Cong., 1st Sess. (1985) ["Hearing on S.1510"]; Interstate Taxation: Hearings on S.2173 before the Committee on the Judiciary, 95th Cong., 1st and 2nd Sess. (1977 and 1978); State Taxation of Interstate Commerce: Hearing on S.282, S.1245, S.2092 and H.R.2096 before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance, 93rd Cong., 1st Sess. (1973); Interstate Taxation Act: Hearings on H.R.11798 and Companion Bills before the Special Subcomm. on State Taxation of Interstate Commerce of the Comm. on the Judiciary, 89th Cong., 2nd Sess. (1966); State Taxation of

Interstate Commerce: Report of the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, 89th Cong., 1st Sess., H. Rept. 565 (1965) ("Willis Report").

While there is debate about the form that such legislation should take, all of the proposals seek to address the substantial compliance burdens for out-of-state mail order vendors recognized by this Court in Bellas Hess, 386 U.S. at 753, 759-60.

The typical mail order vendor sends advertising into regional and national markets and receives orders from many jurisdictions. If North Dakota may require a mail order firm to collect taxes merely because it mails catalogs to customers who reside there, then so may every other state in which the vendor has customers. A nationwide application of the North Dakota law would require every mail-order vendor to register under the sales/use tax laws in every state in which it had customers, and incur liability to collect and pay over use taxes for thousands of counties, municipalities and school districts which impose sales/use taxes. For a mail order firm whose advertising runs nationwide, compliance means acting as a tax collector for each of the states and local subdivisions that impose sales and use taxes, approximately 6500 jurisdictions. n27

n27 When this Court considered Bellas Hess, it considered the burdens that would be caused by compliance with approximately 2300 tax jurisdictions. Bellas Hess, 386 U.S. at 759 n.12; Willis Report 841-845. Professor Archibald Cox set forth before this Court in explicit detail the disproportionate burdens which would be placed on interstate commerce if state and local governments were able to impose use tax collection burdens on out-of-state vendors who conducted a general interstate business. Brief for Appellant, App. B at 55-69 Bellas Hess (O.T. 1966, No. 241).

The compliance obligations, based on the number of taxing jurisdictions, have increased almost threefold with the passage of time. Advisory Commission on Intergovernmental Relations, State and Local Taxation of Out-of-State Mail Order Sales 6, 11 (April 1986) ["ACIR Report"]; and Note, Collecting the Use Tax on Mail-Order Sales, 79 Geo. L.J. 535, 539 (1991).

In 1967, this Court found that this inevitable result imposed a serious burden on interstate commerce and due process. Bellas Hess, 386 U.S. at 759-760. If state laws were uniform and states would accept one set of records, the cumulative burden might be no more than proportionate to the volume of business. The difficulty results from the variations and inconsistencies in state laws and recordkeeping requirements. In 1966 Congressman Willis, Chairman of the Special Subcommittee, described the plight of the typical out-of-state mail order vendor under a theory similar to that currently espoused by North Dakota:

If it were to anticipate shipping its products into any State, city, county or hamlet from which it received an order, it would require a compilation of 80 volumes of State and local tax laws which reaches more than 22 feet in height when piled one on the other. n28

n28 112 Cong. Rec. A-5055 (Sept. 30, 1966). Congressman Willis was addressing the insurmountable problems faced by the small business having to cope with the complex state and local tax requirements every time its products or its advertising materials are sent across state lines:

[I]t is important to remember that the small businesses of our Nation are conducted by men who have already demonstrated their willingness to comply with reasonable and equitable tax laws. Our present system of taxing interstate commerce defies even their most conscientious efforts. Today, if a small company with less than 50 employees located in my State of Louisiana -- or in Michigan, or in Maine, or in any one of the other States -- were to invest not more than $100 a month for advertising in a trade journal which is given national distribution, it will expose itself to potential tax reporting requirements that are staggering. Id.

The Willis Report discloses --

in all cases the charging and recording of sales tax is more complicated than in a retail store. One reason is, of course, the many States to which mail orders are sent from a single mail-order plant. [Report 771.]

* * *

The interstate seller of consumer goods . . . has the same costs as a local firm selling the same types of items plus the added costs of complying with the laws of many States at once. n29

n29 Willis Report, p. 812 (emphasis added).

The cumulative burdens so obvious in the 1960's are even more onerous today. n30

n30 See Hearing on S.1510 at 80-82 (testimony of Alan Glazer on behalf of the Direct Marketing Ass'n); Hearings on H.R. 1242, H.R. 1891 and H.R. 3521 at 129-130 (testimony of Nat Standing of J. C. Penney Company stating that the administrative costs of compliance "are enormous"); Levering, Federal Legislation, 4 N.Y.U. Inst. on State and Local Taxation, ch. 8 at § 8.03 (1986).

Federal legislation proposed in the wake of Bellas Hess would have allowed collection of local use taxes only if those taxes were uniform as to rate, base and administration by the state. See S.282, 93rd Cong., 1st Sess. (1973); S.2092, 93rd Cong., 1st Sess. (1973); and S.2173, 95th Cong., 1st Sess. (1977).

Current legislative proposals also seek uniformity and the elimination of the tremendous compliance burdens that would face out-of-state mail order vendors and their customers. These proposals would establish a uniform national rate of tax, an adequate collection allowance, uniform national definitions of exempt items, a uniform tax treatment of shipping and handling charges, and a single filing and audit procedure. See, e.g., Committee on State Taxation of the Council of State Chambers of Commerce, COST Endorses Compromise on Bellas Hess Legislation, State Tax Report Nos. 253 at 1 (Sept. 26, 1990); 244 at 1 (Dec. 15, 1989). The reluctance of Congress to enact federal legislation without agreed uniformity among state and local taxing units highlights the numerous compliance problems facing out-of-state mail order vendors.

A. Compliance Burdens Associated with Variances in Tax Laws.

The North Dakota Supreme Court trivializes the expense and administrative burdens which would result from requiring mail order companies to register and comply with the sale/use tax provisions for the 45 states and more then 6500 local taxing jurisdictions in the United States. These costs and problems are immense. n31

n31 The Advisory Commission on Intergovernmental Relations, a nonpartisan Congressionally-authorized body, has examined the issue of state and local taxation of mail order sales in the context of possible federal legislation. In its Executive Summary dated August 26, 1985, the ACIR recognized the significance of the compliance burdens on mail order companies:

Heavy compliance burdens: The mail order firms could be forced to shoulder extraordinary compliance burdens if they are required to comply with the differing tax code provisions of 45 states and 7000 local governments that are now imposing sales taxes. (Page 2, Executive Summary, dated Aug. 26, 1985.)

In its recommendation for federal legislation on this subject, "in order to minimize compliance costs for firms operating in multiple jurisdictions," the ACIR proposed that a "non-discriminatory single rate" be established. (Recommendation of Advisory Commission on Intergovernmental Relations dated September 20, 1985.)

Sales taxes in the various state and local jurisdictions vary considerably. Not only do the tax rates differ, but there is also great disparity in the designations of exempt items. See Brief of Amicus Curiae Coalition for Small Direct Marketers In Support of Petitioner, pp. 13-28.

B. Collection Problems.

In the event that the customers fail to include the tax, the out-of-state mail order vendor must commence collection efforts for the tax. If the tax is not collected from the customer, all state sales/use tax laws (See, e.g., N.D. Cent. Code § 57-40.2-06) impose liability for payment on the mail order vendor. Sales and use taxes are uniformly imposed on sales, not on collections. N.D. Cent. Code § 57-40.2-02.1. The North Dakota statute precludes a retailer from absorbing the tax by paying it (N.D. Cent. Code §§ 57-40.2-07(3) and 57-40.2-08) but makes no provision for the possibility that the retailer may not be able to collect the tax. A local retailer facing a tax-resisting customer can resolve a dispute by declining to consummate the sale until the tax is paid. Out-of-state mail order vendor collection problems are different because the customer is miles away and the out-of-state vendor's costs in collecting taxes are many times greater. n32

n32 See, e.g., Hearings on H.R.1242, H.R. 1891 and H.R.3521 at 199-200 (testimony of William T. End emphasizing the difficulties associated with providing complicated rate, exemption and other information to customers by catalog and attempting to collect unpaid tax after shipment of merchandise or face payment of the tax without reimbursement); Hearing on H.R.1242 at 129-131 (testimony of Alan Glazer regarding the burdensome costs associated with handling orders on which insufficient tax is paid, follow-up costs and the reality for such costs to overrun the amount of tax due on the particular sale).

C. Problems in Determining Tax Liabilities.

The out-of-state vendor faces heavier burdens than the local retailer with respect to computing the correct tax. A local retailer usually deals with customers at a given location. A mail order vendor like Quill normally has a nationwide business and receives orders from as many as fifty states. Sales and use tax rates must be separately computed and tax exemptions determined in each state, county or village. n33 The out-of-state vendor bears the direct tax burdens resulting from misapplication of any state tax rate and exemption; the vendor also bears the burden for processing customer refund claims for erroneously paid taxes, irrespective of whether the customer or vendor has erred.

n33 Appendix 2 summarizes the compliance obligations and rate change effects of North Dakota's sales and use tax laws with which Quill and other mail order vendors would be required to contend. Appendix 3 summarizes some of the variations among state sales/use tax laws in the forty-five state taxing jurisdictions with which mail order vendors would be forced to contend if required to collect taxes in each jurisdiction where sales are made. Local variations to the state rules are too numerous to list and are not summarized in the Appendix.

D. Recordkeeping Burdens.

Recordkeeping for reporting and audit purposes requires maintaining separate records for every state and local taxing jurisdiction where taxes are collected. Sales and use tax rules require detailed supporting records to verify sales, taxes collected, applicable exemptions and timely remittances. Returns are required to be filed quarter-monthly, monthly or quarterly depending on state and local rules.

Computer software programs simply do not solve the cumulative compliance burdens and audit requirements with which Quill and other out-of-state vendors would be faced, nor would computers eliminate the substantial costs of collection. n34 Computers cannot defray the substantial costs of nearly perpetual audits. n35 Computers cannot reduce the costs faced by the out-of-state mail order vendor when customers fail to pay, or underpay, the taxes due. n36 Mail order companies of necessity must rely on their customers to know the tax rate in their own jurisdiction, determine which items are and are not exempt, properly calculate the tax due, and remit it. Customers do not always have access to complete and current tax information and routinely fail to pay, or underpay, the tax due. See Note, Collecting the Use Tax on Mail Order Sales, 79 Geo.L.J. 535, 540 (1991).

n34 Computer tax programs are not equipped to recognize tax exemptions for products, nor can such programs judge whether products fit within a given exemption. See, e.g., Hearing on H.R.1242 at 178 (testimony of Heath Line); Hearing on S.639 and S.1099 at 52 (testimony of Robert Levering); and Hearing on H.R.1242 at 134 (statement of Alan Glazer).

Levering, An Examination of the Merits of Federal Legislation to Require Out-of-State Mail Order Companies to Collect State Use Taxes. 4 NYU Inst. on State and Local Tax'n, § 8.03[1] (1986).

Touche Ross, A Study to Determine the Economic Impact on Mail Order Firms of Multistate Sales Tax Collection at 5 (1986).

n35 Aside from enormous recordkeeping and record production requirements, the growth in the number of taxing jurisdictions raises the spector of nearly perpetual audits. Hearing on H.R.1242 at 31-32 (colloquy between Rep. Judd Gregg and Deputy Assistant Secretary of the Treasury O. Donaldson Chapoton). Cf. Brief for Appellant at 27-28, Bellas Hess (O.T. 1966, No. 241).

n36 "[M]ail order firms cannot effectively control the amount of tax, if any, that has been computed and submitted by the customer without a rather costly effort. I think that the mail order industry has effectively communciated their concern on this issue -- a concern that appears valid based on my experience." Hearing on S.639 and S. 1099 at 206 (Letter from Ray Westphal to Senator Max Baucus (November 24, 1987)).

The dilemma and hardship that out-of-state mail order vendors will encounter if required to collect the sales/use taxes in a large number of states and localities was underscored by this Court:

And if the power of Illinois to impose use tax burdens upon National [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government."

* * *

The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

Bellas Hess, 386 U.S. at 759-60.

E. Overall Burdens on Commerce.

In deciding whether there is sufficient "nexus" to support collection of state sales/use taxes, the resulting burden must be weighed against the vendor's contacts with the taxing state. A contact that will support a slight obligation will not sustain one that is so onerous as to clog interstate markets.

To paraphrase this Court's holding in Bellas Hess:

The many variations in rates of tax, in allowable exemptions and in administrative and recordkeeping requirements could entangle [Quill's] interstate business in a virtual welter of complicated obligations [to North Dakota, as well as other states which have] . . . no legitimate claim to impose a fair share of the cost of local government.

Bella Hess, 386 U.S. at 759-60.

North Dakota would justify its policy by urging that the "privilege" of selling to customers in North Dakota is benefit enough. At the very core of the commerce clause is the purpose of creating "an area of free trade among the several states." McLeod v. J. E. Dilworth Co., 322 U.S. 327, 330 (1944). The practical effect of the North Dakota decision is to hold hostage the privilege of participating in the national market created by the commerce clause. If the law in this field is to change, it should originate in Congress -- which is mindful of the commerce clause concerns -- and not be the product of forty-five different and divergent sets of state legislation.

III. UNCERTAIN STANDARD CREATED BY NORTH DAKOTA LAW.

The uncertainty of North Dakota's "ubiquitous presence" test will create widespread confusion for the business community and for state tax administrators. Out-of-state mail order vendors operating throughout the nation will be forced to speculate whether their solicitations are sufficient to subject them to use tax obligations and will be unable to adequately forecast tax liability. n37

n37 The North Dakota statute uses the terms "regular and systematic solicitation" which the Tax Commissioner has interpreted as three or more mailings into the state. North Dakota's definition of this term is not consistent with other states' use of similar terms in recently enacted state "anti-Bellas Hess" legislation. See Brief of Amici Curiae, L. L. Bean, Inc. et al., Appendix C, for a listing of states that have enacted "anti-Bellas Hess legislation and the various standards used by those states to establish tax nexus.

Approval of the North Dakota statute is likely to spawn additional litigation. If this Court determines that Quill's solicitations in North Dakota create an "ubiquitous presence" sufficient to justify a use tax collection duty, other courts will be required to determine in future cases whether a company with one or more solicitations (and no physical presence) may be compelled to collect use tax. Similarly, this Court will be asked to review other state "anti-Bellas Hess" legislation that focuses on sales rather than solicitations, n38 to determine whether $100,000 of business or ten sales or the use of credit cards n39 constitute a sufficient basis to justify the burden on interstate commerce created by requiring an out-of-state vendor having no physical presence in the taxing jurisdiction to collect taxes. The lines to establish a justifiable tax basis rule under the commerce clause should not change based on state tax administration. n40

n38 See, e.g., Minn. Stat. § 297A.25 (West Supp. 1991); Mo. Stat. Ann. § 27-67-4 (Supp. 1989); Vt. Stat. Ann. tit. 32 § 9701(9) (Supp. 1990).

n39 See Cal. Rev. & Tax. Code § 6203 (West Supp. 1991).

n40 Proponents and critics of the "physical presence" test alike have argued that Congress, not the judiciary, is better equipped to establish a workable "economic presence" test that will foster certainty and stability and permit interstate businesses to order their investments in reliance on clear principles. See, e.g., Nagel, The Emergence of a Single Nexus Standard, 45 Tax Notes No. 3, 237 (October 16, 1989) at 334 ("Ideally, the Supreme Court should not be in the business of making state tax law. This is something that is best left to Congress"); Hartman, Collection of the Use Tax on Out-of-State Mail-Order Sales, 39 Vand. L. Rev. 993, 1028 (1986) (arguing that congressional action is needed because "[t]here appears to be no adequate judicial machinery to establish such [fair compliance] costs"); Note, Collecting the Use Tax on Mail Order Sales, 79 Geo.L.J. 535 at 565 (arguing that congressional action is necessary because "[w]hen Congress drafts legislation on use tax collection both the mail-order industry and the state taxing agencies are represented . . ."); Pomp, Determining the Boundaries of a Post-Bellas Hess World, 44 Nat'l Tax J. No. 2, 237, 239 (June 1991) (urging that federal legislation be "resurrected" because ". . . the compliance burdens [are] too significant for the issue to be left to each state acting in isolation and motivated only by its own financial interests.").

IV. CONGRESS IS THE APPROPRIATE BODY TO REGULATE AND CONTROL COMMERCE.

The distinction drawn in decisions of this Court, that physical presence within a state is required before tax obligations may be imposed upon the out-of-state vendor, is firmly imbedded in business practice and state tax administration, n41 and is a workable standard. State tax administrators, although anxious to extend their sources of revenue, have accepted

for approximately twenty years this distinction. n42 In recent years a number of states have attempted to redraw this distinction and have passed "anti-Bellas Hess" legislation purporting to create use tax obligations for out-of-state vendors not physically present in the state. n43 Approximately nineteen states, including North Dakota, have adopted a more pragmatic alternative to collecting use taxes. Instead of requiring the out-of-state vendor to collect such taxes, these states collect the taxes directly from the consumer by providing integrated returns to facilitate use tax and income tax reporting. Other states annually issue separate use tax returns specifically designed for consumer self assessment. n44

n41 Hearing on H.R. 1242 at 60-61 and Hearing on S.1510 at 59-60 (testimony of North Dakota Senator Nething on behalf of National Conference of State Legislatures recognizing Bellas Hess as the standard in efforts to promote federal legislation); Hearing on S.1510 at 80-81 (testimony of Alan Glazer on behalf of Direct Marketing Association stating that proposed legislation to overturn Bellas Hess "would unfairly change the ground rules for a significant segment of American business.")

n42 See All States Tax Guide, (P-H 1982 ed.) P252, (P-H 1985 ed.) P252 and (P-H 1988 ed.) P252 for a compilation of state tax administrators' responses to questions regarding the applicability of Bellas Hess.

n43 These states have adopted various standards to establish tax nexus, making the use of credit cards and "800" telephone numbers, sales on approval, and similar chimerical contacts sufficient to require imposition and collection of sales and use taxes. See Brief of Amici Curiae, L. L. Bean et al., Appendix C.

n44 See Appendix 3.

North Dakota, however, is one of 36 states that has legislatively attempted to ignore the line drawn by Bellas Hess. n45 If the "physical presence" test is to be abandoned and replaced with some other standard, n46 Congress is the appropriate body to determine the extent to which out-of-state vendors should be held responsible for remitting sales and use taxes to states in which their only connection with customers is by common carrier or the United States mail and that test would be changed prospectively.

n45 The North Dakota legislature recognized that the 1987 amendments to the North Dakota Use Tax Law when enacted conflicted with this Court's decision in Bellas Hess. See House Concurrent Resolution ("H. Con. Res.") No. 3083 (which urged Congress to enact federal legislation to allow the states to impose sales and use tax obligations on out-of-state mail order vendors) (Pet. App. A58-59); See also 1987 House Committee Minutes regarding H. Con. Res. 3083, where State Rep. Hoffner, who introduced H. Con. Res. 3083, urged support for the Resolution by stating:

The [North Dakota] house of representatives passed HB 1195 some weeks ago by a wide margin and that has a fiscal positive aspect on the state of about 14.1 million dollars. The state can only realize that revenue if Congress passes this kind of [federal] legislation (emphasis added). (Pet. App A60.)

HB 1195 and SB 2555 amended N.D. Cent. Code § 57-40.2-01(6) and (7), which is the subject matter of this petition.

See also Testimony Before the House Finance and Taxation Committee (Jan. 13, 1987) where State Tax Commissioner M. K. Heidi Heitkamp stated:

[T]his Bill [HB 1195] prepares the State for immediate implementation of any federal legislation. (Pet. App. A66.)

* * *

HB 1195 is part of the Tax Department's continuing effort to stop sales and use tax loss, caused by the decision in [Bellas Hess] . . . The decision continues to allow out-of-state direct marketers . . . to refuse to collect "use" taxes from buyers . . . (Pet. App. A62.)

n46 The Brooks bills, H.R. 3521 in the 100th Congress and H.R. 2230 in the 101st Congress, contain the standard proposed by the states with respect to jurisdiction to tax interstate transactions under state sales tax laws. The standard is, in essence, the amount of sales to customers in the state. The Multistate Tax Commission has also advocated a similar standard for jurisdiction with respect to state income tax laws. (Resolution dated July 13, 1984, All States Tax Guide (P-H) P694-B).

Justices Black, Frankfurter and Douglas wrote a dissenting opinion in McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176 (1940), wherein they said:

Judicial control of national commerce -- unlike legislative regulations -- must from inherent limitations of the judicial process treat the subject by the hit-and-miss method of deciding single local controversies upon evidence and information limited by the narrow rules of litigation. Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. We would, therefore, leave the questions raised by the Arkansas tax for consideration of Congress in a nation-wide survey of the constantly increasing barriers to trade among the States. Unconfined by the 'narrow scope of judicial proceedings' Congress alone can, in the exercise of its plenary constitutional control over interstate commerce, not only consider whether such a tax as now under scrutiny is consistent with the best interests of our national economy, but can also on the basis of full exploration of the many aspects of a complicated problem devise a national policy fair alike to the States and our Union.

McCarroll, 309 U.S. at 188-189.

In Stockham Valves and Northwestern States Portland Cement, Mr. Justice Frankfurter said:

Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the states and the needed limits on such state taxing power.

Williams v. Stockham Valves & Fittings and Northwestern States Portland Cement v. Minnesota, 358 U.S. 450 at 476 (1959).

As stated by Justice Marshall in Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981):

[t]he nature of the fact finding and judgment that would be required of the courts merely reinforces the conclusion that questions about the appropriate level of state taxes must be resolved through the political process.

Commonwealth Edison, 453 U.S. at 628.

Indeed, there has been a long and active effort by states to expand their power to require out-of-state vendors to collect and remit sales and use taxes. Nevertheless, a coalition of local governments has thus far frustrated such efforts. n47

n47 See Kirschten, Division in Mail-Order Tax Coalition, 21 Nat'l J. No. 19, May 13, 1989 at 1195; 21 Nat'l J. No. 20, May 20, 1989 at 1266.

If this Court abandons the physical presence test and subjects mail order vendors including Quill to state tax collection burdens, there will be economic chaos in the mail order industry. Potential retroactive liability in most states (excluding Connecticut) n48 will literally wipe out these businesses. Mail order vendors cannot collect taxes on past sales. The strong Congressional reluctance to expand the states' taxing powers by overturning the Bellas Hess standard is based on the conflicts between: (i) the constitutional need to eliminate cumulative substantial and discriminatory burdens on the interstate commerce of out-of-state mail order vendors; and (ii) the state and local governments' inability to get together to eliminate those burdens. This Court should not make the Congressional resolution of this conflict unnecessary; the result would be chaos.

n48 See SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (Conn.), cert. denied, 111 S. Ct. 2839 (1991); Cally Curtis Co. v. Groppo, 572 A.2d 302 (Conn.), cert. denied, 111 S. Ct. 77 (1990).

CONCLUSION

For the foregoing reasons, Quill respectfully requests this Court to reverse the judgment below.

Respectfully submitted,

November 21, 1991.

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APPENDIX 1

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1966

NATIONAL BELLAS HESS, INCORPORATED, Appellant, vs. DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS FOR THE USE OF THE PEOPLE OF THE STATE OF ILLINOIS, Appellee.

No. 241

Washington, D.C.

Thursday, February 23, 1967

The above-mentioned matter came on for argument at 10:14 o'clock, a.m.

BEFORE:

EARL WARREN, Chief Justice of the United States

HUGO L. BLACK, Associate Justice

WILLIAM O. DOUGLAS, Associate Justice

TOM C. CLARK, Associate Justice

JOHN M. HARLAN, Associate Justice

WILLIAM J. BRENNAN, JR., Associate Justice

POTTER STEWART, Associate Justice

BYRON H. WHITE, Associate Justice

ABE FORTAS, Associate Justice

APPEARANCES:

ARCHIBALD COX, ESQ., Langdell Hall, Cambridge, Massachusetts; on behalf of the appellant.

TERENCE F. MacCARTHY, ESQ., Special Assistant Attorney General, State of Illinois; on behalf of the appellee.

Oral Argument of Mr. Terence F. MacCarthy, Esq. on Behalf of Appellee

[Department of Revenue of the State of Illinois]

[pp. 22-28 omitted]

[29] MR. JUSTICE FORTAS: Mr. MacCarthy, I am interested in the degree to which you would apply your statute. I hope you will come to that. For example, suppose that Macy's had a hundred customers in the State of Illinois and that Macy's enclosed advertising literature, catalogues, as they usually do I gather in their bills that were sent to these customers every month, would your statute cover that? I hope you will come to that kind of problem.

MR. MacCARTHY: I will answer it now if I may. Yes, the terms of the statute would definitely cover that particular transaction. The statute is quite broad and it mentions advertising per se. In this regard, I might indicate that the statute here is identical -- not quite in total terms but definitely in legal terms to the statute before this Court in the Scripto v. Carson case. The Illinois statute is identical. So the Court has had before it a statute identical in terms to the Illinois Statute in the Scripto case. For that matter in the Scripto case this Court spelled out in the footnote in the margin the Florida Statute.

MR. JUSTICE HARLAN: But would you have a similarity in the two cases?

[30] MR. MacCARTHY: Well they had 10 independent contractors in the Scripto case.

MR. JUSTICE HARLAN: And it was not similar to this case?

MR. MacCARTHY: No. The distinction in Scripto is that there were 10 independent contractors or specialty brokers. Here in lieu thereof we have the catalogues.

MR. JUSTICE FORTAS: This bothers me. Suppose Macy's had only one customer in Illinois and that customer had been to New York and opened a charge account at Macy's, and then thereafter Macy's sent monthly bills and said we are going to have a White Sale and we offer you bed linen at a bargain and the customer responds to that advertising and buys bed linen. Is that enough to subject Macy's to the duty of collecting a use tax?

MR. MacCARTHY: I think the issue then would be one resolved by the courts, Your Honor, and I think the issue as I will state in my suggestion as to the law to be distilled in this field will turn on the continuous and substantial nature of the business.

MR. JUSTICE FORTAS: That is what I am trying to get at. The statute says engaging in soliciting orders, and I ask you in effect whether Illinois makes a distinction between an occasional solicitation as in the cases I put to you or a regular solicitation.

[31] MR. MacCARTHY: In direct answer to your question --

MR. JUSTICE FORTAS: In this kind of thing where you have a sort of a broadside solicitation through mail order catalogues and fliers and so forth.

MR. MacCARTHY: In answer to your question, Mr. Justice Fortas, the Illinois Statute does not make the distinction.

MR. JUSTICE STEWART: How about continuing along the line suggested by my Brother Fortas. I suppose in your Illinois newspapers on Sunday the Book of the Month Club advertises and puts a little coupon in there to send in.

MR. MacCARTHY: Yes, Mr. Justice Stewart, it does. That is the issue in the case.

MR. JUSTICE STEWART: And your statute would cover them?

MR. MacCARTHY: Our statute would cover it. I am not presenting to this Court and I would make this distinction that those particular facts would satisfy the scrutiny of The Court under a due process argument. I am, however, and I make this point quite strongly, suggesting that the Court has before it a statute identical to the statute in Scripto. The Court has before it the particular facts in this case. I would like for particular emphasis to go on. We do not have a Macy's situation, as Mr. Justice Fortas would suggest, nor do we have what I would term the occasional type of advertising.

[32] MR. JUSTICE STEWART: Every Sunday throughout the year in every Chicago Tribune Sunday Paper.

MR. MacCARTHY: I would think the issue would turn not only on the advertising itself but by the business brought by the advertising.

MR. JUSTICE STEWART: The statute I think you already said makes no such distinction.

MR. MacCARTHY: Nor did the statute in Scripto which this Court put in footnote. The statute definitely makes no distinction.

MR. JUSTICE STEWART: And the statute would cover?

MR. MacCARTHY: Yes, sir. The Illinois Supreme Court opinion definitely would not tolerate it and I doubt if the opinion of this Court would.

MR. JUSTICE BRENNAN: Mr. MacCarthy, what is this -- the word "engaging"? Is that why you say there is a distinction between the situation Justice Fortas postulated and this kind of case?

MR. MacCARTHY: Mr. Justice Brennan, I don't think the distinction is to be found in the words of the statute. The statute is quite broad. I think the distinction is to be found in the interpretation of the decisions of this Court in interpreting what is required for the nexus or the minimum contact required. I think that is the issue, and I suggest that it should be addressed in this case to the particular [33] circumstances of this case and not to circumstances as they might be in a subsequent case or another case.

MR. JUSTICE WHITE: You would not really say you would argue for a different result if Bellas Hess had simply switched from sending in catalogues to regular advertisements in the newspapers and on television and radio and sold the same amount of merchandise as a result of it?

MR. MacCARTHY: No, I definitely would not, Mr. Justice White. I think the results bear the most importance, not the method of advertising but rather the results.

MR. JUSTICE HARLAN: But you got to have some kind of a rule that businessmen can understand.

MR. MacCARTHY: Definitely.

MR. JUSTICE HARLAN: At least that is desirable.

MR. MacCARTHY: Oh definitely. I think there should be some kind of a rule they should understand. And the rule that I would suggest should be distilled from the cases of this Court is a rule which businessmen should well understand,

and that is simply where a business is successfully in a state from a business point of view that that should be equated with presence from a legal point of view.

MR. JUSTICE HARLAN: Do you think that is the rule that the case disclosed?

MR. MacCARTHY: I think that is the rule that the case disclosed.

[34] MR. JUSTICE HARLAN: Irrespective of any sales or other physical contacts?

MR. MacCARTHY: Correct. I think that the form, I think that the decisions of this Court, most notably the recent Scripto decision, most definitely indicate that a formal distinction should not be given overemphasis but rather matters of substance should be considered. We should look to the success of the particular business in the state and not to the original form of arrangements enjoyed in the state.

MR. JUSTICE FORTAS: What you are saying, if I understand it, is that while the language of your statute is very broad, you say, your position is that you recognize that there are limits as a constitutional matter.

MR. MacCARTHY: Yes, I do.

MR. JUSTICE FORTAS: And those limits would depend upon the volume and frequency. What are the factors?

MR. MacCARTHY: The factors upon which the limits would depend?

MR. JUSTICE FORTAS: Yes.

MR. MacCARTHY: I would suggest that the principle to be distilled from all of these cases, the nexus cases, is first that stress should be placed on substance and not form, and, secondly, that continual and systematic activity should be distinguished from occasional or casual activities.

MR. JUSTICE BRENNAN: What substance is that?

[35] MR. MacCARTHY: I might give an example. The use of common carriers as opposed to the use of their own trucks within a state. I would think that this is a matter of substance and not form.

Thirdly, I think that the method of solicitation --

MR. JUSTICE STEWART: Do you think that is a matter of substance? Which way did that cut in this case?

MR. MacCARTHY: I do not think there should be a legal distinction between the use of a common carrier within the state.

MR. JUSTICE STEWART: You think it should be the same as Miller even though it is common carrier -- not private carrier?

MR. MacCARTHY: Yes, sir.

MR. JUSTICE STEWART: You think it should be the same as Miller though. Do you think it is substance and not form or just form and not substance?

MR. MacCARTHY: I would suggest that substance should take preference over the form.

MR. JUSTICE STEWART: Which is this distinction between common carriers and their own trucks.

MR. MacCARTHY: In other words, I am suggesting that the distinction that you would make would be a form of distinction between a common carrier on the one hand and a --

MR. JUSTICE STEWART: Form and not substance.

MR. MacCARTHY: Yes.

[36] MR. JUSTICE STEWARD: Your own substance.

MR. MacCARTHY: Yes.

MR JUSTICE BRENNAN: Are you saying you would make or would not make a distinction?

MR. MacCARTHY: I am making a distinction in answer to the questions.

Thirdly, I think that the method of solicitation matters not so long as it does not bear upon the in-state efficiency of the business, and I think this is definitely a principle we can take from the Scripto case.

And finally, I think, as I have already alluded to, successful presence in an economic sense should be equated with sufficient presence in a legal sense, and this, Mr. Justice Harlan, I would suggest would be a fine rule and the best workable rule for the businessman. It is something he fully and well understands.

MR. JUSTICE HARLAN: Well how much success do you need?

MR. MacCARTHY: That I think would depend a great deal on this particular Court. I definitely think in excess of $2 million of business in a period of approximately 15-1/2 months any businessman would agree was economic success within the State of Illinois.

I might make another point here. There were in-state c.o.d. deliveries. Again there seems to be some question raised in the reply brief as to the propriety of our mentioning c.o.d. [37] collections within the state. The record I think bears this out. The quote that counsel mentions, the quote in their reply brief at page 8 in footnote (3) they set out a quote wherein we suggest that c.o.d. collections were made. In setting forth our quote, by the way, that is a typographical or printing error. That is page 15 of our brief and not page 17. In setting out that quote, I think in fairness they might have set forth a footnote which immediately followed that quote. In the footnote we correctly, in accordance with the record, indicated that c.o.d. collections were not the practice in all cases. Unfortunately the record does not indicate in how many instances c.o.d. collections were made. However, the fact remains that c.o.d. collections were made in Illinois. In the same footnote they seem to take issue or object to our reference to the common carriers or the postal authorities as their representatives or as their bill collectors.

Now I think two particular statements by this Court might bear upon this, and again this goes to the substance over form argument which I would now make to the Court. Mr. Justice Douglas writing in the Harvester case indicated in a similar type of case that in these circumstances we are dealing with matters of substance and not with matters of dialect, and, further, Mr. Justice Clark writing for the majority of The Court in the most recent Scripto case said to permit such formal contractual shipments to make a constitutional difference would [38] open the gates to a stampede of tax avoidance.

MR. JUSTICE HARLAN: Mr. MacCarthy, is there any way of estimating the potentialities of this tax as a revenue measure with the volume?

MR. MacCARTHY: What? The volume?

MR. JUSTICE HARLAN: What is your in-state use tax involved? How much revenue do you have?

MR. MacCARTHY: I do not know the exact answer to that, Your Honor, as to what percentage of total revenue this would mean to the state.

MR. JUSTICE HARLAN: It would be very much larger, I suppose.

MR. MacCARTHY: If I may deposit an answer to your question, Mr. Justice Harlan, the problem is not a question of revenue to the State of Illinois. Here is the problem. I think the defendant National Bellas Hess has somewhat ill-characterized its position in this Court. They are suggesting to The Court that they are a small specialty type mail order house, one who wants to eliminate discrimination, one who wants equality of tax treatment. I do not think that the record in this case, Your Honors, or more importantly this record, the state taxation report which they rely upon, bears this particular status out for them.

If I might point to this, they make a great todo about the fact that in most states collection has not or is not [39] made in circumstances such as this. In other words, most states do not require an out-of-state vendor to make a collection of its use tax. They make a great todo about this fact. Now this is true. There is no question about this. We are willing to admit it. Only recently has Illinois enacted such a statute. But I do not think the fact that Illinois or other states have not collected this tax in the past bears one iota on the constitutional issue before this Court. However, and this would be the point I would make, the fact that recently states have this legislation does bear upon the policy considerations and does portray National in a little different light.

I might explain this. The record is also replete with references to the fact that most of the vendor states do not require collection of this tax. Appreciating this fact, it becomes rather obvious that National Bellas Hess or these mail order houses are now in a tax sanctuary situation. They are not paying any tax, and not paying any tax are permitted to discriminate in a way against the local buyers and also against the mail order houses who do pay the tax. This I think is an important point in understanding the policy and the reason for this tax. This tax is not intended to discriminate against out-of-state buyers. The purpose of this tax is to have everyone treated equally to permit the in-state seller the same margin of profit that the out-of-state seller would have.

[40] MR. JUSTICE WHITE: So you really think this may be a business regulation or device rather than a revenue base of measuring?

MR. MacCARTHY: If you are asking me, Mr. Justice White, do I think this particular will pass --

MR. JUSTICE WHITE: No. The Illinois law is really a business regulation.

MR. MacCARTHY: Oh definitely. I think it is intended to be so.

MR. JUSTICE WHITE: And not to raise revenue?

MR. MacCARTHY: Definitely not to raise revenue. The idea is to protect, if you will, not only the local merchants but the interstate merchants who are collecting and remitting the Illinois tax.

MR. JUSTICE WHITE: How far back do you intend to collect tax? How far back are you permitted to go? When will the statute run out?

MR. MacCARTHY: Well the statute was passed in 1961. The statute was passed July 1st 1961. The particular tax in question ran from July 17, 1961, to October 31, 1962.

MR. JUSTICE WHITE: But if you wanted to against Bellas Hess, how far back could you go?

MR. MacCARTHY: July 1st 1961.

MR. JUSTICE WHITE: If you could do this and collect the use tax from Bellas Hess whether they collect it from the [41] purchaser or not, why could you not apply a sales tax to these interstate sales made by Bellas Hess to buyers in Illinois?

MR. MacCARTHY: I think I understand your question. I think we are precluded from collecting a sales tax by this Court's decision in the McLeod case.

MR. JUSTICE WHITE: Why?

MR. MacCARTHY: The McLeod case indicated that the sale would have to be within the state and we have made no argument that the sales are within the state.

MR. JUSTICE WHITE: Why should it have to be within the state?

MR. MacCARTHY: This is The Court's decision.

MR. JUSTICE WHITE: I know it. But how do you understand it? Why is there a rule against collecting a sales tax?

MR. MacCARTHY: Well the late Mr. Justice Wiley Rutledge wrote a vigorous dissent, and if I could possibly paraphrase his dissent, He did not agree that in McLeod a tax should not be collected whether or not it was a sales or use tax.

MR. JUSTICE WHITE: You would say, yes, if you can do this, you should be able to collect a sales tax?

MR. MacCARTHY: I think we are more properly in our rights collecting a use tax and this is the reason we collect a use tax.

MR. JUSTICE WHITE: You think you are constitutionally forced to collect a use tax rather than a sales tax?

[42] MR. MacCARTHY: Yes, we do. I would like for a moment to turn in conclusion to the cases real briefly. National places tremendous reliance upon the Miller case. I think that this reliance is somewhat misplaced, and I think it is somewhat misplaced because National has failed to appreciate the particular facts in Miller. I would like to briefly mention some five distinctions in Miller which I think sufficiently distinguish Miller from this case.

First of all, National in its brief and now again in its oral argument refers to the regular deliveries in Miller. Conversely the Court in deciding Miller specifically referred to these deliveries as occasional deliveries.

Again, Mr. Justice Clark in writing the Scripto decision referring to Miller referred to "occasional deliveries in Miller."

Again, in its reply brief at page 3 National refers to the regular mailings in Miller. Conversely this Court in deciding Miller referred to the occasional sales circulars in Miller.

National fails to make a distinction which I think is quite salient to Miller, and that is in the Miller case the buyers left the State of Maryland, went into the State of Delaware and at the vendor's stores made the purchase. They do not particularly give any credence to this fact. However, the majority of The Court in writing Miller specifically noted [43] that the seller in the Miller case did not know where the goods were to be used.

Mr. Justice Douglas in writing a dissent felt otherwise and believed that the seller should have known where they were used. The fact remains whether or not he did or did not know was pertinent.

Thank you, Mr. Justices.

APPENDIX 2

NORTH DAKOTA

Obligations Imposed on North Dakota Vendors: Every vendor deemed to be a "retailer maintaining a place of business" in North Dakota is required to register under the North Dakota Sales and Use Tax Acts to obtain a permit to collect the use tax, subject to all conditions and fee requirements imposed on retailers with locations or representatives in the state otherwise subject to North Dakota's sales tax provisions. N.D. Cent. Code § 57-40.2-07. Specifically, the compliance obligations placed on out-of-state vendors include:

1. registering to obtain a sales and use tax permit and complying with all application procedures, including providing specific information regarding estimated monthly sales, names of owners/corporate officers, and detailed credit information;

2. posting a bond or other security to insure payment of taxes, if required by the tax commissioner;

3. maintenance of records (invoices, receipts and other pertinent documents) for a period of three years and three months for examination by the State;

4. making records, books and papers available for inspection in North Dakota;

5. determination of the extent and application of specific exemptions from the tax including: exemptions for sales for resale (retailer must obtain a certificate of resale from the purchaser at least once a year); exemptions for sales to specific exempt organizations; exemptions for new machinery and equipment, including computers (retailer must obtain certificate); and exemptions for certain food items;

6. timely and accurate collection and/or payment of both state and locally imposed taxes;

7. preparation and timely filing of the state tax return reporting all state and local taxes;

8. determination of refunds due customers for over-collected taxes;

9. filing of refund claims for overpaid taxes on behalf of any customer erroneously paying tax;

10. administration of the collection of taxes and filing of returns to avoid violation of penalty provisions for underpayment of tax and failure to pay or file rules, which can lead to personal liability of officers; and

11. keeping abreast of the continuing changes occurring under the North Dakota Sales and Use Tax Acts including changes in compliance provisions, exemption provisions and rate changes, whether issued through the legislature, judiciary or the administrative process.

N.D. Cent. Code § 57-39.2-15, et seq.; N.D. Cent. Code § 57-40.2-04, et seq.; North Dakota Application for Sales and Use Tax Permit.

Legislative Changes: The applicable sales and use rate and the rules for determining tax due in North Dakota have been the subject of frequent changes. In North Dakota, the applicable sales and use tax rate was modified three times between January, 1987 and December, 1989. N. Dakota State Tax Reporter (CCH) P60-401. Two bills proposed in the 1991 legislative session, HB 1386 and SB 2580, would have changed the rate again. In 1983 and 1985, SB 2497 and HB 1663 were enacted, respectively, providing for contingent 1% increases in the sales and use tax rate depending on the general fund balance at particular points in time. Ch. 632, SB 6497; Ch. 638, HB 1663. HB 1386, referenced above, would have also imposed a 1% contingent increase based on the level of funds.

A total of twenty-five (25) different bills affecting the use tax in North Dakota have been enacted since 1987. See North Dakota State Tax Reporter (CCH) P87-060 et seq. Since 1967, there have been sixty-nine (69) bills enacted affecting the use tax. In addition, the last three legislative sessions have seen twenty-two (22) bills related to the use tax proposed but not passed: 1987-8; 1989-7; and 1991-7.

Local Rates: There are currently twelve cities with local taxing authority imposing rates varying from 1/2% to 1%: Bismarck, Minot, Fargo, Grand Forks, Dickinson, Williston, Mandan, Grafton, Harvey, Wahpeton, Devils Lake and Jamestown. An additional local city tax for Valley City is set to be imposed as of January 1, 1992. See N. Dakota State Tax Reporter (CCH) P60-403.

Exemptions: Sales of the following are exempt from tax: items purchased by certain educational, government and charitable organizations, manufacturing equipment for new and expanding facilities (including computers), food and drugs, certain medicines, and farm and feed items. See N. Dakota Tax Reporter (CCH) P60-200 et seq. North Dakota also exempts sales of newsprint and ink (N.D. Cent. Code § 57-40.2-04(6)) and newspapers and free magazines. Id. §

57-39.2-01(9). Each of these exemptions has certain limitations. For example, there are variations within the North Dakota food exemption. The provision exempting food and food products includes a nonexclusive laundry list of items but specifically excludes from exempt food more than nine general types of "food." N.D. Cent. Code § 57-39.2-04.1.

Refund Claims: In North Dakota, a retailer maintaining a place of business that has erroneously overcollected tax must pay all tax collected to the state. If the tax is subsequently refunded to the customer, the retailer may take a credit on the next return for the tax properly refunded. N.D. Cent. Code § 57-40.2-17. It is the retailer's obligation to administratively handle all claims for refund of taxes overpaid by customers even if attributable to customer error or developments subsequent to the sale. Claims for refund are allowed for the person who made the erroneous payment, if filed before the later of (1) three years of the return due date or (2) one year after the amount is paid. Id. § 57-39.2-24 (incorporated by reference at § 57-40.2-13). If a refund claim is disallowed, the denial becomes final and irrevocable within 30 days after notice unless a written protest is filed. Id. § 57-39.2-25 (incorporated by reference at § 57-40.2-13).

APPENDIX 3

ALL STATES

State Tax Rate Variations: The tax rate differences as of September, 1991, categorized by rate are as follows:

3 Percent: Colorado and Wyoming; 3.5 Percent: Virginia; 4 Percent: Alabama, Georgia, Hawaii, Iowa, Louisiana, Michigan, New York, North Carolina and South Dakota; 4.225 Percent: Missouri; 4.25 Percent: Kansas; 4.5 Percent: Arkansas and Oklahoma; 5 Percent: Arizona, Idaho, Indiana, Maryland, Massachusetts, Nebraska, New Mexico, North Dakota, Ohio, South Carolina, Utah, Vermont and Wisconsin; 5.5 Percent: Tennessee; 5.75 Percent: Nevada; 6 Percent: California, Connecticut, District of Columbia, Florida, Kentucky, Maine, Mississippi, Pennsylvania and West Virginia; 6.25 Percent: Illinois and Texas; 6.5 Percent: Minnesota and Washington; 7 Percent: New Jersey and Rhode Island.

2 State Tax Guide (CCH) P60-100.

In addition, the following changes in the sales/use tax rates have been recently enacted:

1) California-decrease from 6% to 5.5% no later than July 1, 1993;

2) Maine-decrease from 6% to 5% on July 1, 1993;

3) Minnesota-decrease from 6.5% to 6% on January 1, 1992;

4) Missouri-additional 1.5% use tax on July 1, 1992; and

5) Nevada-increase from 5.75% to 6.5% on October 1, 1991.

2 State Tax Guide (CCH) P60-100.

Local Rates: At present there are thirteen different state sales and use tax rates and hundreds of local rates which vary by jurisdiction within each state. In the states where locally imposed taxes are collected by the state, vendors must still account separately for the following local taxes in their records and/or on their state tax returns: Alabama (counties-56, cities-240+); Alaska (boroughs-5, cities-94); Arizona (counties-9, cities-84); Arkansas (counties-56, cities-138); California (counties-58, cities-2,000+); Colorado (counties-39, cities-157); Florida (counties-25); Georgia (counties-148); Illinois (counties-8, cities-46, special districts-3); Iowa (counties-13); Kansas (counties and cities-200+); Minnesota (cities-2); Missouri (counties and cities-1400+); Nebraska (cities-45); Nevada (counties-7); New Mexico (counties-32, cities-104); New York (counties-61, cities-27); North Carolina (counties-76); North Dakota (cities-12); Ohio (counties-85); Oklahoma (counties-25, cities-480); Pennsylvania (cities-2); South Carolina (counties-6); South Dakota (cities-144); Tennessee (counties-95); Texas (counties-102, cities-1800+); Utah (counties-29); Virginia (all cities and counties); Washington (counties-38); Wisconsin (counties-40); and Wyoming (counties-17). Several states have local jurisdictions which separately administer and collect local taxes: Alabama (counties-5, municipalities-41); Alaska (cities-12); Arizona (cities-12); Colorado (cities-42); Louisiana (parishes and cities-240+); and Minnesota (city-1). See 2 State Tax Guide (CCH) P60-200 et seq.

Exemptions: Many states provide exemptions for: manufacturing machinery and equipment (some apply reduced rate); computer hardware; materials/packaging used in certain functions or processes; pollution control equipment; and agricultural or farm related equipment. See 2 Multi-state Corporate Tax Guide (Panel) 178-220.

Twenty-six states provide an exemption for the sale of food: Arizona, California, Colorado, Connecticut, District of Columbia, Florida, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, Texas, Vermont, Washington, and Wisconsin; five states exempt food sales only if purchased with federally-funded food stamps: Arizona, District of Columbia, Iowa, Kentucky and Nebraska; and six states exclude candy or gum from the definition of food: Indiana, Minnesota, New Jersey New York, Texas and North Dakota. 2 State Tax Guide (CCH) P60-110.

Return Filing Requirements: Thirty-nine states require monthly returns: Alabama, Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, North Dakota (depending on sales level), Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota (Bi-Monthly), Tennessee, Texas, Vermont, Virginia, Washington, West Virginia and Wyoming.

Eight states require quarterly returns: California, Iowa, Missouri, New York, North Dakota, Pennsylvania, Utah and Wisconsin. All States Tax Guide (P-H) P250.

Refund Claims: Several states require the retailer (as opposed to the customer) to file refund claims: Alabama (joint customer/retailer petition allowed; Ala. Admin. Code r. 810-6-4-.16), Florida (Fla. Admin. Code r. 12A-1.014), Missouri (Mo. Code Regs. tit. 12, § 10-4.255), and Texas (Tex. Admin. Code, tit. 34, § 3.325). Kansas, Ohio and South Dakota require retailer claims unless the customer has paid the tax directly to the state. Kan. Admin. Regs. 92-19-49: Ohio Admin. Code § 5703-9-07; and South Dakota Rev. Info. Bull. re: Retailer refund claims.

Bond/Security and Service of Process: In thirty-six states the tax commissioner may require a retailer to post a bond or security when registering with the state to collect sales and use taxes: Ala. Code § 40-23-24 (1990); Ariz. Rev. Stat. Ann. § 42-1305.01 (1991); Ark. Reg. GR-88; Cal. Rev. & Tax Code § 6701 (West 1987); Conn. Gen. Stat. § 12-430 (1983); Fla. Stat. Ann. § 212.14(4) (West 1987); Idaho Code § 63-3625 (1989); Ill. Ann. Stat. ch. 120, P441a (Smith-Hurd 1991); Indiana Code § 6-2.5-8-1 (1989); Iowa Code § 422.30 (1990); Kan. Stat. Ann. § 79-3616 (1989); Ky. Rev. Stat. Ann. § 139.660 (Michie/Bobbs-Merrill 1991); Me. Rev. Stat. Ann., tit. 36 § 1759; Md. Tax-Gen. Code Ann. § 13-824(g) (1988); Mass. Regs. Code tit. 80, § 62C.66.1 (1988); Mich. Comp. Laws § 205.53 (1986); Minn. Stat. § 297A.28 (1991); Miss. Code Ann. § 27-65-27 (1990); Mo. Rev. Stat. § 144.087 (Supp. 1991); Neb. Rev. Stat. § 144.087 (Supp. 1991); Nev. Rev. Stat. § 372.510 (1986); N.J. Rev. Stat. § 54:32B-18 (1986); N.Y. Tax Law § 1137(e) (McKinney 1987); N.C. Reg. 46; N.D. Cent. Code § 57-40.2-07 (1987); Okla. Stat. tit. 68, § 1368 (1986); Pa. Stat. Ann. tit. 72, § 7277 (1990); R.I. Gen. Laws § 44-19-23 (1990); S.D. Cod. Laws Ann. § 10-46-24 (1989); Tenn. Code Ann. § 67-6-522 (1989); Tex. Tax Code Ann. § 151.251 (West 1982); Utah Code Ann. § 59-12-107 (1990); Vt. Stat. Ann. tit. 32, § 9776 (1981); Va. Code Ann. § 58.1-630 (Michie 1991); W. Va. Code § 11-15A-12 (1989); and Wis. Stat. § 77.61 (1989).

Seven states require the out-of-state vendor to appoint the Secretary of State as agent for service of process for sales/use tax purposes: Ga. Code Ann. § 48-8-65 (Michie 1982); Ill. Ann. Stat. ch. 120, P444i (Smith-Hurd 1991); Nev. Rev. Stat. § 372.540 (1986); Ohio Rev. Code Ann. § 5739.131 (Anderson 1986); Pa. Stat. Ann. tit 72, § 7245 (1990); R.I. Gen. Laws § 44-19-34 (1990); and Tex. Tax Code Ann. § 151.606 (West 1982).

Self-Assessment of Tax By Purchasers: Nine states utilize a mechanism for collecting use tax from purchasers by providing a separate line item on the individual income tax return filed by residents (references to 1990 tax forms): Idaho (Form 40, line 44), Indiana (Form IT-40, line 18), Kentucky (Form 740, line 23), Maine (Form 1040ME, line 19), New Jersey (Form NJ-1040, line 28), Utah (Form TC-40, line 19), Vermont (Form 103, line 9), West Virginia (Form IT-140, line 8), and Wisconsin (Form 1, line 17). Nine states, including North Dakota, provide a separate self-assessment return, often specifically referenced in the instructions to the individual income tax return: Illinois (Form ST-44), Michigan (Form C-3001), Minnesota (Form UT-1), Nevada (Form DOT-ST-19), North Carolina (Form E-554), North Dakota (F-22, North Dakota Use Tax Return), South Dakota (Form TF-125, Use Tax Form and Booklet), Virginia (Form ST-7), and Washington (Form REV 83.2501). Although California does not provide a separate form, specific reporting instructions are provided in the instructions to Forms 540A and 540, the individual income tax returns.

Anti-Bellas Hess Legislation: In addition to North Dakota, the following states have enacted anti-Bellas Hess legislation: Alabama: Ala. Code §§ 40-23-1 (Supp. 1990) (eff. 4-30-86) and 40-23-68 (eff. 9-01-91); Arizona: Ariz. Rev. Stat. Ann. § 42-1401 (1991) (eff. 9-15-89); Arkansas: Ark. Code Ann. §§ 26-53-102 and 26-53-121 (Mich. 1987) (eff. 2-11-87); California: Cal. Rev. & Tax. Code § 6203 (West Supp. 1991) (eff. 1-01-88, rev. 3-88); Colorado: Colo. Rev. Stat. §§ 39-26-102 (Supp. 1990) and 39-26-301 et seq. (Supp. 1990) (becomes effective when authorized by federal legislation); Connecticut: Conn. Gen. Stat. § 12-407 (West Supp. 1991) (eff. 7-01-89, rev. 10-89); Florida: Fla. Stat. §§ 212.0596 and 212.05 (1987) (eff. 10-01-87); Georgia: Ga. Code Ann. § 48-8-2(3)(H) (Supp. 1991) (eff. 7-01-90); Idaho: Idaho Code § 63-3611 (1989) (eff. 7-01-89); Illinois: Ill. Ann. Stat. ch. 120, P439.2 (Smith-Hurd 1991) (eff. 1-01-90); Iowa: Iowa Code Ann. § 422.43(12) (West 1990) (eff. 7-01-88); Kansas: Kan. Stat. Ann. § 79-3702 (1989) (eff. 7-01-90); Kentucky: Ky. Rev. Stat. Ann. § 139.340 (Michie/Bobbs-Merrill 1991) (eff. 7-15-88); Louisiana: La. Rev. Stat. Ann. §§ 47:301(4)(1) (West Supp. 1991) (eff. 10-90) and 47:305(E) (West Supp. 1991) (effective when authorized by federal legislation); Massachusetts: Mass. Gen. Laws Ann. ch. 64H, § 1 (1991), Tech. Info. Release 88-13 (1988) (holds application until authorized by federal legislation); Minnesota: Minn. Stat. § 297A.21 (West Supp. 1991) (eff. 6-01-88); Mississippi: Miss. Code Ann. §§ 27-67-3 and 27-67-4 (1990) (eff. 7-01-88); Missouri: Mo. Rev. Stat. §§ 144.605(2) and (14) (West Supp. 1991) (eff. 10-01-90); Nebraska: Neb. Rev. Stat. § 77-2702(21) (1990) (eff. 10-01-87); Nevada: Nev. Rev. Stat. § 372.728 (Supp. 1989) (eff. 10-01-89); New Mexico: N.M. Stat. Ann. § 7-9-10 (1990) (eff. 7-01-90), N.M.G.R. Tax Reg. 3(E):4 (eff. 7-01-91); New York: N.Y. Tax Law § 1101(b)(8) (McKinney 1987 and West Supp. 1991) (eff. 9-01-89); North Carolina: N.C. Gen. Stats. §§ 105-164.3 and 105.164.8 (1989) (eff. 1-01-89); Ohio: Ohio Rev. Code Ann. § 5741.01(H) (Supp. 1990) (eff. 10-05-87); Oklahoma: Okla. Stat. Ann. tit. 68, §§ 1354.3 and 1354.5 (West Supp. 1991) (eff. 7-01-86, rev. 6-87); Rhode Island: R.I. Gen. Laws § 44-18-23 (Supp. 1990) (eff. 9-01-90); South Carolina: S.C. Code Ann. §§ 12-35-95 and 12-36-80 and 12-36-70 (Law. Co-op. Supp. 1990) (eff. 6-22-87); South Dakota: S.D. Cod. Laws Ann. §§ 10-46-1 and 10-46-18.3 (1989) (eff. 7-01-87); Tennessee: Tenn. Code Ann. § 17-6-102(6) (1989) (eff. 1-01-89); Texas: Tex. Tax Code Ann. § 151.107 (West Supp. 1991) (eff. 7-22-87, rev. 10-01-87); Utah: Utah Code Ann. § 59-12-107(1) (West Supp. 1991) (eff. 7-01-90); Vermont: Vt. Stat. Ann. tit. 32, § 9701(9) (1981 and Supp. 1990) (eff. 7-01-90); Virginia: Va. Code Ann. § 58.1-612(c) (Michie 1991) (eff. 1991); Washington: Wash. Rev. Code Ann. § 82.12.040(1) (West Supp. 1991), Wash. Admin. Code R. 458-20-221 (eff. 4-89 by regulation); and West Virginia: W. Va. Code § 11-15A-6a (Supp. 1991) (eff. 7-01-89).

APPENDIX 4

National Meat Ass'n. v. Deukmejian, 743 F.2d 656, 658 n.1 (9th Cir. 1984), aff'd, 469 U.S. 1100 (1985) (reviewing nexus required for taxation of interstate commerce and noting lack of physical presence in Bellas Hess); Aldens Inc. v. LaFollette, 552 F.2d 745, 752-53 (7th Cir. 1977) (recognizing Bellas Hess as establishing the commerce and due process clause standards for taxing interstate vendors); Aldens Inc. v. Packel, 524 F.2d 38, 43 (3rd Cir. 1975), cert. denied, 425 U.S. 943 (1976) (citing Bellas Hess for the due process standard applied in tax cases); Direct Marketing Association v. Bennett, No. Civ. S-88-1067 (E.D. Cal. 1991) (1991 U.S. Dist. LEXIS 10736) (prohibiting California from imposing use tax collection obligations on mail order vendors whose only connection with the state is solicitation of sales and acceptance of credit cards issued by California financial institutions); Evanston Ins. Co. v. Merin, 598 F.Supp. 1290, 1305 (D.N.J. 1984) (focusing on Bellas Hess as the "leading case defining the minimal connection required" before a state can impose tax liability); Strescon Industries, Inc. v. Cohen, 508 F.Supp. 786, 788-89 (D. Md. 1981), aff'd, 664 F.2d 929 (4th Cir. 1981) (recognizing Bellas Hess as the standard which would apply to determine constitutional nexus); Aldens, Inc. v. Miller, 466 F.Supp. 379, 382-83 (S.D. Iowa 1979), aff'd 610 F.2d 538 (8th Cir.), cert. denied, 446 U.S. 919 (1980) (due process nexus standard of Bellas Hess applies to tax cases); Confederated Tribes of the Colville Indian Reservation v. State of Washington, 446 F.Supp. 1339, 1357 (E.D. Wash. 1978), rev'd in part, 447 U.S. 134 (1980) (under Bellas Hess, commerce clause test is satisfied if "some definite link" or "minimum connection" with the taxing jurisdiction); Boswell v. Paramount Television Sales, Inc., 282 So.2d 892, 897 (Ala. 1973) (recognizing that Bellas Hess requires physical presence); White v. Kimberly-Clark Corporation, 503 So.2d 296, 301 (Ala. Cir. App. 1986), aff'd 503 So.2d 304 (Ala. 1987) (quoting Wisconsin v. J.C. Penny Co. as cited in Bellas Hess for the due process standard established by these cases); Illinois Commercial Men's Ass'n v. State Bd. of Equal., 671 P.2d 349, 355 (Cal. 1983), app. dism'd, 466 U.S. 933 (1984) (distinguishing Bellas Hess because presence of agents in state in this case formed "minimum connection" required to justify imposition of tax); Montgomery Ward & Co. v. State Board of Equal., 78 Cal. Rptr. 373, 381 (Cal. Ct. App. 1969), cert. denied, 396 U.S. 1040 (1970) (analyzing Bellas Hess and the constitutional principles addressed therein); Associated Dry Goods v. City of Arvada, 593 P.2d 1375, 1377 n.2 (Colo. 1979) (recognizing that delivery by mail or common carrier is insufficient nexus connection for taxation); SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 670 (Conn.), cert. denied, 111 S. Ct. 2839 (1991) (holding nexus

requirement of Bellas Hess not satisfied where mail order company mailed catalogs, provided toll-free "800" number and used magazine advertising to solicit sales from in-state customers); Cally Curtis Co. v. Groppo, 572 A.2d 302, 305 (Conn.), cert. denied, 111 S. Ct. 77 (1990) (following Bellas Hess in finding company not taxable based on leased films in the state); Reader's Digest Ass'n v. Mahin, 255 N.E.2d 458, 460 (Ill. App.), cert. denied, 399 U.S. 919 (1970) (finding nexus based on resident solicitors and local advertising); Good's Furniture House, Inc. v. Iowa State Board of Tax Review, 382 N.W.2d 145, 149-50 (Iowa), cert. denied, 479 U.S. 817 (1986) (finding nexus test as refined by Bellas Hess and National Geographic satisfied by in-state activities); Sabine Pipe and Supply Company v. MacNamara, 411 So.2d 1167, 1169 (La. App. 1982) (recognizing state cannot compel out-of-state seller to collect use taxes under Bellas Hess although taxes collected voluntarily must be paid over to state); Burke & Sons Oil Co. v. Director of Revenue, 757 S.W.2d 278, 280 (Mo. App. 1988) (stating that Bellas Hess establishes that "communicating with customers in a state by mail or common carrier as part of a general interstate business does not create a sufficient nexus"); Alaska Airlines, Inc. v. Dept. of Revenue, 769 P.2d 193, 198 (Or. 1989), cert. denied, 110 S. Ct. 717 (1990) (noting that Bellas Hess provides the standard by which nexus is judged); Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania, 567 A.2d 773, 777 (Pa. Commw. 1989), aff'd per curiam, 591 A.2d 1047 (Pa. 1991), cert. applied for sub nom. Penn. v. Bloomingdale's By Mail, Ltd., No. 91-383 (applying commerce clause and due process clause standards of Bellas Hess in analyzing whether mail order vendors had sufficient nexus with state); Fingerhut Corporation v. Commonwealth Pennsylvania, 275 F&R 1990, 1990 Pa. Tax LEXIS 1048 (Pa. Commw. 1990) (holding out-of-state vendor conducting business by mail, telephone and common carrier not liable under holdings of Bellas Hess as well as other U.S. Supreme Court and Pennsylvania court decisions); L.L. Bean, Inc. v. Commonwealth of Pennsylvania, 516 A.2d 820 (Pa. Commw. 1986) (holding insufficient nexus between mail order company and state based on Bellas Hess and Miller Bros.); Pearle Health Services, Inc. v. Taylor, 799 S.W.2d 655, 658 (Tenn. 1990) (citing Bellas Hess as the standard for constitutional limits on taxing companies whose only contact is by mail and common carrier); Rowe-Genereux, Inc. v. Vermont, 411 A.2d 1345, 1348 (Vt. 1980) (citing Bellas Hess in analyzing long line of tax nexus standard cases). See also Land's End, Inc. v. California State Board of Equalization, No. 620135 (San Diego Superior Court, Cal. 1991), appeal docketed, No. D014839 (Cal. App. 4th July 15, 1991) and Sturbridge Yankee Workshop, Inc. v. State Board of Equalization, No. 512584 (Sacramento Superior Court, Cal. 1991), appeal docketed, No. C011169 (Cal. App. 3d May 30, 1991) (holding out-of-state mail order vendors not liable for collection of California use taxes on facts substantially similar to Bellas Hess).

QUILL CORPORATION, Petitioner, v. STATE OF NORTH DAKOTA,by and through its Tax Commissioner, HEIDI HEITKAMP, Respondent.
No. 91-194

1991 U.S. Briefs 194

October Term, 1991

December 26, 1991

On Writ Of Certiorari To The Supreme Court Of The State OfNorth Dakota

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

Whether, under the commerce clause and the due process clause of the fourteenth amendment, North Dakota may apply its use tax collection statute to a direct marketer that has established minimum contacts with the state by purposefully availing itself of carrying on business within the state.

STATEMENT OF THE CASE

North Dakota use tax law requires "every retailer maintaining a place of business in this state" to collect use tax from its customers. N.D. Cent. Code § 57-40.2-07 (Supp. 1991). In 1987 the definition of "retailer maintaining a place of business" was amended to include a retailer who regularly or systematically solicits sales in North Dakota through various means of communication. N.D. Cent. Code § 57-40.2-01(7) (Supp. 1991); Pet. App. A47-A48. "Regular or systematic solicitation" is defined as three or more separate transmittances of advertisements during a specified twelve month period. N.D. Admin. Code § 81-04.1-01-03.1(3); Pet. App. A56-A57.

Petitioner Quill Corporation ("Quill"), one of the nation's largest direct marketers of office supplies and equipment, is incorporated in Delaware, and maintains its principal place of business in Lincolnshire, Illinois, with offices and warehouses in Illinois, California, and Georgia. J.A. 28.

Quill solicits sales through the mailing of catalogs and advertising flyers to customers throughout the United States, including several thousand North Dakota customers. J.A. 29; Brief in Response to Defendant's Motion for Partial Summary Judgment and in Support of Tax Commissioner's Cross-Motion for Summary Judgment, Mar. 18, 1990, ("T.C. Response") Ex. D at 8-9.

Proceedings Below

Respondent State of North Dakota ("North Dakota"), through its State Tax Commissioner ("Tax Commissioner"), notified Quill in 1989 that Quill was statutorily required to obtain a permit and remit use tax on its sales to North Dakota customers. J.A. 6. When Quill failed to comply, North Dakota filed a declaratory judgment action in North Dakota district court asking that Quill be declared a retailer maintaining a place of business in North Dakota. J.A. 5-6. Quill resisted, arguing that N.D. Cent. Code §§ 57-40.2-01(6),(7) and 57-40.2-07, as applied to Quill, violate the due process and commerce clauses of the United States Constitution as interpreted in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). J.A. 14-17.

Deciding cross-motions for summary judgment, the district court found persuasive the state's arguments that the use tax statute as applied to Quill was constitutional, Pet. App. A40; however, the court concluded that the facts in Quill were indistinguishable from the facts in Bellas Hess and held that the statute was unconstitutional as applied to Quill. Pet. App. A42. North Dakota appealed to the North Dakota Supreme Court. Notice of Appeal, June 27, 1990; J.A. 2. On review, the North Dakota Supreme Court reversed, concluding that

Quill's significant economic presence within the State and its retained ownership of property within the State generate a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax.

Pet. App. A35-A36. Quill then petitioned this Court for review. The Court granted review on the first question presented in Quill's petition (concerning the application of Bellas Hess to this case) and denied review on the second question presented (concerning the retroactivity of a holding that Quill is required to collect the use tax). J.A. 52.

Statement of Facts

Quill enjoyed annual gross sales in excess of $200,000,000 nationwide and North Dakota gross sales in excess of $970,000 during the tax periods at issue. T.C. Response, Ex. D at 6-7. Quill's net North Dakota sales (gross sales less returns) were $925,000 annually, making Quill the sixth largest retailer of office supplies and equipment in North Dakota. Id.; J.A. 38-39; J.A. 43. Quill paid neither the North Dakota use tax nor the Illinois sales tax on its North Dakota sales. T.C. Response, Ex. D at 5-6.

Quill sells more than 9,500 different office products ranging from computers to staples. T.C. Response, Ex. D at 6. All of the office products Quill sells to North Dakota consumers are subject to the state's sales or use tax if purchased by anyone other than a person holding an exemption or a resale certificate. Id. Quill's principal customers are businesses that purchase Quill's products for their own use. Quill has 3,427 active North Dakota customers, and advertises its products to the North Dakota customers and others by mailing catalogs and flyers, by placing advertising materials in nationally circulated card packs, and by placing magazine advertisements in nationally distributed periodicals and trade journals. T.C. Response, Ex. D at 8, 10, 11-12, 13.

Quill solicits North Dakota businesses with 62 different bulk mailings of its catalogs and flyers annually, sending 230,000 pieces of mail, weighing more than 48,000 pounds, into the state each year. T.C. Response, Ex. D at 9-10. Quill's active customers may receive as many as five different mailings per month. Schwartz, "Quill Bares Its Teeth in Battle with Office Supply Superstores," 30 Adweek's Marketing Week, Nov. 27, 1989, at 19. Quill employees also conduct telephone solicitations of its active North Dakota customers. T.C. Response, Ex. D at 11-13 and Ex. 1 at 2.

Quill maintains a telephone bank of 95 operators in Lincolnshire, Illinois, to receive customer orders. Of the more than 200,000 nationwide orders Quill receives each month, approximately 50% are received by phone, with the remaining orders taken by a combination of mail, fax, telecopy, telex, and computer modem. T.C. Response, Ex. D at 14-15.

Quill service representatives communicate, by telephone, with customers to assist in the selection of custom printing orders and to handle problems with the print orders forwarded to Quill. T.C. Response, Ex. H at 9 and Ex. F at 10-11. Quill maintains a telephone "help line" to assist customers with questions or problems that may arise after the customer receives the merchandise. T.C. Response, Ex. 1 at 6-7.

Quill has licensed to North Dakota customers a computer software program, Quill Service Link ("QSL"), which allows direct communication between Quill and its customers via computer modem. T.C. Response, Ex. F at 8-9 and Ex. A attached thereto. Quill issues a packet containing two floppy diskettes to the customers who purchase QSL. The customers must insert the diskettes into their own computers to communicate with Quill. T.C. Response, Ex. I at 20-21. Quill retains title to the diskettes and the software program while the diskettes are in the customer's possession. T.C. Response, Ex. F at 8-9 and Ex. A attached thereto. With QSL, a customer may determine inventory availability, check price lists, order merchandise, and communicate with others having access to Quill's computers via an electronic bulletin board. Id. Quill can also initiate communications with its customers via QSL. Id.

All of Quill's merchandise is sold on the basis that its customers must be "100% satisfied." To back this guarantee, Quill provides free trial periods and a ninety-day period within which the customer may return merchandise to Quill for any reason. T.C. Response, Ex. F at 14-15 and Ex. B attached thereto. Prices in Quill's semiannual catalogs are guaranteed for six months and in its sales flyers for up to two months. T.C. Response, Ex. H at 9 and Ex. 5 attached thereto at 1.

Before December 1989 Quill sold merchandise only upon an open account, accepting only money orders or checks drawn on the customer's bank account. T.C. Response, Ex. D at 20 and Ex. K at 4. In December 1989 Quill began accepting credit cards as payment in all states except North Dakota. T.C. Response, Ex. H at 16-21 and Dep. Ex. 1 attached thereto.

Quill employees conduct credit checks on its customers, telephoning North Dakota customers and North Dakota banks and financial institutions to verify credit information. T.C. Response, Ex. D at 22-23 and Ex. F at 3. Credit checks on certain customers are also performed by Quill employees at the Illinois location by mail, telephone, and telecopy. Id.

Quill directly competes with North Dakota office supply and equipment retailers. T.C. Response, Ex. M. Quill employees conduct telephone price surveys of various merchants in order to price Quill's products competitively. Id. Potential Quill customers in North Dakota have used Quill's catalogs and flyers to negotiate lower prices from local office supply and equipment retailers. Id. These customers then have told North Dakota retailers that they do not want to pay the North Dakota sales tax because Quill does not charge tax on its sales. T.C. Response, Ex. D at 11-13 and Ex. 1 at 2.

Direct marketing has been defined by industry experts as "the distribution of goods, services, or information to targeted consumers through response advertising while keeping track of sales, interest, behavior, wants and needs in a relational computer database." Rapp, "The Tower of Babel," 54 Direct Marketing Magazine 1, May 1991, at 76. Direct marketers today use a full panoply of communications techniques, including bulk mailings, telephone and fax communications, and computer technology, as well as other telemarketing methods. n1

n1 For in-depth factual treatment of the mail-order industry and the use tax collection issue, see Defendant's Brief in Response to Plaintiff's Cross-Motion for Summary Judgment and Reply Brief, Ex. N.

The mail order component of direct marketing (referred to by one author as "direct-order-marketing") has been further described as

all forms of business based on selling goods or services directly to the public without an intermediary, while obtaining orders by means of direct-response advertising in magazines and newspapers, on television or radio, by direct mail or in any other medium and delivering [the product or service] to the customer's address.

Id. It is estimated that between 65% and 75% of all American households now receive mail order catalogs each year. Fishman, 1990 Guide to Mail Order Sales (Lincolnshire, Illinois: Marketing Logistics, Inc.) 1991, at X-13. In 1990 alone 13.7 billion catalogs were mailed; this amounts to a 74% increase since just 1982. Direct Marketing Association, Inc., DMA Statistical Fact Book 1991-1992 ("DMA Stat. Book") at 88. Quill, by itself, accounts for the mailing of 65,000,000 pieces of mail a year. Schwartz, supra, p. 4 at 18-19.

Outbound telemarketing (the solicitation of business by telephone) has grown dramatically in the past decade because of the reduction in the cost of long-distance telephone service. Spending on outbound telemarketing is now estimated at $30,000,000,000 annually. Baier, Hoke, Jr., Stone, "Direct Marketing Flow Chart," 54 Direct Marketing Magazine 6, Oct. 1991, at 2.

In the 1990's undoubtedly even more direct marketers will follow Quill's lead in relying on technological advancements in computer software programming, database management, fax machines and telephones to communicate more effectively with customers than by mail. n2 Direct marketing service experts have predicted that in the 1990's direct marketers will receive more orders by fax than by mail, and that more catalogs will be delivered in the format of interactive media, such as television, video disk and on-line computer systems. Haggin and Kartomten, "Predictions for the 1990's," 7 Catalog Age 3, Mar. 1990, at 95-96.

n2 A database provided by one computer service company costs only $695 and provides information useable by business-to-business direct marketers on 7,000,000 companies, segmenting these companies by geographic area, sales volume and industry type. See 54 Direct Marketing Magazine 4 (Aug. 1991), at 14. Additionally, the National Center for Database Marketing has even been developed to present conferences on the use of databases for direct marketing. 53 Direct Marketing Magazine 10 (Feb. 1991), at 25-26.

Interactive voice response technology will be in widespread use in the near future. This technology permits a customer to place an order by merely pressing a few buttons on a touch-tone telephone. Deloitte and Touche, A Special Report on the Impact of Technology on Direct Marketing in the 1990s (New York: Direct Marketing Association, Inc.) 1990, at 45-47. Interactive television, which is currently being developed, provides a direct electronic linkage between the viewer and the broadcaster. Future transmission of interactive television via fiber-optic cable will enable the viewer to request specific product displays on the viewer's television screen at any time and to place purchase orders directly over the same cable that sends the television program. Id. at 51.

Based in part upon the technological advancements described above, the direct marketing industry has grown from sales of $2,400,000,000 in the days of Bellas Hess, to a $130,400,000,000 industry today. See Bellas Hess, 386 U.S. at 763; Advisory Commission on Intergovernmental Relations ("ACIR"), State Taxation of Interstate Mail-Order Sales: Revised Revenue Estimates, 1990-1992, Dec. 1991, at 3 (report updating the ACIR's two earlier reports, State and Local Taxation of Interstate Mail Order Sales (A-103), Apr. 1986, and Estimated Revenue Potential from State Taxation of Out-of-State Mail Order Sales (SR-5), Sept. 1987. As a direct result of the shifting of purchases to out-of-state direct marketers, the 1991 uncollected use tax loss from mail order sales is estimated to be $3,080,000,000 with a $3,270,000,000 projected tax loss for 1992. Id. at 2.

SUMMARY OF ARGUMENT

In accordance with the fundamental fairness principle that is at the heart of both the due process and commerce clauses, North Dakota may constitutionally impose a use tax collection obligation on Quill, a direct marketer that has established minimum contacts with the state by purposefully availing itself of the substantial privilege of carrying on business within the state.

The essence of Quill's argument is that this Court's 1967 decision in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), established a rule that a state may impose a use tax collection obligation only on an out-

of-state business that has a physical presence in the state. Pet. Br. at 18. Assuming this is the correct construction of Bellas Hess, the underpinnings of that decision have been repudiated by this Court. Further, under current commerce clause and due process jurisprudence, fundamental fairness is served when a multistate business having sufficient minimum contacts with a state pays for the benefits it receives from the state and competes on a level playing field with other businesses.

Bellas Hess is grounded on an interpretation of the commerce clause that prohibited all state taxation of businesses engaged in interstate commerce. This Court rejected that formalistic free trade interpretation of the commerce clause in 1977. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Court, instead, adopted a test that considers the practical effects of a tax statute on multistate businesses. Under the Complete Auto four-prong test, application of a state tax statute to multistate businesses is constitutional when the tax: 1) is applied to an activity with a substantial nexus with the taxing state; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services provided by the state. Id. at 279.

The second and third prongs of the Complete Auto test state traditional commerce clause principles: A state may only tax its fair share of an interstate transaction (avoiding duplicative taxation), and multistate businesses must be allowed to compete with local business on a fair, nondiscriminatory basis. The commerce clause does not create a nationwide tax-free haven for multistate business. North Dakota's use tax statute comports with these commerce clause principles because it cannot result in duplicative taxation and treats multistate business on the same terms as in-state business.

The remaining prongs of the Complete Auto test embody traditional due process concerns of fair play and substantial justice. Applying the due process principles that govern both personal jurisdiction and taxing jurisdiction, a state may impose a tax on a multistate business when that business has sufficient minimum contacts with the state, International Shoe Co. v. Washington, 326 U.S. 310 (1945), and there is a fair relation between the tax and the benefits received, Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940). This due process fairness standard has been articulated more clearly in the taxing context in decisions concluding that authority exists when a marketer has purposefully "avail[ed] itself of the substantial privilege of carrying on business within the State." Mobil Oil Corp. v. Commissioner, 445 U.S. 425, 437 (1980). This functional test, which permits a court to consider a variety of factors in determining nexus, is more fundamentally fair than an arbitrary physical presence test which is dependent upon what may be the mere happenstance of the location of a piece of property.

Quill has regularly and systematically solicited North Dakota's consumer market through its bulk mailings into the state, and telephone, fax, telex, and computer modem connections with its North Dakota customers. It is the sixth largest retailer of office supplies and equipment in North Dakota. Quill has received substantial benefits from the state, including state laws that create the commercial structure within which an orderly marketplace may function. Requiring Quill to pay its own way for these benefits is not only fair to Quill and the state, but also to the local merchants and multistate direct marketing businesses that have physical property in the state.

Quill's administrative cost of complying with the North Dakota use tax statute is simply a cost of doing business and is irrelevant to the constitutional analysis. In addition, computer technology already exists which would allow Quill to comply readily with its use tax collection obligations. Requiring Quill to collect and remit the state's use tax would not be unduly burdensome and would not violate either the due process clause or the commerce clause.

Even under the nexus test Quill promotes, Quill has sufficient contacts in North Dakota to require Quill to comply with its use tax law. These contacts include: 1) Quill's retention of title to the QSL diskettes and software property that its customers use in North Dakota; 2) Quill's many telephone, telex, fax, and computer modem connections with North Dakota residents; and 3) Quill's delivery into North Dakota of 24 tons of catalogs and advertising flyers that must be processed through North Dakota's waste disposal system.

A decision that Quill must bear the administrative duty of collecting the state's use tax from its North Dakota customers will result in Quill, its multistate and in-state competitors, and the citizens of North Dakota being accorded the fairness the Constitution requires.

ARGUMENT

I. THE PHYSICAL PRESENCE TEST ESPOUSED BY QUILL IS NOT SUPPORTED BY THE CASE LAW AND DOES NOT ACHIEVE THE FAIR RESULT REQUIRED BY THE DUE PROCESS AND COMMERCE CLAUSES.

North Dakota imposes a sales tax on sales of tangible personal property made within the state's boundaries. N.D. Cent. Code ch. 57-39.2 (1983 & Supp. 1991). North Dakota also imposes a use tax on the in-state use of property which was purchased outside of the state and upon which no sales tax was paid. Id. ch. 57-40.2. The state sales and use tax rates are identical. Id. §§ 57-39.2-02.1, 57-40.2-02.1 (Supp. 1991).

State use taxes are enacted to prevent state residents from avoiding payment of the state sales tax by making purchases outside the state. In addition, use tax laws "put local retailers subject to the sales tax on a competitive parity with out-of-state retailers exempt from the sales tax." National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 555 (1977); see also Boeing Co. v. Omdahl, 169 N.W.2d 696, 714 (N.D. 1969). This Court has recognized the "impracticability of collecting the state's use tax from the multitude of individual purchasers." National Geographic, 430 U.S. at 555. Because of this collection difficulty, states place the burden of collecting use taxes on out-of-state sellers. See generally Hartman, Collection of the Use Tax on Out-of-State Mail-Order Sales, 39 Vand. L. Rev. 993, 994-95 (1986); McCray, Commerce Clause Sanctions Against Taxation on Mail Order Sales: A Re-Evaluation, 17 Urb. Law. 529, 557 (1985).

In 1967 this Court held that state and local governments may not impose a use tax collection duty on an out-of-state mail order firm that communicates with local purchasers in the taxing jurisdiction only by mail or common carrier as part of a general interstate business. National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). Quill construes Bellas Hess as holding that out-of-state firms must maintain a physical presence in a state to be subject to the state's tax jurisdiction. See Pet. Br. at 18.

Bellas Hess, a national mail order firm, argued that the Illinois statutes requiring it to collect use taxes violated the due process clause and created an unconstitutional burden on interstate commerce. The Court found the application of the Illinois statutes to Bellas Hess unconstitutional, but it did not clearly articulate whether its holding was grounded on the commerce clause, the due process clause, or both. Bellas Hess, 386 U.S. at 756, 758-760.

Whatever the doctrinal basis for the Bellas Hess decision, the case is distinguishable from the facts here because, unlike Bellas Hess, Quill owned property physically present in the taxing jurisdiction. n3 The more fundamental reason for not applying Bellas Hess to this case is that the underpinnings of that decision have been removed by this Court's subsequent decisions and does not comport with current due process and commerce clause jurisprudence. Therefore, the argument that a physical presence in the taxing jurisdiction is required for taxing authority to exist should be rejected.

n3 See discussion of Quill's contacts with North Dakota, infra, at 29-31, 45-47.

II. THE BELLAS HESS DECISION WAS BASED ON THE FREE TRADE COMMERCE CLAUSE DOCTRINE THAT WAS OVERRULED IN COMPLETE AUTO.

Because it is unclear whether the Bellas Hess holding was grounded on the due process clause or the commerce clause, both issues will be addressed in this brief. However, due process decisions rendered at the time of the Bellas Hess decision and the language of Bellas Hess itself indicate that the ruling was based primarily, if not completely, on commerce clause considerations.

At the same time the Court decided Bellas Hess, it dismissed for want of substantial federal questions two appeals in which state courts, under the due process clause, had found taxing or regulatory nexus where there was no in-state physical presence. The two cases involved pure due process considerations because they concerned the insurance industry, an area over which Congress has removed all commerce clause restrictions. McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1982)). In Ministers Life & Casualty Union v. Haase, 30 Wis. 2d 339, 141 N.W.2d 287, appeal dismissed, 385 U.S. 205 (1966), the state court upheld state taxation and regulation of an out-of-state insurance company that did business only by mail and national advertisements. In People v. United Nat'l Life Ins. Co., 66 Cal. 2d 577, 427 P.2d 199, 58 Cal. Rptr. 199, appeal dismissed, 389 U.S. 330

(1967), the court held that the state could require an out-of-state insurance firm to obtain a certificate of authority to sell insurance by mail. These summary dismissals demonstrate that even at the time Bellas Hess was decided, the Court did not require physical presence to establish nexus under the due process clause.

The language of Bellas Hess also demonstrates that the decision was premised on a "free trade" interpretation of the commerce clause. The Court wrote:

[i]f the power of Illinois to impose use tax burdens upon [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. . . .

The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

Bellas Hess, 386 U.S. at 759-60 (emphasis added) (footnote omitted). This analysis embodies the very essence of the free trade rule articulated in Freeman v. Hewitt, 329 U.S. 249 (1946), and in Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951), overruled, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Freeman and Spector stood for the proposition that "a tax on the 'privilege' of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce. . . . [This] rule reflect[ed] an underlying philosophy that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation." Complete Auto, 430 U.S. at 278 (footnote omitted).

The Bellas Hess commerce clause analysis, which was based on the free trade, tax immunity approach of Freeman and Spector, has been soundly rejected by this Court because it did not address "the problems with which the Commerce Clause is concerned." Id. at 288. To the extent that Bellas Hess has been interpreted to require physical presence for taxing nexus, the fundamental change in the law under Complete Auto compels a rejection of that interpretation.

III. THE NORTH DAKOTA USE TAX STATUTE IS CONSTITUTIONAL AS APPLIED TO QUILL BECAUSE IT SATISFIES THE FOUR-PRONG TEST OF COMPLETE AUTO AND DUE PROCESS CASE LAW.

The most basic goal of the commerce clause is to ensure that out-of-state businesses are not placed at a competitive disadvantage and may compete with local businesses on a level playing field. See Complete Auto, 430 U.S. at 288 (1977) (quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254-256 (1938)). Where interstate commerce is accorded equal treatment with local commerce, the challenged state tax will be sustained. See, e.g., Tyler Pipe Industr., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232, 243-247 (1987); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 272 (1984); Maryland v. Louisiana, 451 U.S. 725, 759 (1981); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 331 (1977).

It is indeed ironic that Quill relies upon the commerce clause to maintain a tax-free mail order haven. Instead of "employing the Commerce Clause as a shield against unfair, discriminatory practices [that favor] local merchants, Quill . . . raises the Commerce Clause as a sword to carve out a tax-free mail order niche and gain an unfair competitive advantage over local retailers." North Dakota v. Quill Corp., 470 N.W.2d 203, 215 (N.D. 1991) Pet. App. A25.

Quill's theory places multistate businesses not on a level playing field with "Main Street" businesses but in a privileged position and at a competitive advantage. This Court has rejected this result. In Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-24 (1981), the Court found:

The exploitation by foreign corporations . . . of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations. . . . To accept appellants' apparent suggestion that the Commerce Clause prohibits the States from requiring an activity connected to interstate commerce to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity, would place such commerce in a privileged position. But . . . [i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.

(Citations and internal quotation marks omitted.)

All businesses that have sufficient contacts with a state must pay their own way. Requiring those businesses to collect the state's use tax ensures a level commercial playing field; this is all that North Dakota seeks.

In Complete Auto the Court rejected the formalistic Spector rule that any direct tax on interstate commerce is unconstitutional per se and, instead, adopted a test based on the practical effects of the tax statute in question. Complete Auto, 430 U.S. at 279. Under the rule announced in Complete Auto, a state tax will survive a commerce clause challenge "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." Id.

A. The North Dakota Use Tax Statute Is Fairly Apportioned And Does Not Discriminate Against Interstate Commerce.

The second and third prongs of the Complete Auto test address traditional commerce clause concerns, i.e., apportionment and allocation.

"Fair apportionment" of taxes requires that each state tax only its fair share of an interstate transaction; this avoids the risk of multiple taxation. Goldberg v. Sweet, 488 U.S. 252, 260-261 (1989). Because the use tax at issue here is assessed on individual sales to individual consumers and is collected by the retailer for each such purchase, the transaction cannot result in duplicative taxation. Additionally, in the unlikely event that a sales or use tax has already been paid on the same item or transaction, North Dakota provides a credit for that amount, thus precluding any actual multiple taxation. N.D. Cent. Code §§ 57-40.2-04(1), 57-40.2-11 (1983 & Supp. 1991).

The North Dakota use tax collection responsibility does not discriminate against interstate commerce by allocating a larger share of the tax burden to out-of-state retailers. The state sales tax rate is the same as the state use tax rate, the collection responsibility is applied uniformly to sales made by in-state retailers and by out-of-state retailers, and the same administrative allowance is provided to both in-state and out-of-state retailers. See id. §§ 57-39.2-02.1, 57-39.2-12.1, 57-40.2-02.1 (Supp. 1991), 57-40.2-07.1 (Supp. 1991).

B. Complete Auto And The Due Process Clause Require Minimum Contacts With The State And A Fair Relationship Between The Tax Imposed And The In-State Activities.

The first and fourth prongs of the Complete Auto test are "a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818, 828 (1991) (quoting Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 436-437 (1980) (internal quotation marks omitted). The Court has recognized that these two prongs of the Complete Auto test embody due process principles. Id. ("The Complete Auto test, while responsive to Commerce Clause dictates, encompasses as well the[se] Due Process requirement[s] . . ."); see also Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66, 79 (1989) ("[T]he Complete Auto test encompasses due process standards."); I J. Hellerstein, State Taxation, § 4.8 (1983). Therefore, the first and fourth prongs of the Complete Auto test may be analyzed in conjunction with the due process clause.

The due process nexus requirement is grounded on the principle that a state may not assert authority over an out-of-state entity in a manner that "offend[s] 'traditional notions of fair play and substantial justice.'" International Shoe, 326 U.S. at 316. This "fair play" principle assures that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." J.C. Penney at 444. n4

n4 Although the Court certainly has the power to delineate constitutional standards for state tax statutes, the Court has maintained a long tradition of allowing states to set their own revenue policies:

Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize.

J.C. Penney, 311 U.S. at 445.

The controlling question here is whether it is fundamentally fair for North Dakota to require Quill to collect the North Dakota use tax. International Shoe and J.C. Penney established the two elements of the due process taxing jurisdiction standard: 1) minimum contacts (International Shoe) and 2) a fair relation between the tax and benefits received (J. C. Penney). These two elements both relate to the fundamental fairness of imposing a tax. Fundamental fairness is the essence of the due process clause. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 477-478, 487 (1985).

Nothing in the policies underlying the requirements of the due process clause suggest that a business, such as Quill, which conducts a regular and systematic retail sales campaign in competition with North Dakota "Main Street" retailers, must be exempt from all state taxation. This is particularly the case when the levy involved is a use tax, for which "[t]he out-of-state seller becomes liable . . . only by failing or refusing to collect the tax from that resident consumer. . . . [T]he sole burden imposed upon the out-of-state seller by [a use tax statute] is the administrative one of collecting it." National Geographic, 430 U.S. at 558. It hardly offends traditional due process notions of fair play to make the marketer the tax collector for the State when the taxed activity results from the marketer intentionally projecting its presence into the state. See General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335, 338 (1944).

1. Quill Has Minimum Contacts Sufficient To Satisfy The Due Process And Commerce Clause Requirements.

a. The same minimum contacts standard should be applied in tax jurisdiction and personal jurisdiction cases.

The Court held in International Shoe, a case involving both personal jurisdiction and taxing jurisdiction, that due process objections to personal jurisdiction and state taxing authority are judged by the same standard: "The activities which establish [the taxpayer's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." International Shoe, 326 U.S. at 321. This is hardly surprising, as the "minimum contacts" formula is the touchstone in each setting. See Burger King, 471 U.S. at 474 (personal jurisdiction); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297 (1980) (personal jurisdiction); National Geographic, 430 U.S. at 561 (taxing authority); Miller Bros. Co. v. Maryland, 347 U.S. 340, 345 (1954) (taxing authority).

The Court in Shaffer v. Carter, 252 U.S. 37 (1920), recognized that jurisdiction to tax is coextensive with personal jurisdiction. In upholding the imposition of the Oklahoma income tax law to nonresidents with property or business in the state, the Court held that "[g]overnmental jurisdiction in matters of taxation, as in the exercise of the judicial function, depends upon the power to enforce the mandate of the state by action taken within its borders, eithern in personam or in rem." Id. at 49.

In addition to these cases, logic compels application of the same minimum contacts standard to personal and taxing jurisdiction questions. There is no qualitative difference between the consequences of a state's exercise of taxing authority and personal jurisdiction which would justify a more stringent test, or closer contacts, in the taxing case. There are potential burdens on out-of-state entities in both instances.

Imposition of a use tax collection responsibility requires collection and remittance of use tax. This is an obligation that is fixed and easy to ascertain. An out-of-state enterprise is only required to collect the statutorily established use tax and remit that amount to the state.

In the personal jurisdiction situation, an out-of-state business may be haled into a state's court and required to defend itself against any number of citizens' claims. The business must incur the cost of litigating a case outside its home state and may encounter the uncertainties of a trial before a court or jury in that "foreign" jurisdiction. In some instances, a state's exercise of personal jurisdiction over an out-of-state business may result (directly or indirectly) in extensive and continuing regulation of that business. For example, a defendant may face the possibility of a large damage award in a products liability case and be required to modify its business practices accordingly. In environmental and other regulatory cases, a state court exercising long-arm jurisdiction may impose even more direct regulation on an out-of-state business over which it has personal jurisdiction. In other cases that are appropriate for the forum state's exercise of its equitable powers, businesses may be permanently enjoined from or mandated to perform certain duties. See Rothfeld, "Mail-Order Sales and State Jurisdiction to Tax," 53 Tax Notes 12,Dec. 23, 1991, at 1410-1414.

The performance of an administrative duty, such as use tax collection, is not, as a constitutional matter, so different from other legal duties that a separate jurisdictional test is required. As long as the tax complies with the fair relations test of J. C. Penney, notions of fundamental fairness do not require a closer connection to tax than those required for an appearance in court.

b. Physical presence is not a necessary element of nexus for either personal jurisdiction or tax jurisdiction.

In personal jurisdiction cases, the Court has established that physical presence is not necessary for a state to exercise its jurisdiction. The Court held in Burger King that

[j]urisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are "purposefully directed" toward residents of another State, [the Court] ha[s] consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.

Burger King, 471 U.S. at 476 (emphasis in original); see also Keeton v. Hustler Magazine, Inc., 465 U.S. 770 (1984).

This Court has recently articulated how the nexus standard should apply to tax jurisdiction. The Court has held that taxing authority exists when the marketer has purposefully "avail[ed] itself of the substantial privilege of carrying on business within the State," Mobil Oil Corp. v. Comm'r, 445 U.S. 425, 437 (1980), or when "the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the state," Tyler Pipe Industr., Inc. v. Washington State Dep't. of Revenue, 483 U.S. 232, 250 (1987). This standard provides a functional test by which taxing nexus should be judged.

While physical presence may be relevant to a nexus inquiry, this Court has not equated nexus and physical presence. In Miller Bros., upon which the Bellas Hess Court relied, 386 U.S. at 756-57 n.9, the Court applied a nexus standard that requires a purposeful direction of commercial activities (often shown by regular or systematic solicitations) directed at in-state residents. There the Court held that Maryland lacked jurisdiction to impose a use tax collection responsibility on an out-of-state firm that, on occasion, sent its own delivery trucks into Maryland because there was "no invasion or exploitation of the consumer market in Maryland." Miller Bros., 347 U.S. at 347.

The due process analysis "cannot be simply mechanical or quantitative," International Shoe, 326 U.S. at 319, or "formulary," J. C. Penney, 311 U.S. at 445. Although a physical presence test maybe simple and absolute in its approach, it is incomplete and falls short of fully addressing economic realities. The ease with which a test may be administered is not determinative of the test's constitutional merit. As the Court recognized in Complete Auto,

[i]t might also be argued that adoption of a rule of absolute immunity for interstate commerce . . . would relieve this Court of difficult judgments that on occasion will have to be made. We believe, however, that administrative convenience, in this instance, is insufficient justification for abandoning the principle that "interstate commerce may be made to pay its way."

Complete Auto, 430 U.S. at 288-289 n.15.

Strict adherence to the concept of physical presence "is, as far as due process is concerned, the most pointless sort of formalism." Rothfeld, supra, p. 25 at 1413. Under the "bright line" physical presence test advocated by Quill, if a small multistate business were to sell a machine for $1,000 and hire an in-state contractor to install the machine, nexus would exist. In contrast, there would not be nexus when a multistate business systematically solicited the state's consumer market, sold millions of dollars of machinery, yet avoided maintaining an office, an employee, a contractor, or a piece of property in the state. Traditional due process notions of fair play and substantial justice are not satisfied by such a result.

The more reasoned approach here is to apply the due process minimum contacts standard provided by this Court in personal jurisdiction cases. This approach will best ensure that the ultimate purpose of the due process clause, fundamental fairness, is satisfied. n5

n5 The alleged commercial need for a bright line test is satisfied in the present case. By regulation, North Dakota has established a bright line. That is, a North Dakota use tax collection responsibility is invoked in any year Quill mails three or more separate bulk solicitations into the state. N.D. Admin. Code § 81-04.1-01-03.1(3). This bright line is not dependent on the sometimes fortuitous physical presence or "warm body" analysis. Hartman, supra, p. 14 at 1014. Rather, Quill has complete control over the events which lead to use tax collection responsibility. Other states have established similar de minimus standards. See note 19, infra.

It is beyond argument that North Dakota courts could assert personal jurisdiction over Quill if, for example, an in-state purchaser brought suit because he was injured by one of Quill's products. See Burger King, 471 U.S. at 473; World-Wide Volkswagen, 444 U.S. at 297-298; McGee v. International Life Ins. Co., 355 U.S. 220, 223 (1957); Hust v. Northern Log, Inc., 297 N.W.2d 429, 433 (N.D. 1980). In fact, Quill has never argued in the present case that the North Dakota courts lacked jurisdiction to resolve this dispute.

c. Quill has purposefully availed itself of the privilege of carrying on business in North Dakota.

Quill concedes that it has regularly and systematically solicited North Dakota's consumer market. Memorandum in Support of Defendant's Motion for Partial Summary Judgment, Dec. 18, 1989, at 10. Quill has purposefully "avail[ed] itself of the substantial privilege of carrying on business" within North Dakota. Mobil Oil, 445 U.S. at 437. During the 12-month period at issue, Quill mailed 230,000 pieces of mail, weighing more than 24 tons, to North Dakota residents. n6 Quill sent 62 different bulk mailings into North Dakota in the 12-month period. In contrast, Bellas Hess mailed two catalogs per year into Illinois to its active or recent customers; it also occasionally mailed flyers to both active and potential customers. Bellas Hess, 386 U.S. at 754. Quill directly entered the North Dakota market through its regular and systematic mailings to North Dakota consumers. These mailings created tons of garbage, which remain in North Dakota landfills.

n6 Quill mails into North Dakota each year 230,000 written solicitations in the form of bulk mailing of semiannual catalogs, monthly sales flyers, monthly tabloids, monthly multimailers, bimonthly computer supplies flyers, bimonthly furniture and office machine flyers, imprint products flyers, legal flyers, card packs, and filling flyers. T.C. Response, Ex. D at 10. On the average Quill made more than one mailing per week to its active North Dakota customers.

Quill is in close communication with its North Dakota customers, providing services traditionally performed only by local merchants. Quill targets its active customers in North Dakota, on an average basis sending them as many as five mailings per month. Quill maintains a telephone bank of operators to receive customer orders. Approximately 50 percent of the orders Quill receives are made by phone, with the remaining orders taken by a combination of mail, fax, telephone, telex, and computer modem. Quill maintains a telephone "help line" to assist customers with questions or problems that may arise after the customer receives the merchandise.

Quill's QSL software permits direct communications between Quill and its customers. With QSL, a customer may determine inventory availability, check price lists, order merchandise, and communicate with others having access to Quill's computers via an electronic bulletin board. Quill also can initiate communications with its customers via QSL. n7

n7 Quill's high-tech use of computer connections with its customers is representative of similar advancements being used by the direct marketing industry. Two nationwide networks, Prodigy and CompuServe, provide home shopping services via computer modem and now have more than 1.3 million subscribers. Fishman, "Mail Order Top 250," 54 Direct Marketing Magazine 3, July 1991, at 41-43. Through their computers Prodigy subscribers can make purchases of goods, services and securities, write checks, conduct other banking transactions and have access to more than 40

companies; more than 100 companies are accessible in CompuServe's "Electronic Mall." Id. at 40, 43. These networks are experiencing explosive growth, driven by the rapid penetration of personal computers into American households. Prodigy membership grew 125% in 1990 and CompuServe grew 77%. Id. at 40-41. Electronic purchasing transactions on Prodigy quadrupled in 1990. "On-Line Services," 53 Direct Marketing Magazine 9, Jan. 1991, at 14. It is predicted that there will be increased public acceptance of "video-text services" like Prodigy and CompuServe, thus increasing the shift of the sales tax base from customers of store-bound retailers to those using cable, fiber optic, and satellite communications. Deloitte and Touche, supra, p. 9 at 50. Marketers consider video-text users to be a highly desirable market segment. Id. CompuServe estimates that the average income of its household subscribers is $86,200. Fishman, "Mail Order Top 250," 54 Direct Marketing Magazine 3, July 1991, at 42. Thus, those without access to in-home computers with which to shop will continue to pay sales tax, while those having such access will often be able to avoid, should they desire to do so, the direct payment of any sales or use tax.

Quill's activities in the state have resulted in annual untaxed sales of nearly $1,000,000 to North Dakota customers. Through Quill's electronic communication and sophisticated computer marketing and mailing list techniques, Quill has intentionally projected its presence into the state and systematically exploited North Dakota's markets. It would be anomalous to hold that commercial entities may escape all taxation by the states from which they draw substantial benefits simply because they do not have a contractor, employee, traveling salesman, or office location in the state. Quill's almost $1,000,000 in annual sales proves it is present in North Dakota. Requiring Quill to collect the North Dakota use tax comports with fundamental fairness.

2. The North Dakota Use Tax Law Is Fairly Related To Quill's North Dakota Activity.

The fair relation test established in J. C. Penney and embodied in the fourth prong of the Complete Auto test is satisfied when "the measure of the tax [is] reasonably related to the extent of the contact." Commonwealth Edison, 453 U.S. at 626. This Court consistently has rejected assertions that the tax must be fixed or prorated to benefits to be constitutional. Rather, it is enough that a state "runs mass transit and maintains public roads which benefit [the taxpayer's] customers, and supplies a number of other civic services," D.H. Holmes Co. v. McNamara, 486 U.S. 24, 32 (1988), makes possible "'the benefit of a trained work force,'" Commonwealth Edison, 453 U.S. at 624 (citations omitted), or offers the taxpayer "other advantages of civilized society," Goldberg, 488 U.S. at 267. In such cases the tax is adequately "tied to the earnings which the State . . . has made possible, insofar as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes." J.C. Penney, 311 U.S. at 446; see also Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 188-191 (1989).

The Court repeatedly has held that there need not be a dollar-for-dollar correlation between the benefits conferred by the state and the tax imposed on an out-of-state commercial entity:

[t]he tax which may be imposed on a particular interstate transaction need not be limited to the cost of the services incurred by the State on account of that particular activity. . . . On the contrary, "interstate commerce may be required to contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct 'benefit.'".

Goldberg, 488 U.S. at 267 (emphasis in original) (quoting Commonwealth Edison, 453 U.S. at 627 n.16).

While it would be impossible to enumerate every way in which North Dakota services benefit Quill, many are readily apparent. State and local governments build and maintain the roads that permit Quill to ship its goods from out-of-state. The state also provides other general services that benefit Quill. North Dakota devotes a major portion of its resources to the education of its citizens, thereby encouraging a prosperous economy for the benefit of all businesses. The state-supported education system contributes to an ordered and civilized society, which benefits direct marketers as well as local businesses. These services alone would be sufficient to invoke the use tax collection duty.

North Dakota and its local governments also provide other services that are more directly related to the success of Quill and other direct marketers. One such benefit is the provision of reliable telephone service, which is regulated by the North Dakota Public Service Commission. See N.D. Cent. Code § 49-02-01 (Supp. 1991).

The benefits that direct marketers derive from state regulation of telephone service are closely intertwined with the benefits conferred by state regulation of financial institutions. See id. § 6-01-04 (1987). Modern direct marketers depend heavily on credit checks. The credit check system functions well because the state closely regulates banks, other financial institutions, and creditor networks. Quill employees also conduct credit checks on North Dakota customers by telephoning North Dakota financial institutions. Quill uses this information to make decisions about extending credit before shipping goods to North Dakota. Thus, Quill relies upon and benefits from this assistance.

North Dakota laws protect transactions and support orderliness in the state's marketplace. See N.D. Cent. Code chs. 28-01.1 (Products Liability Act), 41-02 (Uniform Commercial Code sales provisions), 51-10 (Unfair Trade Practices Act), 51-12 (prohibits false advertising), 51-13 (Retail Installment Sales Act), 51-14 (regulates revolving charge accounts), 51-15 (concerning consumer fraud and unlawful credit practices), 51-18 (regulates home solicitation sales), § 54-12-17 (creating consumer fraud and anti-trust division to protect against fraud). These laws directly benefit Quill's commercial activities within North Dakota.

Also, North Dakota provides and maintains a judicial system for the enforcement of a direct marketer's property and contract rights, as well as for the collection of its debts. While the record does not reflect that Quill used North Dakota's courts to enforce its contracts or other rights, the state judicial system must remain open and available to Quill should it seek judicial recourse. If Quill decides to enforce collection of its delinquent North Dakota accounts, it must do so in the North Dakota courts. See Spiegel, Inc. v. Federal Trade Comm'n, 540 F.2d 287 (7th Cir. 1976) (holding it an unfair trade practice for a mail order firm to sue in its own state of commercial domicile and requiring the firm to sue in the court of the customer's residence).

Without state and local garbage disposal services and regulation, Quill could not conduct its business in the same fashion. In Quill's case, approximately 40% of its catalogs are sent to prospective customers. n8 "1990 Direct Mail Order Roundup," 53 Direct Marketing Magazine 9, Jan. 1991, at 12. Most direct marketing mail solicitations are unwanted; nearly one-half are disposed of unopened and unread. Time, Nov. 26, 1990, at 54; see also Pet. App. at A34 n.14. Common sense dictates, and the North Dakota Supreme Court found, that "[i]t is the mail order seller who derives the most direct benefit from its own mailings, and it therefore is not unreasonable to assume that the seller derives some measure of benefit from the entity that is ultimately responsible for disposing of the veritable mountain of trash created thereby." Pet. App. at A34-A35; see also D.H. Holmes, 486 U.S. at 24, 32. Under traditional nexus principles, Quill receives the benefits and protections of North Dakota laws and services through the disposal of its trash in North Dakota.

n8 Quill's activity is close to average for business-to-business direct marketers, 48% of whose mailings are sent to prospects. DMA Stat. Book at 201.

Absent the role of government, Quill could not effectively penetrate and saturate local markets. It is entirely appropriate and consistent with both the due process and commerce clause to require that direct marketers pay for their fair share of local services. Compliance with the use tax collection duty is a minimal obligation to impose upon a business that reaps such great rewards from the state's marketplace.

Therefore, the North Dakota use tax statute does not violate the commerce clause or the due process clause. n9

n9 Although Quill and its amici have raised the specter of retroactivity in their briefs, that issue is not before the Court. The Court denied certiorari on that question. Also, because the Commissioner has not attmepted to collect use taxes from Quill, the record is silent on the issue. Finally, retroactivity raises a separate and distinct consideration under the due process clause. See Chevron Oil Co. v. Huson, 404 U.S. 97 (1971). That separate question need not be decided in this case.

IV. NATIONWIDE APPLICATION OF THE NORTH DAKOTA SUPREME COURT'S RULING WILL NOT CONSTITUTE AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

A. Administrative Costs Related To Use Tax Compliance Are Constitutionally Allowed.

Under the four-part Complete Auto test, the existence of a nondiscriminatory cost associated with the collection of a use tax is irrelevant to the commerce clause inquiry. See 430 U.S. at 288-89. As stated in Complete Auto,

the court has rejected the proposition that interstate commerce is immune from state taxation:

"It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.'"

430 U.S. at 288 (quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975)).

Because the North Dakota statute does not require Quill to incur costs which are greater than the administrative costs imposed on its competitors, the commerce clause is satisfied. For a multistate company that chooses to enter several states' markets and has sufficient minimum relevant contacts with those states, the administrative cost of collecting a use tax in those states is a constitutionally permissible costs of choosing to enlarge its marketplace. A holding to the contrary would discriminate against local businesses and direct marketing competitors simply because those entities have physical property in a state.

There is no logical reason for differentiating between multistate direct marketing businesses such as Sears or J.C. Penney and their direct marketing competitors. Sears or J.C. Penney must pay the administrative costs of collecting state and local taxes in each state. See Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 364-65 (1941) (holding that costs and inconvenience of use tax collection are a legitimate "price of enjoying the full benefits" of being privileged to do business in-state); Nelson v. Montgomery Ward, 312 U.S. 373 (1941).

The decisions holding that nationwide retailers like Sears must collect sales or use taxes on their catalog sales further demonstrate that an administrative burden associated with use tax collection is irrelevant to the commerce clause inquiry. If the existence of such a cost were sufficient to establish a commerce clause violation for direct marketers like Quill, it should also be sufficient for Sears and J.C. Penney. Yet, the Court has held that those retailers must collect those taxes in each jurisdiction in which they do business. Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941); Nelson v. Montgomery Ward, 312 U.S. 373 (1941).

Further, Quill's argument is premised on the Spector/Freeman tax immunity principle that was rejected in Complete Auto. Spector and Freeman were grounded on a "burden" argument not unlike that Quill raises here. In Freeman, for example, the Court stated:

[a] State is . . . precluded from taking any action which may fairly be deemed to have the effect of impeding the fair flow of trade between States. It is immaterial that local commerce is subjected to a similar encumbrance. . . . A burden on interstate commerce is none the lighter and no less objectionable because it is imposed by a State under the taxing power rather than under manifestations of police power in the conventional sense. . . . Moreover, the burden on interstate commerce involved in a direct tax upon it is inherently greater, certainly less uncertain in its consequences, than results from the usual police regulations. . . . Because the greater or more threatening burden of a direct tax on commerce is coupled with the lesser need to a State of a particular source of revenue, attempts at such taxation have always been more carefully scrutinized. . . .

Freeman, 329 U.S. at 252-253 (emphasis added). As discussed above, the Court has overruled the Spector/Freeman rule, concluding that a state tax may impose a burden on businesses engaged in interstate commerce, as long as that tax satisfies the four-pronged test set out in Complete Auto.

Acceptance of Quill's argument that the North Dakota use tax is unconstitutional because it is burdensome would return this Court to the discredited Spector rule. A multistate business may have more total administrative costs related to use tax collection because it is present in multiple taxing jurisdictions. However, the business has voluntarily incurred these costs to avail itself of the benefits of a larger market base. This is a cost of "paying its own way" in the states in which it has chosen to exploit the markets.

B. The Cost Of Compliance With The North Dakota Use Tax Law Is Not Burdensome Or Unfair.

Even if Quill's administrative cost in collecting use taxes for multiple jurisdictions were relevant to the constitutional analysis, those administrative costs, when realistically analyzed, are reasonable and do not justify granting Quill immunity from the state use tax collection requirements.

North Dakota has not sought Quill's collection and payment of any local government use tax. The North Dakota Tax Commissioner seeks only the collection of the state use tax. Appellant's N.D.S.Ct. Br. at 35. North Dakota, therefore, respectfully suggests that the Court reserve for an appropriate case the issue of the alleged administrative burden of collecting local government use taxes. However, should the Court reach that issue in this case, there is sufficient information available upon which the Court may conclude that this alleged burden is not constitutionally significant.

The simplest solution to complying with use tax obligations rests on the same technology that has allowed the direct marketing industry to flourish. Computer software companies, such as Vertex, Inc., and AVP Systems, now offer off-the-shelf tax compliance software. n10 The Vertex and the AVP compliance systems run on mainframes, minicomputers, or IBM-PC compatibles. Both contain complete, regularly updated state and local use tax ratet information for every taxing district in the country and cross-reference tax rates by city name and Zip Code. The compliance systems calculate the tax on each transaction by integrating the tax rate information directly into the direct marketers' own computerized billing system. The systems also automatically generate state and local tax returns, on appropriate forms, for each taxing district. n11 See generally Westphal, The Computer's Role in Simplifying Compliance with State and Local Taxation, 39 Vand. L. Rev. 1097 (1986); 1988 Hearings, infra, p. 48 at 415, 620-36. They are available at prices ranging from $7,000 to $12,000. Note, Collecting the Use Tax on Mail-Order Sales, 79 Geo. L. J., 535, 552 n.102 (1991).

n10 No such systems existed in 1967. Vertex released its tax rate system in 1975; AVP released its system in 1979. Westphal, The Computer's Role in Simplifying Compliance with State and Local Taxation, 39 Vand. L. Rev. 1097, 1103 n.9 (1986); 1988 Hearings, infra, p. 48 at 415, reprinting "New Software Package is Designed to Help Dm'ers Deal with Use Tax", DM News, Dec. 1, 1987, at 18, 22. See also Defendant's Reply Brief, Apr. 30, 1990,Ex. 42, which sets forth a description of various use tax compliance systems; and Amicus Curiae Brief of the States of Connecticut, Tennessee, California, et al, App. D at 45a.

n11 Contrary to the suggestion (Brief of Amicus Curiae Direct Marketing Association ("DMA Br.") at 20) that tracking exemptions will stump the computer programs described here, Vertex notes that it is "in the final development" of such an update to its software. See DMA Br. App. 4, Quest 12. AVP Systems presently offers such a product. See AVP Systems, "The Sales Tax Beacon," Insert (Autumn 1991). Of course, to the extent that any particular tax compliance product for direct marketers does not presently exist, it is likely because the demand for it has not existed.

The direct marketing industry is aware of the capabilities of such computer technology. "The database plays a vital role in direct marketing, from customer acquisition through the creative process, then the customer transaction and fulfillment, and finally analysis." Deloitte & Touche, supra, p. 9 at 15. Direct marketers have amassed "significantly more customer data" as storage costs have decreased. n12 Id. at 21. Recent improvements in the price and performance of smaller, less expensive machines have changed the way even the smallest companies do business. According to an article in a leading direct marketing publication, now "[a]nyone can afford to be a database marketer and do the same things that [American Express] and other database marketers do, and do it without mainframes and at hundreds times less the cost." Stacey, "The Microprocessor Revolution," 53 Direct Marketing Magazine 10, Feb. 1991, at 65. n13 The industry has, at times, acknowledged as much. See 1988 Hearings, infra, p. 48 at 243 (testimony of William T. End, Executive Vice President of L.L. Bean, Inc.) (conceding, that "I think the computer side of this . . . is irrelevant. . . . [A] small company can handle the computer part of it if it is made simple.") n14

n12 Since 1967 the cost of computing has fallen exponentially. According to Brookings Institution economist Kenneth Flamm, between 1957 and 1978, the inflation-adjusted price/performance ratio - the amount in real terms that a consumer must spend to do a given computing task - decreased at an average of 28% per year (or 20% non-inflation-adjusted per year). Flamm, Targeting the Computer 25 (1987). A recent Bureau of Labor Statistics study indicates that

such price declines have continued. See Sinclair and Catron, An Experimental Price Index For the Computer Industry, Monthly Lab. Rev., Oct. 1990, at 21, Table 21.

As of 1980, computer memory capacity cost 40 times less than it did in 1970. See J. Cortada, Historical Dictionary of Data Processing 114 (1987). In any event, an 80 megabyte computer system can be purchased today for less than $1500. That amount of memory is more than sufficient to operate the computerized sales and use tax compliance programs currently available.

n13 A DMA-commissioned study indicates that over 50% of small direct marketing companies, those with less than $10 million in annual sales, presently use minicomputers. Deloitte & Touche, supra, p. 9 at 14. Forty-six percent of consumer catalog companies use the larger and more powerful mainframe computers. Forty-three percent use a combination of mainframes and "end-use" data processing. DMA Stat. Book at 268. Almost 65% of direct marketing companies use a computerized inventory system to provide customers with immediate information on item availability. See id. at 89. A 1989 DMA survey revealed that only 3.9% of direct marketing companies do not control any end-user applications with personal computers. Id. at 274.

n14 The DMA Brief is itself an example of the ease with which computerized systems can quickly compile large amounts of use tax information. The brief extensively relies upon Vertex for a wise range of current use tax data. See DMA Br. App. 2, 3. If DMA can accumulate use tax information for the purposes of a brief, it can certainly centralize this information and make it available for the benefit of its members' compliance with collection requirements. DMA could, for example, establish an 800 number where members or their customers could call to get amounts of tax calculated by computer. DMA already provides centralized services to its members. See DMA Br. at 23 n.29.

In any case, computer technology also enables both Vertex and AVP to provide even the smallest direct marketers with the manual counterpart of the computer software. Nationwide tax rate manuals, updated monthly, are available for a fraction of the cost of a computerized compliance system.

Quill claims that direct marketers could have use tax collection duties in approximately 6,500 state and local jurisdictions. n15 However, a nationwide mail order business would not be required to file 6,500 separate use tax returns per reporting period. A more accurate number of the jurisdictions in which a mail order company may have to file a return (effective July 1, 1992) is 192. n16

n15 The number of jurisdictions in the United States levying sales and use taxes is variously cited as "approximately 6500 jurisdictions" (Pet. Br. at 36); "45 states (plus the District of Columbia) and over 6,100 local governments" (DMA Br. at 16).

n16 See DMA Br., App. 3 at 1, setting forth selected responses to questions posed to Vertex, Inc. by the Multistate Tax Commission.

While the maximum potential administrative cost of filing returns in 192 jurisdictions is not to be ignored or unduly minimized, that potential burden is not unmanageable.

The industry's description of the chaos that may result from customer calculation of tax rates fails to take into account the nature of most direct marketing transactions. The increasing use of credit cards by customers for mail-order purchases alleviates the collection costs that accompany customers' errors or omissions when payments are made by check or money order. n17

n17 Note, Collecting the Use Tax on Mail-Order Sales, 79 Geo. L.J. 535, 552 n.103 (1991). When a customer makes a purchase on credit, the mail order vendor need not rely on the customer's tax calculation but can itself calculate the tax and charge the customer's account. Id. Approximately 53% of all catalog purchases are paid by either credit card or house credit. DMA Stat. Book at 81. In addition, a significant number of catalog companies offer a toll-free number for

ordering or for customer service, id. at 94, and could calculate tax rates over the phone for customers preferring to pay by check.

Finally, a number of states have enacted legislation to lessen whatever collection burdens do exist. Thus, several states exempt small direct marketers from collecting any use tax, n18 provide uniform rates for state and local use tax collection, n19 or include collection allowance provisions. n20

n18 See, e.g., Fla. Stat. § 212.0596(G) (Supp. 1990); Minn. Stat. Ann. § 297A.21(4)(c) (West Supp. 1991); Mo. Ann. Stat. § 144.605(14)(a) (Vernon Supp. 1991); N.Y. Tax Law § 1101(8)(iv) (McKinney Supp. 1991); Wash. Admin. Code § 458-20-221(2)(c) (1989).

n19 See, e.g., Tenn. Code. Ann. § 67-6-702(f) (1989); Wash. Admin. Code § 458-20-221 (1989).

n20 See ACIR, State and Local Taxation of Out-of-State Mail Order Sales (A-105), Apr. 1986, Table 2-6, at 44.

Direct mail companies with in-state branches have long complied with nationwide use tax requirements. Their experience demonstrates that the rest of the direct marketing industry would be able to comply as well.

V. QUILL'S ACTIVITIES IN NORTH DAKOTA WERE SUFFICIENT TO SATISFY THE NEXUS REQUIREMENTS OF BELLAS HESS.

Quill's contacts with North Dakota exceeded in both type and frequency those presented to the Court in Bellas Hess. Assuming the Court concludes that taxing nexus must include a physical contact between an out-of-state direct marketer and a state, that standard is met under the facts in this case.

Quill's connections with the state include its QSL software; its use of telephone, modem, fax, and telex communications with North Dakotans; and its contacts with North Dakota financial institutions to conduct credit checks on its customers. The North Dakota Supreme Court properly relied upon these contacts to find sufficient nexus under Bellas Hess. See also Good's Furniture House, Inc. v. Iowa Bd. of Tax Review, 382 N.W.2d 145 (Iowa), cert. denied, 479 U.S. 817 (1986) (approving the imposition of a use tax collection responsibility based upon the out-of-state marketers' use of television advertising followed by merchandise delivery in their own trucks).

Quill owns property that is physically present in North Dakota. Quill licenses its QSL software to North Dakota customers. As part of its license agreement, Quill retains title to the floppy diskettes necessary to operate the QSL program. Those floppy diskettes are sent to and retained by QSL customers, including its North Dakota customers. T.C. Response, Ex. I at 20-21, Ex. F at 8-9 and Ex. A attached thereto.

Under the physical presence test Quill espouses, the existence of one piece of physical property in the state, even one floppy diskette, is sufficient to establish nexus. See also In re Heftel Broadcasting Honolulu, Inc., 57 Hawaii 175, 554 P.2d 242 (1976), cert. denied, 429 U.S. 1073 (1977) (holding existence of the presence of a film property and a licensing agreement granting telecast rights sufficient to establish taxing nexus). It is questionable whether such a result comports with fundamental fairness. The state concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus. However, if one piece of property is not sufficient, then a question arises as to what quantity or quality of physical property within a state is necessary for nexus to exist. If so, the purported "bright line" status of the physical presence test disappears.

Quill's computer modem/telephone line connection with its North Dakota customers presents another type of contact that was not before the Court in Bellas Hess. Unlike Bellas Hess, Quill does not conduct its business with North Dakota residents merely through the use of the United States Postal Service and common carriers. Quill maintains a telephone bank of 95 persons for the receipt of orders. It solicits customers by telephone, takes orders by fax, telex, and telephone, and allows its customers to check its inventory and prices and order through computer modem.

These activities within North Dakota may constitute sufficient nexus for taxing purposes. In an analogous case the Court found sufficient nexus to tax a telephone call when the call either originated or terminated in the state and was billed or paid for from an address within the state. Goldberg, 488 U.S. at 252. Quill conducted similar activities in North Dakota.

Quill's contacts with North Dakota were also much more frequent than the contacts in Bellas Hess. There Bellas Hess mailed two catalogs per year (and occasional flyers) to its Illinois customers; Quill mailed 62 different bulk mailings to its North Dakota customers during one 12-month period.

Based upon Quill's varied and frequent contacts with North Dakota, the North Dakota Supreme Court properly concluded that, under applicable due process and commerce clause principles, Quill had nexus with North Dakota sufficient to justify imposition of the purely administrative duty of collecting and remitting the state's use tax. n21

n21 The North Dakota Supreme Court has reserved the question as to whether Quill's retention of title and risk of loss to the goods it sent to its North Dakota customers constituted sufficient nexus under the physical presence test under North Dakota's version of the Uniform Commercial Code (N.D. Cent. Code §§ 41-02-43(1)(a) and 41-02-44(1)). See Pet.App. A30-A31. See also the Brief Amicus Curiae for State of New Mexico for a discussion of this argument.

VI. THE CONSTITUTIONAL QUESTION PRESENTED SHOULD BE RESOLVED BY THIS COURT AND NOT DEFERRED TO CONGRESS.

Quill and its amici urge the Court to defer to Congress. They argue that if any taxing nexus test other than the physical presence standard they claim Bellas Hess established is to be articulated, that standard should be set by Congress and not this Court. See Pet. Br. at 46-49; DMA Br. at 4. It is disingenuous for the direct marketing industry to make this assertion when it has argued to Congress that Congress lacks power to pass legislation revising or limiting Bellas Hess. See Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 100th Cong., 2d Sess. 74-79 (1988) ("1988 Hearings") (prepared statement of Lucas A. Powe, Jr., on behalf of the Direct Marketing Association and Magazine Publishers Association); Collection of State Sales and Use Taxes by Out-of-State Vendors, Hearing on S. 639 and S. 1099 before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance and Taxation, 100th Cong., 1st Sess. 43-44 (1988) (statement of Lucas A. Powe, Jr., on behalf of the National Marketing Association, Inc., contending that Bellas Hess was a due process decision and that Congress may not alter the Bellas Hess nexus standards).

This assertion also suggests, incorrectly, that this Court does not have jurisdiction to address the constitutional issues raised in this case. For the reasons stated in Quill's petition and North Dakota's response, this Court should resolve the constitutional question presented.

Should this Court articulate, as North Dakota urges, a nexus standard different from that suggested by Quill, direct marketers will undoubtedly seek congressional protection from additional state use tax collection duties. In a similar situation that arose after the Court decided Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), many large interstate businesses feared that the Court would eliminate entirely any restriction on states' ability to tax interstate transactions. These businesses immediately sought protective legislation, and Congress reacted promptly by enacting Pub.L. 86-272, 73 Stat. 555 (1959) (codified as amended at 15 U.S.C. § 381 (1982)), which prohibits states from imposing a tax on a corporation's net income based solely on solicitation of orders in the state. n22 The direct marketers will likely not be deterred by their own reliance on the due process clause in seeking a congressional reversal of a decision here. n22

n22 The legislative history of Pub.L. 86-272 establishes that Congress, even by its adoption of that statute, did not intend to restrict the states from imposing their sales and use taxes on interstate sales. See Senate floor remarks of Senator Bush and Senator Bennett:

"Mr. BUSH. I should like to ask the Senator a question. The question deals with the net income tax on income derived within the State, and so forth. The illustration the Senator from Georgia gave is one of a corporation which does a tremendous business in the State and does not pay any tax. Is it not true that this bill does not in any way inhibit a State from imposing sales taxes, for instance, upon goods sold in the State by a corporation from without the State?

"Mr. BENNETT. This bill does not affect in any way the power of a State to impose sales taxes, property taxes, licenses, any form of tax, except a tax on the income of the foreign corporation."

105 Cong. Rec. 16,362 (1959).

CONCLUSION

For the reasons set forth above, North Dakota respectfully requests the Court affirm the judgment below.

Dated December 26, 1991.

Respectfully submitted,

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QUILL CORPORATION, Petitioner, v. STATE OF NORTH DAKOTA, byand through its Tax Commissioner, HEIDI HEITKAMP, Respondent.
No. 91-194

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October Term, 1991

January 15, 1992

On Writ of Certiorari to the Supreme Court of the State ofNorth Dakota

REPLY BRIEF

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I.

COMPLETE AUTO DOES NOT OVERRULE BELLAS HESS

North Dakota directly challenges the continuing validity of this Court's decision in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), and contends that Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), overruled Bellas Hess 15 years ago. n1 Resp. Br. at 10, 15, 17. To the contrary, Complete Auto reconfirmed the Bellas Hess requirement that an out-of-state business must have "substantial nexus" with a state before a tax obligation may be imposed on that business. n2

n1 North Dakota acknowledges that the recent amendments to the North Dakota Use Tax Act would be constitutionally deficient if tested in 1967 under the Bellas Hess rationale. Brief for Respondent (hereinafter "Resp. Br.") at 10, 15. See also Brief for Petitioner (hereinafter "Pet. Br.") at 47 n.45 (the North Dakota legislature also recognized that the 1987 amendments to the North Dakota Use Tax Act when enacted conflicted with Bellas Hess).

n2 North Dakota contends that this Court has never limited tax nexus to localized, intrastate activities physically conducted by the out-of-state vendor within the taxing state. Resp. Br. at 26. North Dakota's contention belies this Court's reasoning in cases preceding and succeeding Bellas Hess (Pet. Br. at 15-19, 27-33) which held that out-of-state mail order vendors that did not conduct a localized, intrastate business were not obligated to collect the state's use tax. See, e.g., Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 365 (1941) where the Court stated:

[T]hose [mail order businesses] are not doing business in the state as foreign corporations. Hence, unlike [Sears] they are not receiving benefits from Iowa for which it has the power to exact a price.

Id. (Bracketed material added.)

See also National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 555 (1977):

[N]ot every out-of-state seller may constitutionally be made liable for payment of the use tax on merchandise sold to purchasers in the [taxing] State.

Id. (Bracketed material added.)

North Dakota asserts that Bellas Hess is grounded on an interpretation of the commerce clause that prohibits all state taxation of businesses engaged in interstate commerce. n3 Resp. Br. at 10, 16-17. Bellas Hess stated:

[i]f the power of Illinois to impose use tax burdens upon [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote . . .

The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

Bellas Hess, 386 U.S. at 759-60 (emphasis added).

n3 North Dakota restates the issue in Bellas Hess to be whether the use tax in question was a tax on the "privilege of engaging in interstate commerce." Resp. Br. at 16-17. A use tax is not a "privilege tax." General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335, 338 (1944). Quill does not contend in this case that North Dakota may not tax North Dakotans who purchase mail order goods; it only contends that North Dakota lacks jurisdiction to impose that tax obligation on Quill.

North Dakota argues that this analysis embodies the free trade rule articulated in Freeman v. Hewit, 329 U.S. 249 (1946) and Spector Motor Service Inc. v. O'Connor, 340 U.S. 602 (1951). Resp. Br. at 16-17. In fact, the quoted language restates the universally accepted meaning of the commerce clause. It is the same analysis found in post-Bellas Hess and post-Complete Auto cases such as Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 328-29 (1977) and Dennis v. Higgins, 111 S.Ct. 865, 870-71 (1991).

The antecedents of Bellas Hess are not Freeman and Spector but the line of cases applying a commerce clause analysis to state use taxes. They are Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939); Nelson v. Sears, Roebuck & Co., 312 U.S. 359(1941); Nelson v. Montgomery Ward & Co.,312 U.S. 373 (1941); Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954); and Scripto, Inc. v. Carson, 362 U.S 207 (1960). The Court in Bellas Hess quoted from Freeman solely for the proposition that "state taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." 386 U.S. at 756. The opinion goes on to say that the same principles have been held applicable in determining the power of a state to impose the burden of collecting use taxes upon interstate sales. "Here, too," said the Court, "the Constitution requires 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax'. Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-345; Scripto, Inc. v. Carson, 362 U.S. 207, 210-211." Bellas Hess, 386 U.S. at 756-57.

In Bellas Hess the Court described cases involving a variety of circumstances in which it had upheld the power of a state to impose liability on an out-of-state seller to collect a local use tax on an interstate sale. It then declared: "[T]he Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail." 386 U.S. at 758. Nowhere in the opinion is the tax or the collection liability characterized as a tax on the "privilege" of engaging in interstate commerce, and, therefore, unconstitutional under the holdings of Spector and Freeman.

North Dakota's historical revisionism also ignores the fact that by 1967 interstate commerce was subjected to state and local property taxes, use taxes, capital stock taxes, and direct net income taxes. In fact, the only state tax not imposed on interstate commerce was, under the Spector rule, one for the "privilege" of engaging in interstate commerce -- a privilege the court believed was not one a state had the power to deny or tax. n4 But even that "draftsmanship" rule of Spector had been narrowed to one of phraseology by 1959 -- long before Bellas Hess was decided. See Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959); Complete Auto, 450 U.S. at 284-85, 287 n.14.

n4 See Developments in the Law -- Federal Limitations on State Taxation of Interstate Business, 75 Harv. L.Rev. 953 (March 1962).

In Complete Auto, the sole issue was the constitutionality of a "privilege tax", 450 U.S. at 278, imposed on the gross income of Complete Auto from providing transportation services to automobile dealers located in Mississippi. n5 430 U.S. at 275-76, 287. Complete Auto argued that the services it provided in Mississippi were but one link in the chain of interstate commerce that was previously placed off-limits to state "privilege" taxes in Spector Motor Service v. O'Connor, 340 U.S. 602 (1951). This Court quickly recognized that Spector did not control the issue in Complete Auto. n6

n5 Complete Auto operated substantial property located in Mississippi (office, storage yard, maintenance facilities and trucks) and its employees performed a full array of transportation services in the state. Brief of the Appellee at 5-6, 12; Appendix at 4-6, 81-88, Complete Auto Transit (O.T. 1976, No. 76-29).

n6 First, the Spector rule refused to look to the "practical effect of the tax" in question. 430 U.S. at 278. Under the Spector rule, a state tax on interstate business labeled as a "privilege" tax would unequivocally be stricken; whereas a tax of identical economic consequence called by a different name might survive a commerce clause attack. Compare Railway Express Agency v. Virginia, 347 U.S. 359 (1954) where the Court struck down an "annual license tax" levied on gross receipts for the privilege of doing business in the State of Virginia with Railway Express Agency v. Virginia, 358 U.S. 434 (1959) where the same tax was upheld under a new name. Complete Auto, 430 U.S. at 284. Second, the Spector rule could insulate interstate business from tax, even though the taxpayer physically carried on local business activities within the taxing jurisdiction. Third, the Spector rule had in effect been abandoned by the Court in 1959, approximately eighteen years prior to Complete Auto by its decision in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959). See Complete Auto, 430 U.S. at 285, 287, n.14. The Court in Northwestern States Portland Cement applied the same rationale for taxing income derived from interstate business activities that it applied in Complete Auto:

We conclude that net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same.

Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. at 452 (emphasis added). Cf. Complete Auto, 430 U.S. at 279 (four prong test).

Complete Auto is entirely consistent with the Court's decision in Bellas Hess. In order to sustain a state tax under commerce clause challenge, the first prong of the Complete Auto test requires a finding of an "activity with a substantial nexus with the taxing State" and the fourth prong requires that the tax obligation be "fairly related to the services provided by the State" to the taxpayer. n7 Complete Auto, 430 U.S. at 279. These tests are not only consistent with Bellas Hess, they had been applied by the Court in sales/use tax cases decided before and after Bellas Hess. n8

n7 At page 20, Resp. Br., North Dakota completely mistates the first and fourth prongs of the Complete Auto test by asserting that:

The first and fourth prongs of the Complete Auto test are "a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise."

Compare Resp. Br. at 20-21 with Reply Br. text accompanying this n.7 and Complete Auto, 430 U.S. at 279.

n8 See Pet. Br. at 15-19 and 27-34. The Court also applied these standards in 1959 when it upheld state taxation of income derived from interstate businesses that maintained offices and employees within the taxing jurisdictions. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 454 (1959) (maintained a large office, salesmen, employees, and automobiles in Minnesota); Williams v. Stockham Valves and Fittings, 358 U.S. 450, 455-56 (1959) (maintained an office, equipment and employees in Georgia); Brown Forman Distilleries v. Collector of Revenue, 101 So.2d 70 (1958), cert. denied, 359 U.S. 28 (1959) (salesmen/"missionary men" in Louisiana); International Shoe v. Fontenot, 107 So.2d 640 (1958), cert. denied, 359 U.S. 28 (1959) (fifteen salesmen in Louisiana).

In each of the cases where this Court found nexus sufficient to sustain the tax on the interstate business in question, the taxpayer conducted localized business activities which included a substantial physical presence with that taxing jurisdiction. Contrary to North Dakota's assertion, this Court has never intimated in any of its decisions that Complete Auto eliminated the constitutional requirement (determinative in Bellas Hess) that there be a substantial localized activity conducted within the state by the mail order vendor before that state has jurisdiction to impose a tax on the out-of-state business. n9 Additionally, any tax imposed has to be fairly related to the services provided by the state to the taxpayer (fourth prong of Complete Auto). Compare Bellas Hess, 386 U.S. 756-58, 760 with Complete Auto, 430 U.S. at 279. North Dakota's contention that the Bellas Hess standard has been undermined and overruled by Complete Auto defies scrutiny of the applicable authorities. n10

n9 See Goldberg v. Sweet, 488 U.S. 252 (1989) (where the taxing state had substantial nexus over the taxpayers, the tax collecting agent and the telecommunications reached by the tax), D. H. Holmes Co. v. McNamara, 486 U.S. 24 (1988) (taxpayer owned and operated 13 department stores that employed about 5,000 workers in the taxing state), Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) (taxpayer conducted substantial mining activities in the state) and National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977) (taxpayer maintained offices and employees in the state) discussed in Pet. Br. at 15-16 n.6, 27-33.

For cases where taxpayers' activities did not create a substantial nexus with the taxing state, see Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954); Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania, 567 A.2d 773 (Pa. Commw. 1989), aff'd per curiam, 591 A.2d 1047 (Pa. 1991), cert. applied for sub nom. Penn. v. Bloomingdale's By Mail, Ltd., No. 91-383; SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (1991), cert. denied, 111 S.Ct. 2839 (1991); Cally Curtis Co. v. Groppo, 572 A.2d 302 (Conn.), cert. denied, 111 S.Ct. 77 (1990); L. L. Bean, Inc. v. Commonwealth of Pennsylvania, 516 A.2d 820 (Pa. Commw. 1986); Direct Marketing Ass'n v. Bennett, No. Civ. S-88-1067 (E.D. Cal. July 12, 1991) (1991 U.S. Dist. LEXIS 10736); Land's End, Inc. v. California Bd. of Equalization, No. 620135 (San Diego Superior Court, Cal. 1991), appeal docketed, No. Do14839 (Cal. App. 4th, July 15, 1991); and Sturbridge Yankee Workshop Inc. v. California Bd. of Equalization, No. 512584 (Sacramento Superior Court, Cal. 1991), appeal docketed, No. CO11169 (Cal. App.3d, May 30, 1991).

n10 North Dakota's argument also misses the mark because nexus is not at issue in the very cases it cites; whereas in Bellas Hess nexus is the only issue. Just as nexus for tax purposes was the issue in Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941), Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954), and Scripto, Inc. v. Carson, 362 U.S. 207 (1960); it was not an issue in Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985) which cites International Shoe Co. v. Washington, 326 U.S. 310 (1945), or in Mobil Oil Corp. v. Commissioner, 445 U.S. 425 (1980) which cites Wisconsin v. J. C. Penney Co., 311 U.S. 435 (1940) - cases which North Dakota mistakenly argues support its contention that Bellas Hess has been rejected by this Court. In each of the cases relied upon by North Dakota, the taxpayer had employees or property in the taxing state. Although tax nexus was not an issue in Mobil, the Court cites Bellas Hess in support of the principle that before a state may tax income generated in interstate commerce, there must be some "intrastate values of the enterprise" carried on within the state. 445 U.S. at 436-37. Mobil carried on substantial wholesaling and marketing activities in Vermont, reporting an annual Vermont payroll in excess of $230,000 and Vermont property values ranging from $3.9 million to $8.2 million for the years in question. 445 U.S. at 428-29.

II.

IN PERSONAM JURISDICTION IS NOT A SUBSTITUTE FOR "SUBSTANTIAL NEXUS"

North Dakota urges that the nexus standard in tax and personal jurisdiction cases is or should be the same. Resp. Br. at 23-25. n11 This attempt to conflate the "substantial nexus" standard used in tax cases and the "minimum contacts" standard used in personal jurisdiction cases ignores the fundamentally different constitutional concerns which they reflect. n12 In Burger King Corp. v. Rudzewicz 471 U.S. 462 (1985), the Court explains this difference.

n11 North Dakota admits that Complete Auto's "substantial nexus" test incorporates both commerce clause and due process clause concerns, Resp. Br. at 20-21, but it then avoids any further discussion of the role of the commerce clause.

n12 North Dakota's reliance on International Shoe Co. v. Washington, 326 U.S. 310 (1945) to suggest that the "minimum contacts" analysis for personal jurisdiction should control this case also ignores the role of the commerce clause. While International Shoe involved taxes, the unemployment tax in question was immune from commerce clause challenge. Congress had given the states specific authority to impose those taxes on compensation paid to employees performing services within the state. 326 U.S. at 315,321. Thus, that decision does not address commerce clause concerns.

In Burger King, the Court considered whether a franchisee could fairly be required to defend a claim by its franchisor in the State of Florida. The Court pointed out that the requirements of the due process clause in personal jurisdiction cases are "a function of the individual liberty interest preserved by the Due Process Clause". 471 U.S. at 472, n.13. However, due process clause requirements do not address "federalism concerns". Id. See also Insurance Company of Ireland, Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702-703 n.10 (1982). Federalism concerns are, of course, at the heart of commerce clause requirements which limit state taxation of interstate businesses.

It was precisely "federalism" concerns which the Court highlighted in Bellas Hess, that to permit Illinois and other states to tax Bellas Hess would entangle the company in:

a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of local government."

The very purpose of the Commerce Clause was to insure a national economy free from such unjustifiable local entanglements.

Bellas Hess, 386 U.S. at 760.

The adoption of a "minimum contacts" test in personal jurisdiction cases and a "substantial nexus" test in commerce clause cases reflects more than a mere difference in terminology. n13 In personam jurisdiction balances the interests of claimants and out-of-state defendants with respect to the forum in which their controversy will be determined. It generally does not affect substantive rights or obligations. The appropriateness of the limitations placed on such jurisdiction takes into account the extent of the burden on defendants in defending a lawsuit at a location distant from residence or principal place of business, entailing the inconvenience of transporting documents and witnesses over a considerable distance. In balancing those burdens with the burdens imposed on claimants bringing suit in a foreign jurisdiction, the Court looks to whether "the maintenance of the suit" would "offend traditional notions of fair play and substantial justice." International Shoe, 326 U.S. at 316.

n13 In Bellas Hess, the Court rejected Illinois' argument that the due process standards for personal jurisdiction and tax jurisdiction were similar and refused to apply McGee v. International Life Insurance Co., 355 U.S. 220 (1957) -- which involved a classic mail order insurance operation where the company had no physical contacts with the state except solicitations by mail -- as the standard to determine tax nexus. Brief of Appellee at 32-34, Bellas Hess (O.T.

1966, No. 241). In McGee, the Court upheld the state court's in personam jurisdiction over the insurance company, ruling that physical presence was not required by the due process clause for adjudicatory jurisdiction.

North Dakota's contention that adjudicatory and tax jurisdiction standards are similar falters considering that neither the majority nor dissenting opinions applied McGee to determine the tax obligations of Bellas Hess.

The commerce clause requires a different analysis of the tax burden from that which North Dakota, its sister states and local taxing bodies would place on out-of-state vendors having no contacts with customers in the taxing state other than by electronic communication, U.S. mail or common carrier. Tax jurisdiction entails burdens of complying with the tax laws of the state. n14 A multitude of affirmative obligations and liabilitiesto the state are created. n15 These greater burdens require a higher level of contact, "a substantial nexus," 430 U.S. at 279, to justify the state's imposition of the burden of tax liability and compliance obligations. North Dakota's blithe dismissal of these burdens, Resp. Br. at 25, ignores the constitutional distinction between International Shoe and Bellas Hess.

n15 A description of the cumulative effect of the tax burdens involved is set out in Amici Brief of New Hampshire, et al. at 18-22 and Amici Brief of American Council for the Blind, et al. at 11. These burdens would be especially severe for small mail order businesses. Amicus Brief of Coalition for Small Direct Marketers at 10-11, 17-20; Amici Brief of Carrot Top Industries, Inc., et al. at 9-11; Amicus Brief of Direct Marketing Association at 16-23; and Amici Brief of American Council for the Blind, et al. at 8-17.

The impact of the North Dakota Supreme Court's ruling extends beyond mail order vendors and impacts publishers, financial organizations and service businesses generally. Amici Brief of Magazine Publishers of America, Inc., et al. at 10-12; Amicus Brief of American Bankers Association, et al. at 8; and Amicus Brief of Tax Executives Institute, Inc. at 18-22.

Quill does not have the substantial nexus with North Dakota necessary to justify the obligations which the State wishes to impose. In the absence of these contacts, the commerce clause prohibits North Dakota from imposing tax obligations on Quill.

III.

ADOPTION OF NORTH DAKOTA'S IN PERSONAM JURISDICTION STANDARD EFFECTIVEL / NEGATES ESSENTIAL COMMERCE CLAUSE RESTRICTIONS

North Dakota's substitution of the in personam standard for the Bellas Hess/Complete Auto standards, Resp. Br. at 20-23, is a sharp departure from established law which has guided businesses, states and the courts for fifty years. n16 North Dakota's position could lead to an abyss of uncertainty in the law that would in all likelihood generate unnecessary litigation. n17

n16 In the last two terms, this Court has refused to grant certiorari in two cases raising the same issue as Quill. Cally Curtis v. Groppo, 572 A.2d 302 (Conn. 1990), cert. denied, 111 S.Ct. 77 (1990); SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (Conn. 1991), cert. denied, 111 S.Ct. 2839 (1991). Prior to that, this Court has cited with approval Bellas Hess on at least six occasions, most recently in 1989; lower state and federal courts have referred to Bellas Hess in approximately 70 cases, most recently in 1991. See Pet. Br. at 27-33, App. 4 to Pet. Br. at 26a-29a, and Pet. App. A76-A81.

n17 North Dakota's approach is also inconsistent with National Geographic, 430 U.S. 551, where this Court did not adopt California's "slightest presence" test, stating:

[N]ot every out-of-state seller may constitutionally be made liable for payment of the use tax on merchandise sold to purchasers in the [taxing] state.

National Geographic, 430 U.S. at 555, discussed in Pet. Br. at 28.

North Dakota's administrative rule of "three mailings" extends North Dakota's tax jurisdiction to Quill and others; in other states, one sale satisfies the same standard adopted by the North Dakota statute. n18 The test urged by North Dakota, Resp. Br. at 20-23 extends a state's taxing jurisdiction to interstate businesses that have no presence in the state, under the pretext that the interstate business benefits from the services the state is providing to its own residents. Resp. Br. at 33. Under North Dakota's test no service of any kind would ever have to be provided to the interstate business. North Dakota makes no effort to define the true limits of its proposed test and, in fact, no standard is created. Whether three solicitations or a single sale, abandonment of the Bellas Hess standard will eliminate essential commerce clause protection. n19

n18 See, for example, Brief Amicus Curiae State of New Jersey at 1 and Brief Amicus Curiae State of New Mexico at 4-5, where one sale into those states is sufficient to impose tax liabilities on the out-of-state vendor.

n19 North Dakota urges reversal of Bellas Hess in order to restore a competitive advantage to North Dakota retailers who are obligated to pay North Dakota sales tax as a result of their intrastate activities. Resp. Br. at 6-7, 18; R. 211-27. There is a dearth of evidence to support North Dakota's suggestion, Resp. Br. at 6-7, that consumers purchase merchandise by mail to avoid a state's sales/use tax. See Collection of State Sales and Use Taxes by Out-of-State Vendors: Hearing on S.639 and S.1099 Before the Subcomm. on Taxation and Debt Management of the Comm. on Finance, 100th Cong. 2nd Sess. (1987) at 37-38 (colloquy between Sen. Mitchell and Messrs. Baldwin, of the National Ass'n of Tax Administrators, and Hanson, of the Multistate Tax Commission, over the failure of states and retailers to provide any evidence to Congress to substantiate their claims that imposition of sales/use taxes affect consumer purchasing decisions). In fact, the State of North Dakota, which is exempt from state sales/use taxes, purchases products from Quill, presumably "to get the best deal possible." Patrick Spaeth, State Buys Products From Firm It Is Suing, Bismarck Tribune, December 24, 1991 at 1A, 12A.

If the historical standard in tax jurisdiction cases is to be abandoned, what will take its place? North Dakota argues that the test should not be simply mechanical, or quantitative, or formulary. Resp. Br. at 27. North Dakota would apparently prefer to apply a facts and circumstances test to establish the tax liability of out-of-state vendors. Resp. Br. at 28. What are those minimum contacts that will establish that tax liability? The closest that North Dakota comes to providing an answer or defining a standard is to quote from the language in Burger King Corp., 471 U.S. at 476 (1985), which upholds personal jurisdiction if "a commercial actor's efforts are 'purposefully directed' toward residents of another State." Resp. Br. at 25-26. This is the same standard advanced by Illinois on oral argument in Bellas Hess:

Mr. MacCarthy: . . . I think there should be some kind of a rule they [businessmen] should understand. And the rule that I would suggest be distilled from the cases of this Court is a rule which businessmen should well understand, and that is simply where a business is successfully in a state from a business point of view that that should be equated with presence from a legal point of view.

Transcript of Oral Argument at 33, Bellas Hess, 386 U.S. 753 (O.T. 1966 No. 241), reproduced in Pet. Br., App. 1 at 6a.

North Dakota advances to this Court the same theory rejected in Bellas Hess. North Dakota's proposal seeks to measure state taxing jurisdiction not against current tax jurisprudence but rather against each state's subjective assessment of what is "fair and just." n20 North Dakota's proposed standard amounts to a "facts and circumstances" approach that would guarantee uncertainty over the issue of a state's authority to tax out-of-state businesses that derive an alleged and amorphous "economic benefit" but do not conduct business activities in the state in the traditional sense. North Dakota makes no effort to explain the limits of its proposed new test.

n20 Will advertising in a national magazine create tax jurisdiction in every state in which the magazine is circulated? See Keeton v. Hustler Magazine, Inc. 465 U.S. 770 (1984) and Calder v. Jones, 465 U.S. 783 (1984), where an author

(in Calder) and a publisher (in Hustler) of articles appearing in national magazines were subject to libel actions in states where the magazines were circulated.

The jurisdictional tests advanced by North Dakota, Resp. Br. at 23-28, will in all likelihood lead to unnecessary litigation to resolve the inevitable confusion that would be created in the business community, state tax administration and the courts if a reliable and predictable standard is replaced with a subjective "totality of the circumstances" test. n21

n21 Cf. Burnham v. Superior Court of California, 110 S.Ct. 2105, 2117 (1990) (where Justice Scalia eschewed the "totality of the circumstances" test because it did not establish a rule of law but, instead, fostered uncertainty and litigation).

IV.

NORTH DAKOTA DOES NOT PROVIDE SERVICES TO QUILL

At pages 31-35 of its brief, North Dakota attempts to respond to the concerns of the trial judge who explicitly asked: What services were provided by North Dakota to Quill? n22

n22 The trial judge stated:

Rather than dwell on the intricacies of title passing as the State has done in this case, they should have been presenting facts to the Court showing that the State of North Dakota spends funds for the protection and benefit of the mail order business. By doing so, they could show that taxation was not only for the benefit of local residents, but for the benefit of the mail order houses. . . . The focus must be on the beneficiary of the taxes as opposed to the consequences. Until this can be established, it would appear that the tax dollars spent protects the local resident and does not benefit the out of state mail order business in any significant manner.

Pet. App. A41, North Dakota v. Quill, (Dist. Ct. Mem. Op.).

The litany of services that North Dakota recites to this Court covers the gamut of all services provided by North Dakota to its residents. Resp. Br. at 33-34. North Dakota argues that Quill receives the benefit of all these services because it is doing business in North Dakota. This argument assumes the answer. The trial court did not find any fact which would establish that Quill does business in North Dakota. In fact, it found to the contrary. Pet. App. A40. North Dakota, ignoring the traditional tests for "doing business," comes to its conclusion by relying upon the reasoning contained in the dissent in Bellas Hess. 386 U.S. at 762-63.

Stripped to the bone, North Dakota's argument is quite simply that because Quill solicits North Dakota residents on a regular basis, it is "carrying on a business" in North Dakota. Having so argued, North Dakota can point to nothing in the record to distinguish Quill from Bellas Hess. Pet. Br. at 17-34.

In reviewing the record herein, the trial court found that "In Hess, the facts are very similar to those found in this case". Pet. App. A40. It is not disputed that the services allegedly provided by North Dakota to Quill were similar to the services allegedly provided by Illinois to Bellas Hess. It is not disputed that Illinois' activities in Bellas Hess resulted in the maintenance of a market among Illinois residents comparable to that in North Dakota. North Dakota's argument is reduced to the proposition that since a state confers benefits upon persons within its borders, it indirectly confers benefits upon anyone outside of those borders who solicits those residents, and that those "indirect" benefits are sufficient to sustain an extraterritorial tax obligation on the out-of-state vendor. This is precisely the argument considered and rejected in Bellas Hess. 386 U.S. at 760 (Fortas, J., dissenting). In Bellas Hess, it was pointed out to this Court that acceptance of Illinois' "economic benefit" argument would have the following results:

Upon this theory Massachusetts could tax Florida hotels because the prosperity it bestows upon Massachusetts residents enables them to visit those resorts. Minnesota could tax Michigan factories because her farmers are a market for Michigan tractors and cars. Idaho could reach out and tax the seller of gasoline in Utah where the property was to be brought into Idaho following the purchase. It was to prevent just such mutual aggressions and economic retaliation that the States entered into the federal union.

Reply Brief for Appellant at 8-9, Bellas Hess, 386 U.S. 753 (O.T. 1966, No. 241).

The lower court's question -- What services has North Dakota performed for Quill? -- remains unanswered by North Dakota. Based upon the record herein the answer is none!

V.

NORTH DAKOTA HAS MISSTATED MATERIAL FACTS

North Dakota misstates the record when it repeatedly alleges that "unlike Bellas Hess, Quill owned property [QSL diskettes] physically present in [North Dakota]." Resp. Br. at 15; see also Resp. Br. at 13, 30, 45, 46. The Record does not support the State's contention.

The gravamen of the North Dakota complaint against Quill under its "economic benefits" theory is that Quill sells merchandise "using state-of-the-art marketing techniques, including a software program" that permits Quill customers to order merchandise by telephone and to communicate with other Quill customers about Quill products. Respondent's Brief in Opposition to the Petition for Writ of Certiorari at 2; see North Dakota v. Quill, Pet. App. A29; Resp. Br. at 5, 33, 45-46.

QSL (also known as Quill Service Link) is a software program n23 with a retail value of $15 each that Quill sells or occasionally gives at no charge to customers who purchase computers. (R. 130, 231, 243 -- separately bound; J.A. 47). Quill sold or gave QSL to six customers in North Dakota (R. 123), only one of whom has ever used it to order merchandise from Quill (R. 123).

n23 QSL allows the customer to keep a diary of activities, keep track of its own inventory (not Quill's inventory as alleged by Respondent, Resp. Br. at 5, 30, 46), order merchandise from Quill, and place messages on the "electronic bulletin board" maintained on a Quill micro-computer located in Illinois to which other QSL customers have telephone access. (R. 247-77.) QSL users are prohibited from unauthorized copying, commercial advertising or publishing of any profane, abusive or offensive language on the "electronic bulletin board". (R. 273, 280.) A QSL user who would violate the rules established for use of the "electronic bulletin board" loses its access privilege, i.e., its access code is deleted from Quill's computer memory. (R. 231, 273, 280; J.A. 47.)

The Record does not support North Dakota's contention that Quill "retains title" to QSL while the diskettes are in the customer's possession (Resp. Br. at 5, 45) or that Quill retains any physical control over QSL or the diskette after sale or gift of the diskette to the customer. (R. 231; J.A. 31, 47.) The intangible right that Quill has under the software agreement to terminate access for inappropriate use of the program is distinct from the customer's ownership and use of QSL. n24 That intangible right is indistinguishable from the protections offered under trademark, trade name, copyright and patent laws. Bellas Hess clearly retained comparable intangible rights in its catalogs and advertising flyers distributed in Illinois and had an even larger intangible interest in accounts receivable owed by Illinois customers. n25 Any right that Quill has under the software agreement has no connection with North Dakota; the agreement specifically provides that any dispute between Quill and the customer will be governed by the laws and courts of Illinois. (App. to Reply Br.; R. 246.)

n24 The QSL software agreement is reproduced in the Appendix to the Reply Brief and is included in the Record at R. 246 and 249.

n25 North Dakota's reliance (Resp. Br. 46) on In re Heftel Broadcasting Honolulu, Inc., 554 P.2d 242 (Hawaii 1976), cert. denied, 429 U.S. 1073 (1977) is misplaced. Heftel held that CBS was subject to the Hawaii gross income tax on income it earned by leasing 104 films of the TV series Wild Wild West to a local TV station. CBS retained ownership and control over all films while they were used by the TV station in Hawaii. Under CBS' agreement the station was obligated to preserve and safeguard each film and return it to CBS in the same condition within 24 hours after broadcast. In the event of damage to any film, the TV station was obligated to reimburse CBS for the costs of making a new print. The films constituted substantial tangible property located in Hawaii and thereby subjected CBS to tax in that state. 554 P.2d at 245-48.

North Dakota erroneously states that Bellas Hess did not conduct its business with Illinois residents by telephone. Resp. Br. at 46. The record in Bellas Hess clearly establishes that Bellas Hess sold merchandise by telephone from its facilities in Missouri. n26

n26 Record on Appeal, National Bellas Hess 1967 Catalog, Spring and Summer Ed. (O.T. 1966, No. 241); Affidavit of Thomas Curry (former Vice President of Marketing with Bellas Hess) at J.A. 49, Quill Record on Appeal at R. 234-35, and National Bellas Hess Catalog, attached as Ex. I-2 (R. 235 -- separately bound).

North Dakota contends that Quill has a meaningful "presence" in North Dakota by communicating with customers by telephone but the Record establishes that Quill does not have any telephone listing, toll-free telephone line, "800" number or WATS line in North Dakota (R. 88; J.A. 32) and that Quill does not solicit by means of any communication system owned by Quill and located in North Dakota (R. 100, 101-02; J.A. 31-32). North Dakota's reference to "Quill's computer modem/telephone line connection with its North Dakota customers" (Resp. Br. 45; see also Resp. Br. at 13 and 46), is to property and equipment that Quill owns and operates only in Illinois. (R. 270, 273; J.A. 47.) Quill does not own, control or have an interest in any computer modem located in North Dakota. (R. 232; J.A. 47.)

Quill conducts no business in North Dakota except by United States mail, telephone and common carrier. (R. 87-90, 231-32; J.A. 29-33 and 44-48; Pet. App. A39, North Dakota v. Quill (Dist. Ct. Mem. Op.). The Record does not support North Dakota's factual allegations to the contrary.

VI.

STARE DECISIS IS PARTICULARLY APPOSITE

North Dakota asks this Court to overrule a construction of the commerce clause that is based on fifty years of case law. Resp. Br. at 17. North Dakota totally ignores stare decisis considerations and dismisses the legitimate concern of "retroactive application" in a footnote, Resp. Br. at 35-36 n.9, with respect to that reversal. Resp. Br. at 17, 47.

This Court has repeatedly recognized that the doctrine of stare decisis is of fundamental importance to the rule of law, promoting stability, predictability and respect for judicial authority. Hilton v. South Carolina Public R. Comm'n, 60 U.S.L.W. 4056, 4057 (U.S. Dec. 16, 1991) (No. 90-848); Vasquez v. Hillery, 474 U.S. 254, 265-66 (1986). The Court attempts to balance these continuing needs with society's changing fabric.

Quill submits that in this case the policies in favor of following stare decisis far outweigh those supporting departure. The principles of Bellas Hess were well reasoned in 1967 and provide a certain and workable framework relied upon by taxpayers and lower courts for over twenty-five years. n27 Because Bellas Hess involved a judicial interpretation of the commerce clause, Congress may correct through legislative action any misapplication it perceives. n28

n27 Pet. Br. at 27-33, App. 4 at 26a-29a; Pet. App. A76-A81; Amici Brief of National Association of Manufacturers, et al. at 14-19; Amici Brief of Arizona Mail Order Company, Inc., et al. at 7-11.

n28 The Advisory Commission on Intergovernmental Relations (ACIR), a non-partisan congressionally authorized body, examined the issue of state and local taxation of mail order sales. Recognizing the significance of several issues,

especially that litigation has no possibility of addressing the various administrative problems concerning tax compliance, the ACIR recommended legislative rather than judicial revision of the Bellas Hess standard:

In the judgment of the majority of the Commission, only carefully crafted Congressional action can both negate the National Bellas Hess decision and achieve a delicate -- but essential -- balance.

ACIR Report, State and Local Taxation of Out-of-State Mail Order Sales (A-105) (April, 1986) at 18.

In fact, Congress is fully aware of the Bellas Hess decision and over the years it has refused to enact legislation urged by the states to alter the decision or its effect. n29 The fact that the Bellas Hess decision has been considered but not changed by Congress and that it has been consistently relied upon by taxpayers and numerous lower courts in determining taxable nexus raises "to their acme" the considerations in favor of applying stare decisis herein. n30 See Payne v. Tennessee, 111 S.Ct. 2597, 2610 (1991). Additionally, abandonment of Bellas Hess would likely result in state claims for billions of dollars of uncollected use taxes allegedly justified by anti-Bellas Hess statutes enacted as long ago as 1986. n31

n29 See Pet. Br. at 34-36, 46-49.

n30 For a discussion of the problems that may be created for the mail order industry if Bellas Hess is not followed, see Amici Brief of Arizona Mail Order Company, Inc., et al. at 11-20. Adherence to established rules has a beneficial impact on the economy in general and departure from established precedent that affects investment decisions is harmful to a healthy and competitive economy. Amici Brief of National Association of Manufacturers, et al. at 10-12.

n31 See Amici Brief of Arizona Mail Order Company, Inc., et al. at 11-20, and App. 1b-3f

North Dakota advances no "compelling justification" for urging the Court to depart from the doctrine of stare decisis. n32 Its major premise is that "things have changed" and therefore the law must also change. In its enthusiasm to support the State's fisc, the North Dakota Supreme Court fails to see that the Bellas Hess decision is more analogous to a statutory standard and should only be altered by Congressional action. A lack of such action does not equate to "compelling justification." Arizona v. Rumsey, 467 U.S. 203, 212 (1984).

n32 Many states, including North Dakota, have alternative means for collecting use taxes from residents. See Pet. Br. at 46 and App. 3; Amicus Brief of Direct Marketing Association at 27-28; Amici Brief for New Hampshire, et al. at 23.

VII.

REAFFIRMATION OF BELLAS HESS

The most important practical effect of reaffirming the vitality of Bellas Hess will be in all likelihood to galvanize action in Congress to resolve inconsistencies in the application of use taxes nationwide in a manner which avoids undue burdens on interstate commerce while promoting fair and efficient state revenue systems. As the states have become more and more aggressive in asserting taxing power over out-of-state sellers, as illustrated by the behavior of North Dakota's legislature and North Dakota's Supreme Court in this case, there has been less and less pressure for states to compromise their differences in designing Congressional legislation for uniform, simple and efficient measures for collection of use taxes by out-of-state sellers. That solutions can be reached under difficult political circumstances has recently been illustrated by actions of the European Community in establishing rules for cross-border mail order sales within Europe effective January 1, 1993, with respect to their sales taxes, which they call value-added taxes.

Overruling Bellas Hess will destroy the interstate marketplace as we now know it. The existing scope of freely flowing commerce among the states will be curtailed by reduced sales to consumers and, equally importantly, by reduced sales to business firms. One after the other the amici briefs in support of Petitioner illustrate:

1. the increased costs and compliance burdens on sellers which will lead to reduced interstate sales, n33

n33 Amicus Brief of Direct Marketing Association at 14-23, 25-27; Amici Brief of Carrot Top Industries, Inc., et al. at 6, 8-13; Amicus Brief of Coalition for Small Direct Marketers at 12-21

2. the reduced availability of goods and supplies to consumers and businesses in rural areas and smaller cities, n34

n34 Amici Brief of American Council for the Blind, et al. at 11-12.

3. the likely reduction in the number of sellers and suppliers who through their huge number and wide variety offer customers a conveniently exercisable range of choice that probably exists nowhere else in the world, n35

n35 Amicus Brief of Direct Marketing Association at 15; Amici Brief of Carrot Top Industries, Inc., et al. at 12; Amicus Brief of Coalition for Small Direct Marketers at 17-21; Amici Brief of American Council for the Blind, et al. at 12-13.

4. and a general reduction in marketing efficiency which will be reflected in increased prices and a narrower range of choice in selecting goods by size, shape, color, and design. n36

n36 Amicus Brief of Direct Marketing Association at 15-16; Amici Brief of American Council for the Blind, et al. at 12-13.

The national market is one of American's most prized possessions and is largely accounted for by this Court's continuing vigilance through its enforcement of the commerce clause. This Court can and does through its administration of this clause assure that the inevitably parochial interests of states acting alone are not allowed to thwart the national economic policy established by the Constitution's commerce clause. That critical power, coupled with Congressional power to regulate commerce among the states, permits the orderly, efficient, and fair evolution of state tax systems.

CONCLUSION

For the reasons set forth in its briefs, Quill respectfully requests this Court to reverse the judgment below.

Respectfully submitted,

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SOFTWARE LICENSE NUMBER: 232527

QUILL CORPORATION, Petitioner, v. STATE OF NORTH DAKOTA, byand through its Tax Commissioner, HEIDI HEITKAMP, Respondent.
No. 91-194

1991 U.S. Briefs 194

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On Writ of Certiorari to the Supreme Court of North Dakota

BRIEF AMICUS CURIAE FOR THE STATE OF NEW JERSEY SUPPORTINGRESPONDENT

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INTEREST OF AMICUS

The State of New Jersey, like respondent the State of North Dakota, imposes a sales and use tax on retail sales and tangible property, payable by New Jersey customers and collectible by vendors. Under the New Jersey statute, the term "vendor" is defined as: "A person who solicits business either by employees, independent contractors, agents or other representatives or by distribution of catalogs or other advertising matter and by reason thereof makes sales to persons within the State of tangible personal property or services, the use of which is taxed by this act." N.J.S.A. 54:32B-2(i)(c). Despite this provision, numerous vendors, relying on the decision in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), promote and sell their goods in New Jersey -- through the use of direct mail catalogs, telephones, television, and computers -- but refuse to collect the requisite taxes. The New Jersey Division of Taxation estimates that in 1990 such direct-marketing sales to New Jersey residents and businesses amounted to approximately $4.34 billion. As a result, New Jersey lost approximately $141 million in tax revenue for that year.

These direct marketers, while refusing to collect the applicable state taxes, nevertheless derive substantial benefits from the organized markets that the State makes available to them. In addition, the flood of direct mail solicitations and glossy catalogs that such vendors pour into the State imposes enormous governmental costs, both directly in terms of waste disposal programs and derivatively in terms of environmental burdens. For these reasons, the State of New Jersey has a direct and immediate interest in the outcome of this litigation. In particular, New Jersey requests that National Bellas Hess be overruled so that companies like petitioner can be made to collect and remit their fair share of the taxes necessary to support the benefits that they derive from, and the costs that they impose on, the State.

SUMMARY OF ARGUMENT

This Court's decision in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), should be overruled. To begin with, it rests on two legal propositions that are inconsistent with constitutional doctrine as it has been clarified since 1967. First, National Bellas Hess relies on the formalistic notion that so-called "exclusively" interstate commerce is immune from state taxation, but that notion was explicitly repudiated by this Court in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Second, National Bellas Hess also relies on the notion that some physical presence in a State is an essential precondition to the State's exercise of jurisdiction over a person, but that notion -- which even in 1967 was contrary to due process case law (not cited by the Court in its opinion in National Bellas Hess), see McGee v. International Life Ins. Co., 355 U.S. 220, 222, 223-24 (1957); International Shoe Co. v. Washington, 326 U.S. 310, 321 (1945) -- has likewise now explicitly been laid to rest. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985). Both doctrinal developments turn away from the rigid formal lines reflected in National Bellas Hess toward a more practical focus on current economic realities. See Complete Auto, 430 U.S. at 279; Burger King, 471 U.S. at 476.

Such a practical focus makes clear that not only the doctrinal underpinnings but also the critical factual assumptions of the majority opinion in National Bellas Hess are today insupportable, both factually and as legal grounds for denying state taxing authority over out-of-state direct marketers. First, the idea that States do not accord such marketers protections and services that benefit their businesses (386 U.S. at 757, 760) simply does not fit the facts: state governments provide or protect the essential infrastructure that makes possible the successful, continuing completion of marketers' transactions -- e.g., the education and economies that create able consumers; the roads, telephone networks, cable television networks, and other means of communication through which the goods are advertised, sales solicited, orders placed, credit checked, bills sent and paid, and goods delivered; insurance, police, and fire services that protect homes and buildings where goods are used or stored; the banking systems that make possible the ubiquitous use of credit cards; the waste services that enable consumers to dispose of the millions of catalogs marketers send out each year; and the legal institutions that structure and enforce the terms of the commercial transactions. Second, the idea in National Bellas Hess that the administrative burdens on marketers justify tax immunity (386 U.S. at 760) is likewise fundamentally wrong. For one thing, the costs of compliance, like the rate of the tax, are not properly relevant to the constitutional analysis of taxing authority at all under the approach of Complete Auto. And, in any event, with the advent of powerful, inexpensive computers, the costs of compliance with state tax laws are now relatively insubstantial.

The problem with National Bellas Hess is not simply that its foundations have been rendered clearly anomalous by legal and factual developments since 1967. The decision affirmatively undermines important constitutional values protecting both States and businesses. First, because of the tremendous growth of direct marketing in the past two decades, National Bellas Hess removes from the States' tax base an ever-growing share of the nation's commercial activity, depriving States of approximately $2 billion annually. The effect of thus immunizing a $180 billion-a-year industry from any State's sales and use tax -- placing the industry in a kind of no-state's land within the national economy -- is directly to threaten States' constitutionally rooted authority to ensure that all businesses that benefit from state services pay their way. Second, in-state businesses are likewise harmed by the tax immunity conferred by National Bellas Hess: they not only suffer a direct disadvantage in competing for customers (who can buy goods tax free from the out-of-state firms) but must also pay higher in-state taxes to make up for the diminishing revenue base available to the States. This sort of discrimination between in-state and out-of-state commerce, effectively compelled by National Bellas Hess, turns the commerce clause antidiscrimination principle on its head.

Petitioner and its amici have not advanced any good reason for preserving the erroneous, unfair, and outmoded rule laid down in National Bellas Hess. In particular, there is no substantial claim to reliance on this discriminatory, often-questioned decision, which was rendered in an area of law where evolution and overruling have long been common. Moreover, concerns about determining which direct marketers must comply with tax obligations are both insignificant and, in any event, plainly insufficient to justify retention of the rigid rule immunizing even large companies like Quill from state tax obligations. Finally, the issue of whether any overruling of National Bellas Hess should be retroactive is separate from the question presented here and should be left for another day.

ARGUMENT

NATIONAL BELLAS HESS SHOULD BE OVERRULED

Overruling a constitutional precedent, while less extraordinary than overruling a statutory precedent, nevertheless requires "special justification." Arizona v. Rumsey, 467 U.S. 203, 213 (1984). Such justification is present when a decision of this Court not only was weakly reasoned originally but has become clearly out of step both with basic constitutional doctrine as clarified since the decision and with the present realities governed by the decision. See Payne v. Tennessee, 111 S. Ct. 2597, 2609-10 & n.1 (1991). In particular, in the area of state regulation or taxation of interstate business activities, this Court has frequently overruled precedents under the due process and commerce clauses to bring case law into line with coherent doctrine and current factual context. See ibid.; Appendix G to Brief of Amici Curiae Arizona Mail Order Company, et al.

Under this analysis, National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), should be overruled. It is beyond serious dispute that the imposition of use-tax collection duties on an out-of-state direct-marketing business that regularly solicits and does business within a State, like petitioner Quill, is constitutional under a straightforward application of the prevailing four-part test of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Thus, as explained more fully below, such a State clearly has a substantial nexus with sales to its residents made by a seller who has directed its sales efforts into the State and relied on state protections that make the solicitations and sales possible. The use tax is fairly related to in-state activities, since in-State users pay it; and the requirement that out-of-state sellers collect it is likewise fairly related to the state's protection of the conditions that make the commercial transaction possible, including means of communication, distribution, and disposal. There can be no problem of fair apportionment,if only because no other State can tax the use of the products within the State. See National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 558 (1977). n1 And there is no discrimination in requiring out-of-state sellers, like their in-state competitors, to collect the use tax (or pay the coordinated sales tax).

n1 Nor is there a problem of duplicative taxation arising from sales taxes imposed by sellers' States. In light of constitutional problems with such a tax (see Evco v. Jones, 409 U.S. 91 (1972)), States have not in fact tried to impose sales taxes on their own direct marketers' sales to out-of-state customers. See Rothfeld, Mail-Order Sales and State Jurisdiction to Tax, Tax Notes at 15 n.140 (Dec. 23, 1991). In any event, any duplicative taxation problem would be fully cured by a requirement that payers of use taxes receive a credit for sales taxes paid out of State -- a credit that virtually all States do provide and may even be constitutionally required. See Williams v. Vermont, 472 U.S. 14, 23 n.7 (1985); Rothfeld, supra, at 15 n.140.

Notwithstanding the clear validity of the tax at issue in this case under current doctrine, National Bellas Hess would declare the tax invalid. The reason, quite simply, is that the decision relies on doctrinal principles and factual assumptions that are not today supportable. The underpinnings of the decision, some of them inadequately considered even as an original matter, plainly are no longer valid. To the contrary, the decision undermines central principles of commerce clause law. And there are no sufficient reasons to preserve the ruling. n2

n2 The stare decisis analysis here is not altered by the fact that Congress can overturn commerce clause rulings of this Court. For one thing, National Bellas Hess relies on both the due process and commerce clauses (386 U.S. at 756); and it is, at a minimum, hardly clear that Congress can overturn due process rulings. In any event, this Court has in fact shown no hesitation in revising its commerce clause doctrine over the years -- perhaps because Congress has been singularly inactive in resolving interstate taxing issues.

A. The Central Doctrinal Underpinnings of National Bellas Hess Have Been Clearly Repudiated by This Court.

Citing both the due process and commerce clauses, National Bellas Hess based its decision on the asserted validity of the "sharp distinction" between those sellers who have some physical presence in the taxing State ("retail outlets, solicitors, or property within a State") and those who do not. 386 U.S. at 758. The Court then explained that, without such presence, "it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions" involved in that case. Id. at 759. Such transactions, the Court ruled, fall into the "domain where Congress alone has the power of regulation and control." Id. at 760 (footnote omitted). But both the notion that purely interstate commerce is immune from state taxation and the notion that physical presence is the essential precondition for a State to exercise authority over a person have now been clearly repudiated by this Court.

1. The Formalist Doctrine Immunizing Purely Interstate Commerce from State Taxation Has Been Abandoned.

The turning point of the Court's analysis in National Bellas Hess was its view of the mail-order transactions at issue as "exclusively interstate in character." 386 U.S. at 759. At the time that National Bellas Hess was decided, that characterization was important under prevailing commerce clause doctrine. Freeman v. Hewit, 329 U.S. 249 (1946), and later cases such as Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951), had clearly established the principle, reflected in earlier decisions as well, that States could not tax "the very process of interstate commerce," so that a state tax on a purely interstate transaction, rather than on some local incident or activity, was invalid because it interfered with the freedom of interstate commerce. Freeman, 329 U.S. at 253. See Trinova Corp. v. Michigan Dep't of Treasury, 111 S.Ct. 818, 828 (1991).

This Court has, however, directly repudiated that principle since National Bellas Hess. In the landmark case of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Court overruled Spector Motor (430 U.S. at 289) and rejected "the philosophy underlying [the Freeman] rule" (430 U.S. at 288). Insisting on an approach to commerce clause questions based on "economic realities" (Complete Auto, 430 U.S. at 279), and on "the practical effect of a challenged tax" (Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443 (1980)), the Court thus explicitly abandoned what it has since aptly described as Freeman's "formalistic approach" that kept certain transactions simply out of the reach of state taxing authorities. Trinova, 111 S. Ct. at 828. The critical doctrinal underpinning of National Bellas Hess, in short, is no longer good law.

2. The Reliance on Physical Presence as the Essential Precondition to State Jurisdiction Has Been Clearly Repudiated.

Beyond the Court's reliance on the Freeman principle as the reason for adhering to the "sharp distinction" between sellers with and sellers without physical presence in a State (386 U.S. at 758), the National Bellas Hess Court's very insistence on the necessity of physical presence is itself not sound. Even at the time of National Bellas Hess, the majority's analysis of the need for physical presence to justify exercise of taxing authority was deficient, because it ignored existing precedent on the point. Thus, the Court recognized the essential similarity of the due process and commerce clause requirements of a sufficient connection between the taxing State, its measure of taxation, and the subject of taxation. 386 U.S. at 756. n3 But the majority then wholly failed to consider the pertinent due process precedents on physical presence: McGee v. International Life Ins. Co., 355 U.S. 220, 222, 223-24 (1957), had upheld a State's authority to exercise personal jurisdiction over an out-of-state firm without physical presence in the State (based on purposeful solicitation of business through mailings into the State); and International Shoe Co. v. Washington, 326 U.S. 310, 321 (1945), had held that the minimum contacts that were sufficient to exercise personal jurisdiction over an out-of-state company "subject[ed] it alike to taxation by the state." Together, those precedents directly undermined the National Bellas Hess Court's reliance on physical presence as the key to state taxing authority. Yet the Court never discussed those decisions.

n3 Since National Bellas Hess, of course, those requirements have been stated as the nexus and fair relation components of the four-part commerce clause standard of Complete Auto. The Court has continued to recognize, as it did in National Bellas Hess, that these tests also encompass due process requirements. See, e.g., Trinova, 111 S. Ct. at 828; Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 436-37.

In any event, since National Bellas Hess was decided, the Court has made crystal clear that, under the due process clause, physical presence is not a precondition to a State's exercise of jurisdiction over an out-of-state company. In Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985), the Court expressly stated that physical presence is not required for personal jurisdiction, explaining that "it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted." Thus focusing on the realities of modern commerce -- as the Court has done since adopting the practical, Complete Auto approach to commerce clause analysis -- the Court in Burger King held that a State had jurisdiction over any business that "'purposefully directed'" its commercial efforts toward residents of the State. Ibid. (quoting Keeton v. Hustler Magazine, Inc., 465 U.S. 770, 774-75 (1984)). There is, quite simply, no good reason why taxing jurisdiction should have to meet any higher standard than adjudicative

jurisdiction, or why commerce clause standards in this regard should be any more stringent than due process standards. n4 Accordingly, the "physical presence" litmus test on which National Bellas Hess critically relied is not now, if it ever was, good law.

n4 As to the constitutional equivalence of taxing and adjudicative jurisdiction, not only does International Shoe remain good law, but the equivalence follows from the fact that a State's exercise of personal jurisdiction often does mean, and constitutionally can generally mean, that an out-of-state seller is subject to the State's substantive law in the State's courts. See, e.g., Allstate Ins. Co. v. Hague, 449 U.S. 302 (1981); Restatement (Second) of Conflict of Laws §§ 6, 9, 145-146 (1971); cf. Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985). This is particularly significant for direct marketers, who are forbidden by the Federal Trade Commission to bring suit against purchasers except in the courts of the purchaser's home State. See Spiegel, Inc. v. FTC, 540 F.2d 287 (7th Cir. 1976). See generally Rothfeld, supra, at 5-6 nn.73, 82. If a State may apply its own law in its own courts to out-of-state direct marketers, it surely can impose on those firms the duty of collecting use taxes for goods sold to in-state purchasers.

B. The Critical Factual Assumptions in National Bellas Hess Are Insupportable Today, Both Factually and as Grounds for Immunizing from State Tax Obligations Direct Marketers that Regularly Market in a State.

In setting forth its notions about the need for physical presence and the exclusively interstate character of the commerce at issue, the Court in National Bellas Hess made two critical assumptions, or assertions, of a factual nature. First, as to the State's interest, the Court indicated that a State has "no legitimate claim to impose 'a fair share of the cost of the local government'" on a seller with no physical presence in the State (386 U.S. at 760), stating earlier in the opinion that such a seller is not "accorded the protection and services of the taxing State" (id. at 757). Second, as to the seller's interest, the Court stressed the burden a seller would incur -- if the seller had to obtain and maintain accurate information about the taxes it had to collect in each of the numerous jurisdictions where it made a sale. Id. at 760.

As already noted, the Court has, in its due process doctrine, repudiated the notion that a State provides no protections to businesses unless they are physically present in the State. And the National Bellas Hess concern with administrative burdens seems hard to wrench from the context of the majority's now - rejected focus on "exclusively interstate" commerce. But in any event, both views of the National Bellas Hess majority -- about the absence of state protections for and the significance of burdens on out-of-state sellers -- are insupportable, at least under present legal and factual circumstances.

1. States Provide Important Protections Necessary to the Continuing, Successful Completion of Direct Marketers' Commercial Transactions.

The majority opinion in National Bellas Hess essentially ignored the dissent's description of the significant protections States provide to out-of-state mail-order businesses: most notably, the States protect the soundness of the banking institutions that provide the consumer credit without which many of the transactions would be impossible; and they provide the courts that ensure collection of the purchase price from the seller's customers. 386 U.S. at 762 (Fortas, J., dissenting). Those and other protections -- of the consumers who purchase, of the roads and other means for delivering the solicitations and the goods, of the means of disposing of the inevitable waste byproducts of the seller's efforts in the State -- were inadequately considered by the majority in National Bellas Hess and should have been sufficient to sustain the imposition of tax obligations even in 1967, even on an out-of-state seller that handled its solicitations, order-taking, and delivery entirely through the mails (or other common carrier of physical goods). But whatever the case may have been in 1967, it is clear that, today, the protections given to out-of-state direct marketers are manifold and manifestly substantial, and that States are entitled to "ask return" for those protections by demanding collection of the use tax. See Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940). n5

n5 The seller in National Bellas Hess was truly a "mail order" business, in that the mails were used not only to send solicitations but to take orders for merchandise. The term "mail order" is no longer accurate for the many companies that handle their business, or a large share of it, by telephone, television, or other electronic means. Hence the more general term "direct marketer," describing companies that market goods directly to consumers, without using a retail outlet.

Today, direct marketers like Quill conduct their business differently from the "mail order" business at issue in National Bellas Hess. Rather than relying predominantly on the mails for solicitation, direct marketers massively use the telephone and other means, such as cable television, to solicit sales. Consumers, for their part, rather than placing orders by mail, as in National Bellas Hess (386 U.S. at 754), now tend to place their orders by telephone (or, increasingly, by computers hooked up to telephone lines), using "800" or similar numbers that the direct marketers publish and advertise in the State. (The seller in National Bellas Hess had no telephone listing in the State. 386 U.S. at 754.) And rather than paying either by check or by credit arrangement directly with the seller, as in National Bellas Hess (386 U.S. at 761 (Fortas, J., dissenting)), consumers now pay predominantly with credit cards, which are, of course, infinitely more common than they were in 1967. n6

n6 See, e.g., Stipulation in Lands' End, Inc. v. California State Bd. of Equalization, No. 620135 (Super. Ct., San Diego County) (86% of Lands' End sales by credit card, and 80% of orders placed by telephone).

One consequence of credit-card payment is that, even for consumers that place their orders by mail, the marketer can, upon receiving the order, calculate and add in the proper use tax to the credit card bill.

Given these and the other circumstances surrounding modern direct-marketing transactions, it is easy to identify the numerous protections and benefits offered by States to make the commercial transactions possible -- that is, to make direct marketers' business possible. At the most basic level, States provide a host of services and protections for the economy itself -- that is, for consumers' very ability to buy goods. Through schools and jobs, for example, States help create consumers with the resources to purchase. And consumers' homes and offices, where goods will be used, are protected by government fire, police, and other services. State regulation of insurance, moreover, helps protect the value of goods that consumers buy, thereby making purchase more likely.

States protect numerous aspects of the direct marketers' side of the commercial transaction as well, including solicitation, order-taking, finance, delivery, and post-purchase dispute resolution. Thus, solicitation activities that use the mails depend on roads maintained by state government, traffic regulation provided by the State, and sorting facilities protected by state police, fire, and insurance services. Solicitation activities that use electronic communication depend, for example, on the telephone network regulated by state utility commissions (and their requirements of universal service), on the telephone directories provided under state regulation, or on cable television networks regulated through local government franchises. And the solicitations, when in the form of catalogs, create a major problem of waste that state governments do and must address, through garbage collection, recycling, and disposal in land fills. n7

n7 In fiscal year 1989, for example, Lands' End of Chicago mailed 75,000,000 catalogs averaging 156 pages each. See Lands' End, Inc., supra.

Paper now makes up the largest single component (40 percent) of solid waste in the country. See U.S. Congress, Office of Technology Assessment, Facing America's Trash -- What Next for Municipal Solid Waste, at 73-84, OTA-0-424 (October 1989).

Beyond the solicitation, a customer's ordering of a marketer's goods depends either on the mails or on the electronic communication networks protected by the State. The seller's acceptance of the order often involves an instant credit check by the seller, conducted through the same telephone network. Payment by the customer often is made by credit card, which relies not only on the telephone network and mails for credit-checking and billing, but also on the banking system, whose soundness is a principal responsibility of state governments. Delivery of goods, once ordered and paid for, then itself depends on the roads provided by state government and on the warehouses and other facilities protected by state police, fire, insurance, and other programs. And if the commercial transaction gives rise to disputes, litigation and collection activities inevitably depend on the state courts for adjudication, sheriffs for execution, and commercial and other laws for substantive standards. n8

n8 Not only can state courts exercise personal jurisdiction over out-of-state firms that direct their business into the State (Burger King, supra), but an out-of-state direct marketer must, by FTC requirement, bring any suit against a customer in the customer's home-state courts (Spiegel, Inc., supra). A local bank providing a customer's credit card, and hence guaranteeing payment to the seller, will also use the state courts for collection efforts. And it is well-established that state consumer-protection and usury laws apply to direct-marketing transactions. See, e.g., State ex rel. Meierhenry v. Spiegel, Inc., 277 N.W.2d 298 (S.D.), appeal dismissed, 444 U.S. 804 (1979) (consumer protection laws); Aldens, Inc. v. Miller, 610 F.2d 538 (8th Cir. 1979), cert. denied, 446 U.S. 919 (1980) (usury laws); Aldens, Inc. v. Ryan, 571 F.2d 1159 (10th Cir.), cert. denied, 439 U.S. 860 (1978) (same); Aldens, Inc. v. LaFollette, 552 F.2d 745 (7th Cir.);, cert. denied, 434 U.S. 880 (1977) (same); Aldens, Inc. v. Packel,524 F.2d 38 (3d Cir. 1975), cert. denied,425 U.S. 943 (1976) (same). The protection of consumers by these laws, of course, gives consumers the purchasing confidence needed for direct marketers to survive.

In short, it cannot seriously be contended that direct marketers who lack a physical presence in a State receive no significant protections and benefits from the States into which they protect their commercial activities. Direct marketers that sell throughout the country do not operate in a zone somehow independent of the numerous market-protecting services provided by the 50 States. To the contrary, the States provide the very infrastructure that makes the transactions of direct marketers possible.

2. The Burdens on Direct-Market Sellers Today Cannot Justify the Rule of National Bellas Hess.

As an initial matter, burdens on out-of-state sellers are simply not relevant to the constitutional analysis: such burdens cannot invalidate an otherwise-justified tax on (or collection duty imposed on) out-of-state direct marketers, much less support a rigid rule against such impositions unless the business is physically present in the state. Burdens on taxpayers, let alone on sellers who merely collect taxes owed by others, are simply not relevant to the "nexus" or "fair relation" tests: the former looks only to the existence of a connection between the State and the seller's activities (sale to a resident); and the latter looks only to the relation between the measure of the tax (sales price) and in-state activities (sale in the State). See, e.g., Commonwealth Edison Co. v. Montana, 453 U.S. 609, 622-26 (1981); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 219 (1980). Neither test calls for a balancing of burdens on the seller against protections provided by the State, whether those burdens are administrative in nature or directly monetary (such as the burden of a high tax rate). The majority in National Bellas Hess never explained why administrative burdens should be material to the constitutional inquiry -- rather than, like the rate of the tax, simply a matter for legislative consideration. Cf. Commonwealth Edison Co. v. Montana, 453 U.S. at 628 (refusing to review "acceptable rate or level of taxation"). And those burdens are in fact constitutionally irrelevant. In addition to the obvious judicial unmanageability of an inquiry into "excessive" taxpayer burdens, the Court has made clear that the Constitution cannot relieve businesses of "their just share of [the] state tax burden even though it increases the cost of doing business." Complete Auto, 430 U.S. at 279; see Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938). n9

n9 Even if constitutionally relevant, the practical burdens faced by taxpayers could not justify the rigid National Bellas Hess rule. At most, such burdens could call for constitutional scrutiny of certain cases where state taxes imposed burdens on sellers wholly out of proportion to their in-state activities. Although even that seems intrinsically unlikely, certainly this consideration cannot justify a prohibition on a State's taxing of large companies, like Quill, that regularly solicit and conduct substantial volumes of business in the State. See note 11, infra.

Nor did, or could, the majority in National Bellas Hess explain why, even if administrative burdens were constitutionally relevant, those burdens justified a constitutional line that turns on the direct marketer's physical presence in the State. Thus, companies like Sears and Montgomery Ward may have direct-marketing divisions wholly separate from their retail outlets, and the burdens on those divisions may be identical to those incurred by direct-marketing companies with no in-state presence; yet, even before National Bellas Hess, it was clear that a State could freely impose those burdens on the direct-marketing parts of the businesses. See Nelson v. Montgomery Ward & Co., 312 U.S. 373 (1941); Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941); see also D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33 (1988). n10 And more recently, a dozen years after National Bellas Hess was decided, the point became even more starkly clear. The Court held in National Geographic Soc'y, supra, that a minimal presence unrelated to any retail sales

at all (several solicitors of advertising) was sufficient to sustain a State's requirement that an out-of-State seller (of magazines) collect use taxes -- even though the administrative burden on the out-of-state part of the business was identical to what it would have been if the company had no in- state presence at all. Again, it makes no sense in light of relevant doctrine, especially as clarified since National Bella Hess, to adopt a constitutional standard turning on physical presence based on concerns about administrative burdens on sellers who are exploiting the protections the State provides to their commercial transactions.

n10 The burden that the Court thought decisive in National Bellas Hess was the burden of collecting and maintaining information about the taxes in the numerous taxing jurisdictions where customers live and would use the goods sold. 386 U.S. at 759-60. It is hard to see why the constitutional inquiry should turn on whether a retail store's employees sent the information along to the separate mail-order division or, instead, the mail-order division had to write to the taxing authorities to obtain the tax information. Of course, if there were a large number of local jurisdictions with different tax requirements (a premise of National Bellas Hess), a company that had only a few retail outlets in a State would not likely have tax information about all those jurisdictions in any case.

In any event, the administrative burdens on out-of-state direct marketers, however significant they were at the time of National Bellas Hess, are relatively insubstantial today. The burden that concerned the Court in National Bellas Hess was the burden of obtaining and maintaining accurate information about the taxes due in each of the jurisdictions where the seller's customers reside. But this informational burden is no longer terribly great -- for precisely the same reason that has allowed direct marketing to flourish (see page 20, infra).

Quite obviously, since 1967 there has been a revolution in information collection, processing, storage, and retrieval. Computers have become ubiquitous and cheap. It is computer technology that has allowed direct marketers to target their potential customers, to conduct mass mailings, and to handle high volumes of business. See M. Sroge, Inside the Leading Mail Order Houses at viii (3d ed. 1989). The same computer technology likewise makes possible essentially instant access to up-to-date taxing information.

Even putting aside nationwide tax manuals, the information at issue here -- taxing data from some 6500 jurisdictions -- is readily available in up-dated format through computer software that runs on main-frame, mini-, or IBM-type personal computers. This last type of equipment costs only several thousand dollars and is likely to be already owned and used by the direct marketer for word processing, billing, recordkeeping, and other purposes. And the software -- which also prepares tax returns -- costs roughly $12,000 to purchase and $10,000 per year for service and monthly updates. See Brief Amicus Curiae for Connecticut et al., Appendix D; Brief for Respondent (fuller discussion of computer technology).

Identifying the necessary tax information is thus a task different only in degree, but not in kind, from the seller's job of identifying the shipping and handling charges for the deliveries it makes to different locations. And the task is made much simpler than the direct marketers in this case have alleged by various simplifications contained in state tax statutes. Many states have no local sales or use taxes at all; and some that do have such local taxes nevertheless provide for, or give an option of, a uniform statewide rate for out-of-state sellers. See, e.g., Cal. Rev. & Tax Code § 6203(j) (West Supp. 1991); Tenn. Code Ann. § 67-6-702(f) (1989); Wash. Admin. Code, Rule 458-20-221(5) (1990). In either case a seller must keep track only of the State's own tax law, including rates and exemptions. Keeping track of exemptions, moreover, will often be eased by the fact that such exemptions are often product-specific, so that a particular marketer may know that all of its goods (e.g., clothing) are exempt. Finally, with respect to the burden of filing tax returns, statewide administration is now the norm: at least 40 States provide for the filing of a single tax return covering all jurisdictions within the State. See Brief Amicus Curiae of Direct Marketing Ass'n, Appendix 3.

In short, the costs of complying with state tax laws, if relevant at all, are not a significant impediment to the conduct of direct marketers' businesses, especially for large companies like Quill. n11 Certainly those costs are no different from the costs incurred by in-state retailers; and almost by definition, the costs are commensurate with the amount of business conducted in the State. Most fundamentally, however, these costs are nothing but the inherent price of doing business in numerous jurisdictions. When an out-of-state firm chooses to enter the market in a State, exploiting the government services that sustain the market, it may legitimately be subjected to that State's regulatory and tax laws, particularly those

designed to ensure fair competition and adequate support for the government activities that make the firm's commercial transactions possible.

n11 According to Sroge, supra, at 445-46, Quill had sales in 1985 of $150,000,000. See also Lands' End, Inc., supra (in 1989, Lands' End had sales of more than $500,000,000).

C. National Bellas Hess Directly Frustrates Vital Principles at the Heart of Commerce Clause Doctrine.

Not only is the National Bellas Hess rule's restriction on state taxing authority outmoded both factually and doctrinally, but it works affirmative harm to two values that are central to this Court's commerce clause jurisprudence -- harm that now looms much larger than it did in 1967. First, the rule of National Bellas Hess has become a very substantial impediment to the States' ability to ensure that all businesses pay their fair share for the protections provided them by the State, because the rule exempts an ever-increasing portion of the Nation's sellers from any State's sales or use tax. Second, the rule turns the constitutional bar against discrimination on its head: it gives constitutional protection to out-of-state direct marketers against the very taxes that their in-state retail competitors may be made to pay, leaving the retailers, in fact, with an ever larger share of the state tax burden. These results are antithetical to the commerce clause notions of fairly apportioned and non-discriminatory tax burdens on commerce.

1. National Bellas Hess Has Removed an Ever-Increasing Share of Commerce from States' Tax Base and thus Undermines States' Ability to Make All Commerce Pay Its Fair Share of Government Services.

The magnitude of the National Bellas Hess rule's impact on the States has dramatically increased since 1967. In 1967, total mail-order sales were estimated at $2.4 billion. National Bellas Hess, 386 U.S. at 763 (Fortas, J., dissenting). By 1989, direct-marketing sales were estimated at $183.3 billion. Pet App. A12; see also Hartman, Collection of the Use Tax on Out-of-State Mail-Order Sales, 39 Vand. L. Rev. 993, 1006 (1986) (50 to 150 billion dollars in 1985). These figures reflect the fact that direct-marketing sales have grown faster than local retail sales, thus taking over an ever larger share of total sales. See Sroge, supra, at ix; H. Bruce, Industry Outlook: What Happens Next?, DM News (June 18, 1990), at 13 (between 1980 and 1989, direct-marketing sales grew at 15% a year, while retail sales grew at 5% a year). Today, direct marketing sales account for between 15 and 25 percent of all retail sales in this country. Hartman, supra, at 1007-08.

The consequence of these developments, under the rule of National Bellas Hess, is that States are being stripped of an ever larger part of their tax base. More and more of the sales business of the United States -- not subject to use taxes in the customers' States and not subject to sales taxes in the sellers' States -- is becoming immune from taxation, as though it were part of the national economy without being part of any State's economy. The loss in revenues to financially strapped States was estimated at $1 billion in 1985 and $2 billion in 1988. See Hartman, supra, at 1007-08; Advisory Comm'n on Intergovernmental Relations (ACIR), Estimates of Revenue Potential from State Taxation of Out-of-State Mail Order Sales at 8 (Staff Information Report SR-5, Sept. 4, 1987). Yet sales and use taxes have become an increasingly important revenue source since 1967, rising from 19% of total state tax revenues in 1967 to 24% in 1982, with most States having raised their rates. See ACIR, State and Local Taxation of Out-of-State Mail Order Sales at 6 (Commission Report A-105, Apr. 1986); Rothfeld, supra, at 5-6 & n.16. n12

n12 According to the cited 1986 ACIR report (at 24-25), in 1983, sales tax revenues provided between 16 and 59 percent of individual state tax revenues.

In addition to being a matter of great practical concern to the States, this removal of an increasingly substantial part of commerce from State's revenue base is of constitutional concern. Central to its modern commerce clause jurisprudence, the Court "consistently has indicated that 'interstate commerce may be made to pay its way.'" Complete Auto, 430 U.S. at 281. That principle not only acts as a limit on commerce clause restrictions imposed on the States; it is itself an affirmative, constitutionally rooted protection of the States, implicit in the constitutional structure's commitment to a federal system that protects traditional state power like the power to tax those who exploit state protections. See Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 328-29 (1977) ("reserved 'power of the States to tax'") (quoting

Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 199 (1824)). National Bellas Hess has become a serious practical threat to that cardinal principle.

2. National Bellas Hess Sanctions Discrimination Between In-State Businesses and Their Out-of-State Competitors.

At the same time that it threatens the important interests of the States, National Bellas Hess also works immediate harm to the in-state retail competitors of out-of-state direct marketers. That harm is of two kinds. First, in-state retailers are placed at a direct disadvantage in competing for customers against out-of-state direct marketers, because under National Bellas Hess the out-of-state sellers need not charge to their customers the very taxes that their in-state competitors must charge to their customers. When tax rates are roughly 5-8%, that differential provides a substantial benefit to the out-of-state company. Second, when the out-of-state marketers are removed from a State's tax base, in-state businesses must pay even higher taxes to make up for the revenue shortfall to the State. This shifting of an increased burden onto the in-state businesses further accentuates the advantage given out-of-state marketers by National Bellas Hess.

A rule commanding such favoritism turns the anti-discrimination principle of the commerce clause upside down. That principle is designed to "maintain state boundaries as a neutral factor in economic decisionmaking." American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 283 (1987); see Boston Stock Exch. v. State Tax Comm'n, 429 U.S. at 329-33. Yet the rule of National Bellas Hess gives a distinct advantage to a business depending on whether it is located outside or inside a State, thus affirmatively encouraging a retailer to close up shop, move out of State, and sell its goods as a direct marketer. That is the antithesis of ensuring the neutrality of state boundaries.

By contrast, the extension of use tax collection duties to out-of-state direct marketers directly serves the commerce clause goal of equal treatment of all commercial competitors, whether in-state or out-of-state. Such an extension serves not only "to compensate the state for revenue lost when residents purchase out-of-state goods for use within the State" (D.H. Holmes Co., 486 U.S. at 32), and thus to force out-of-state marketers that exploit in-state customers to share some of the revenue burden carried by their in-state retail competitors; it also serves the fair-competition purpose of removing a substantial inequality in the terms on which they compete for customers. So, too, the overruling of National Bellas Hess would promote the constitutional goal of equal treatment of interstate and intrastate commerce.

D. Reliance Interests and Concerns About Line-Drawing and Retroactivity Do Not Justify Leaving National Bellas Hess in Place.

Retention of National Bellas Hess has been urged on the ground that out-of-state direct marketers have relied on the rule. Another reason given for retaining the rule of National Bellas Hess is that some direct marketers may have difficulty determining whether they meet the various States' tests of "regularly" or "systematically" soliciting business in the State. And concerns about the potential disruption caused by the potential retroactivity of an overruling of National Bellas Hess have also been advanced as a reason not to overrule the decision. None of those arguments can justify leaving this rigid, erroneous, unfair, and outmoded decision on the books.

1. Reliance. The asserted reliance interests cannot warrant retention of National Bellas Hess. To begin with, the claimed reliance interests are no different from those present in the several other cases in which this Court has nevertheless overruled commerce clause precedent to eliminate artificial, outmoded doctrinal limitations on taxing authority. See, e.g., Goldberg v. Sweet, 488 U.S. 252, 265 n.16 (1989); Commonwealth Edison Co. v. Montana, supra; Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978); Complete Auto, supra. And this process of doctrinal evolution, especially in the commerce clause area, has long been a familiar and expected part of the constitutional regime under which commercial enterprises must make their business decisions. See Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 473 (1959) (Frankfurter, J., dissenting).

The reliance interests are particularly weak in this case. The National Bellas Hess rule has been subject to serious question in prominent scholarly literature for many years, and it has been clear at least since Complete Auto that the central doctrinal underpinning of the decision is no longer good law. See, e.g., Hartman, supra; P. Hartman, Federal Limits on State and Local Taxation § 10:8, at 627-28 (1981). Moreover, investments made in reliance on blatantly discriminatory favoritism are hardly worthy of special regard. Direct marketers who grew dramatically faster than their in-state retail competitors based on such advantages over the past 20 years should not now be heard to complain that they must at long last compete on more equal terms. And that, of course, is the only result of overruling National Bellas

Hess, which would hardly stop direct marketers from engaging in their businesses. The complaints about impaired reliance interests have a peculiarly hollow ring when all that is being done is to force direct marketers to share a tax-collection burden that their competitors already incur. In any event, these complaints are insufficient to stand in the way of correcting an anomalous precedent that is profoundly unfair to both the States and in-state businesses.

2. Line-Drawing. Retention of National Bellas Hess likewise cannot be justified on the ground that there is no bright line between those direct marketers who do, and those who do not, meet state statutory or constitutional nexus standards. For one thing, the line-drawing problems, which are initially a question of notice to direct marketers and secondarily a question of judicial definition of the line, are substantially exaggerated by the direct marketers in this Court. Some States, like North Dakota in this case, provide an easy-to-apply rule: in the present case, three separate advertisement mailings in a year. Pet. App. A56. Moreover, state taxing authorities are available and likely to provide guidance to marketers, by regulation or otherwise.

Even aside from such aids to application, however, the standard itself -- certainly the constitutional minimum of purposeful in-state solicitation, but also the prevalent statutory criteria, see Brief Amicus Curiae of National Conference of State Legislatures et al. on Petition for Writ of Certiorari at 7-8 & nn.6 & 7 -- should not present any substantial practical problems. The fact is that even a standard of regular, substantial, systematic, or recurring directed marketing into a State is sufficiently low, indeed not materially different from a simple purposeful solicitation standard, that virtually all direct marketers who deliberately direct their selling activities into a State will have to, and know that they have to, comply with their use-tax collection duties. These standards are, quite simply, every bit as manageable as the purposeful availment standard for due process analysis of personal jurisdiction. See Burger King, supra; McGee, supra.

In any event, these concerns about practical problems in marginal cases cannot conceivably justify retention of the rigid rule of National Bellas Hess. That rule immunizes even large companies doing substantial volumes of business in a State from the tax obligations shouldered by their in-state competitors. That result is so clearly wrong that it should be overruled even if, at a later time, state courts or this Court might have to address whether a particular low level of activity directed into the State is insufficient under state statutes or the Constitution. Just as in Complete Auto, "administrative convenience, in this instance, is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way.'" 430 U.S. at 288 n.15.

3. Retroactivity. Finally, concerns about the retroactivity of a decision overruling National Bellas Hess cannot justify retaining the decision. It is sufficient to say that the question of retroactivity is separate and distinct from the question of the continuing validity of the National Bellas Hess rule. The retroactivity question presents an issue for another day in another case.

CONCLUSION

National Bellas Hess should be overruled, and the judgment of the Supreme Court of North Dakota should be affirmed.

Respectfully submitted,

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Dated: December 26, 1991

A-3285-03T1

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3285-03T1

LANCO, INC.

Plaintiff-Respondent,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Appellant.

Civil Action

ON APPEAL FROM A FINAL JUDGMENT
OF THE TAX COURT OF NEW JERSEY

DOCKET NO. 005329-1997
Sat Below:
Hon. Peter D. Pizzuto

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LANCO, INC.,

Plaintiff,

v.

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Civil Action

BRIEF OF AMICUS CURIAE NEW JERSEY STATE CHAMBER OF COMMERCE

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PRELIMINARY STATEMENT

Concurrently herewith, the New Jersey State Chamber of Commerce (the "*Chamber*") has filed a motion, pursuant to *R.* 1:13-9, seeking leave to appear as *amicus curiae* and to file a brief in *Lanco, Inc.* v. *Director, Division of Taxation*, Docket No. 005329-1997 (N.J. Tax Ct.) (hereinafter, "*Lanco*"). The Chamber respectfully submits this brief on a conditional basis, pending disposition by the Court of its *amicus curiae* motion.

The Chamber is a statewide business organization made up of approximately 1,800 corporate members engaged in all areas of industry throughout the State of New Jersey (the "*State*"), including technology, pharmaceuticals, intellectual property and telecommunications. The Chamber has both an interest in promoting sound tax policy and practice within the New Jersey business community, and an obligation to protect its members.

These institutional interests of the Chamber are directly implicated by the issue before the Court in *Lanco*. This issue involves the interpretation of a New Jersey Corporation Business Tax (the "*CBT*") regulation which was amended by the New Jersey Division of Taxation (the "*Division*") in 1996. *N.J.A.C.* 18:7-1.9, *amended by R.* 1996, d.518, 28 *N.J.R.* 4795(a) (Nov. 4, 1996) (the "*Amended Regulation*"). The Amended Regulation defines the term "doing business" which is one of the predicates for subjecting foreign corporations to the CBT. It was proposed on October 16, 1995 (27 *N.J.R.* 3913(a)), adopted on October 10, 1996 (28 *N.J.R.* 4795(a)), and became effective on November 4, 1996 (*id.*).

Insofar as is here relevant, the Amended Regulation consists of the addition to *N.J.A.C.* 18:7-1.9(b) of the following example:

> Foreign corporation R holds trademarks that were assigned to it by its parent corporation. R receives fees as a result of licensing those trademarks to certain New Jersey companies for use in New Jersey. R is subject to the corporation business tax on its apportioned income as a result of its trademark licensing activities.

As reflected in the Amended Regulation and in *Lanco*, the Division takes the position that foreign corporations which have no physical presence in New Jersey are, nevertheless, subject to the CBT, based solely upon their licensing of intangible property to others located in this State. This expanded definition of "doing business" raises a host of issues, including (i) whether it is constitutional to impose the CBT on foreign corporations having no physical presence in New Jersey, and (ii) whether the Division may apply retroactively an amendment to an administrative regulation which represents an abrupt departure from prior law and practice.

The Chamber supports in every respect Lanco's position that the Division's assertion of nexus over a foreign corporation without physical presence is unconstitutional. Since this issue is covered at length in plaintiff's trial brief, this *amicus* brief, if accepted by this Court, will focus primarily on the argument that should the Amended Regulation be upheld, it may not be retroactively applied to Lanco and other similarly situated foreign corporations going back as far as 1983.

The Chamber believes that taxing foreign corporations without physical presence in this State has profound public and tax policy implications. Among these implications

are: (i) adversely affecting New Jersey's competitive tax climate with adjoining states, (ii) inhibiting the use of software and other intangibles in this State, (iii) encouraging other states to adopt similar rules which will serve to operate against the interests of New Jersey's business community, and (iv) representing the first step in extending the CBT to foreign corporations which earn income from all types of intangible assets. The Chamber further believes that according retroactive effect to the Amended Regulation, as the Director purports to do, will necessarily and prejudicially upset the settled tax expectations of the New Jersey business community.

The interests implicated by the Amended Regulation are both public and private. If allowed to stand, the Amended Regulation will have an adverse effect on the general public by increasing the costs of goods sold in New Jersey which are subject to licensing agreements. Increased costs in turn may prevent New Jersey licensees from successfully competing with similar businesses in neighboring states which do not impose corporation taxes on businesses that are not physically present. An unfavorable competitive industrial climate will thus be fostered in the State to the material detriment not only of the Chamber's members, but also of the New Jersey marketplace.

These public and private interests are also implicated by the retroactive effect which the Director accords to the Amended Regulation. When the Amended Regulation was first proposed in 1995, Governor Whitman had just declared New Jersey "open for business." *1995 State of the State Message*. The controversial application of the Amended Regulation in a retroactive manner not only turns this "business friendly" overture on its head, but upsets the settled—and, based upon prior law and

practice, manifestly justifiable—expectations of the New Jersey business community regarding the State's approach to and policies on corporate taxation in general and the CBT in particular. This detrimental effect is exacerbated both by the complete lack of notice regarding the retroactive application of the Amended Regulation and, most significantly, by the snowball effect that retroactive application of the Amended Regulation is likely to have on the other states in which the New Jersey pharmaceutical, intellectual property, technology and telecommunications industries conduct substantial business through licensing activity.

The Chamber, therefore, respectfully requests leave to file this brief as *amicus curiae* in order to assist the Court in analyzing and determining the important public and tax policy issues raised by the Amended Regulation and to do so by providing the contextual backdrop of the broader range of interests represented by its members. Should the Court grant its motion, the Chamber requests that this brief be considered on the merits.

Because the decision in *Lanco* is so important to the Chamber, to the New Jersey business community and to the State citizenry at large, the Chamber respectfully requests that the Court (i) grant its motion for leave to appear as *amicus curiae*, and (ii) hold that the CBT may not constitutionally be imposed on a foreign corporation with no physical presence in New Jersey, or, in the alternative, hold that any such imposition must be prospective only.

ARGUMENT

I

THE DIVISION'S ASSERTION OF CBT NEXUS OVER A FOREIGN CORPORATION WITHOUT ANY PHYSICAL PRESENCE IN NEW JERSEY IS UNCONSTITUTIONAL.

The principal issue in *Lanco* is whether the Division's assertion of CBT nexus over a foreign corporation with no physical presence in New Jersey, based solely upon the licensing of its intangible property to others located in New Jersey, violates the United States Constitution. The Chamber contends that this assertion of tax nexus violates both the Commerce Clause and the Due Process Clause of the United States Constitution.

Under Commerce Clause jurisprudence, a state income or franchise tax must satisfy the four-prong test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). To pass constitutional muster, a state tax must: **(i)** be applied to an activity with a substantial nexus to the taxing state; **(ii)** be fairly apportioned; **(iii)** not discriminate against interstate commerce; and **(iv)** be fairly related to services provided by the taxing state. *Id.*, 430 U.S. at 279. In *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), the Supreme Court held that "substantial nexus" did not exist when the foreign corporation alleged to have sales and use tax liability had no physical presence in the state. *Id.* at 312-318. The *Quill* Court also found "too slender [a] thread upon which to base [substantial] nexus" the licensing by the foreign corporation of intangibles in the form of software to certain of its North Dakota customers. *Id.*, at 315 n.8 ("agree[ing]" with the State's concession to this effect).

Lanco does not own any real or tangible property in this State, has no employees or offices in this State, and does not maintain or otherwise engage in any activity to protect its intangibles in this State. Because Lanco does not have any physical presence in New Jersey, it cannot have the "substantial nexus" with this State required under *Quill* and, therefore, cannot, consistent with controlling Commerce Clause precedent, be subject to tax here.

The Division concedes its reliance upon *Geoffrey v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C.), *cert. denied*, 510 U.S. 992, 114 S. Ct. 550, 126 L. Ed. 2d 451 (1993), in crafting the Amended Regulation and goes so far as to state that the examples found in the Amended Regulation "take some inspiration" from *Geoffrey*. 28 *N.J.R.* 4795(a), 4797-98. The South Carolina Supreme Court in *Geoffrey* upheld the imposition of a tax on a corporation without any physical presence in the state. Confronting this same issue, the courts of other states have found the reasoning of *Geoffrey* less "inspir[ing]" and persuasive than does the Division, and have flatly rejected attempts to impose tax nexus without physical presence, including ambitious attempts like those of the Division to base nexus upon nothing more than a foreign corporation's licensing of intangibles within the state. *See, e.g., Cerro Copper Products, Inc.*, No. F-94-444, 1995 Ala. Tax LEXIS 211 (Ala. Dep't of Revenue Dec. 11, 1995), *reh'g denied*, 1996 Ala. Tax LEXIS 17 (Ala. Dep't of Revenue Jan. 29, 1996); *Dial Bank, Nos. INC.* 95-289, F.95-308, 1998 Ala. Tax LEXIS 196 (Ala. Dep't of Revenue Aug. 10, 1998); *Crown Cork & Seal (Del.), Inc. v. Comptroller*, No. C-97-0028-01 (Md. Tax Ct. Apr. 26, 1999), *aff'd*, No. 24-C-99-02388 (Cir. Ct. Baltimore City Mar. 17 2000); *MCI Int'l Telecomms. Corp. v. Comptroller*, No. C-96-

0028-01 (Md. Tax Ct. Apr. 26, 1999) *aff'd*, No. 24-C-99-002387 (Cir. Ct. Baltimore City Mar. 17, 2000); *SYL, Inc. v. Comptroller*, No. C-96-0154-01 (Md. Tax Ct. Apr. 26, 1999) (1999 WL 322666), *aff'd*, No. 24-C-99-002389 AA (Cir. Ct. Baltimore City Mar. 17, 2000); *J.C. Penney National Bank v. Johnson*, No. M1998-00497-COA-R3-CV, 1999 Tenn. App. LEXIS 826 (Tenn. Ct. App. Dec. 17, 1999), *permission to appeal denied*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000); *Rylander v. Bandag Licensing Corp.*, No. 03-99-00472-CV, 2000 Tex. App. LEXIS 3034 (Tex. App. May 11, 2000).[1]

The Amended Regulation fares no better under due process jurisprudence. Concededly, *Quill* has now eliminated, at least in the context of sales and use tax nexus, the due process requirement of physical presence suggested by *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967). As framed by the Court, the relevant due process inquiry is whether "a defendant ha[s] minimum contacts with the [taxing] jurisdiction 'such that the ...[imposition of the tax collection duty] does not offend 'traditional notions of fair play and substantial justice.'" *Quill*, 504 U.S. at 307 (comments added), *quoting International Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 90 L. Ed. 95 (1945) (*quoting Milliken v. Meyer*, 311 U.S. 457,

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[1] For convenience of reference by the Court, copies of the cited cases, together with the out-of-state cases cited elsewhere in this brief, are included in the Chamber's Appendix.

463, 61 S. Ct. 339, 85 L. Ed. 278 (1940)). Yet, however reduced in quantum and nature the tax nexus requirements under current due process jurisprudence,[2] the mere licensing of intangibles to persons within the taxing jurisdiction will not suffice. There must exist "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill*, 504 U.S. at 306, *quoting Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345, 74 S. Ct. 708, 98 L. Ed. 1106 (1954).

This "link" was not satisfied in *Quill* by the mere licensing of software to North Dakota customers. *Id.*, 504 U.S. at 315 n.8. Neither was it satisfied by the mere fact that goods offered for sale by an out-of-state mail-order house had been purchased for use in North Dakota. The "definite link" required by the Due Process Clause was satisfied only upon specific findings (i) that "Quill ha[d] purposefully directed its activities at North Dakota residents," (ii) that "the magnitude of those contacts...[was] more than sufficient for due process purposes," and (iii) that "the use tax...[was] related to the benefits Quill receive[d] from access to the State." *Id.*, 504 U.S. at 308.

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[2] The United States Supreme Court has suggested that due process "nexus" requirements may be more stringent in the case of direct taxes than in the case of indirect taxes like sales and use taxes, reasoning that in the latter context:

> The out-of-state seller runs no risk of double taxation. The consumer's identification as a resident of the taxing State is self-evident. The out-of-state seller becomes liable for the tax only by failing or refusing to collect the tax from that resident consumer. Thus, the sole burden imposed upon the out-of-state seller...is the administrative one of collecting it."

National Geographic Society v. California Bd. of Equal., 430 U.S. 551, 558, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977).

This particularized and focused due process analysis stands in stark contrast to the facile approach taken by the Division in the Amended Regulation, an approach which threatens to reduce the "minimum contacts" and fundamental fairness mandates of the Due Process Clause to mere talismans or mantras. In any event, the showing to date by the Division in *Lanco* demonstrates no such "definite link" between the taxpayer and this State and no such "purposeful direction" of the taxpayer's activities at residents of this State.

We, therefore, submit that the imposition of the CBT on foreign corporations like Lanco, solely in reliance on the Amended Regulation, is violative of the Due Process and Commerce Clause constraints on the taxing power of the State and cannot stand.

II

THE DIVISION SHOULD NOT BE PERMITTED TO APPLY THE AMENDED REGULATION RETROACTIVELY.

The Division seeks in *Lanco* not only to impose an unconstitutional tax, but to do so (i) by promulgating in 1996 a regulation which represents a markedly new approach to the doctrine of tax nexus and (ii) by purporting to apply that regulation retroactively to tax years beginning in 1983. Should this Court find Lanco and other similarly situated foreign corporations properly subject to the CBT based upon nothing more than the licensing of intangibles, the Chamber, nevertheless, submits that retroactive application of such a rule is impermissible.

A. New Jersey Applies the Same Standard to Both Statutes and Regulations for Determining Whether Retroactivity is Appropriate.

As a general rule, New Jersey courts apply both legislation and administrative regulations prospectively only. *Lacey Mun. Utils. Auth. v. New Jersey Dep't of Envtl. Protection*, 162 N.J. 30, 40 (1999) ("[R]etroactive application of an administrative rule is not favored"), *quoting Citizens for Equity v. N.J. Dept. of Environmental Protection*, 252 N.J. Super. 62, 76 (App. Div. 1990), *aff'd*, 126 N.J. 391 (1991); *In re Progressive Cas. Ins. Co.*, 307 N.J. Super. 93, 100-101 (App. Div. 1997) ("We recognize the general principle that legislation and administrative regulations are ordinarily accorded prospective effect only"); *Frank A. Greek & Sons v. Township of South Brunswick*, 257 N.J. Super. 94, 105 (App. Div. 1992) ("[L]egislation and regulations are generally applied prospectively"), *certif. denied*, 130 N.J. 602 (1992).

The rationale behind this principle is that:

> Administrative rule-making remains in essence . . . the enactment of legislation of general application prospective in nature. The object is not legislation ad hoc or after the fact, but rather the promulgation, through the basic statute and the implementing regulations taken as a unitary whole, of a code governing action and conduct in the particular field of regulation so those concerned may know in advance all the rules of the game, so to speak, and may act with reasonable assurance."

Consolidation Coal Co. v. Kandle, 105 N.J. Super. 104, 113 (App. Div. 1969) (*quoting Boller Beverages, Inc. v. Davis*, 38 N.J. 138, 151-52 (1962)), *aff'd*, 54 N.J. 11 (1969).

Regulations, like statutes, may only be applied retroactively where (i) "the legislature has expressed its intent . . . that they should be so applied," (ii) the regulation

is "ameliorative or curative," or (iii) "the reasonable expectations" of the parties "warrant... [retroactive] application." *In re Progressive Cas. Ins. Co.*, 307 N.J. Super. at 101, *quoting Seashore Ambulatory Surg. Ctr. v. Dept. of Health*, 288 N.J. Super. 87, 97-98 (App. Div. 1996); *see also In re Certain Amendments to Adopted & Approved Solid Waste Management Plan of Hudson County*, 133 N.J. 206, 223 (1993); *Gibbons v. Gibbons*, 86 N.J. 515, 522-23 (1981). In no event, however, will retroactive application be permitted if "manifest injustice" will result to the party adversely affected. *In re Progressive Cas. Ins. Co.*, 307 N.J. Super. at 101. The burden of overcoming the presumption against retroactivity rests on the party seeking to have the regulation applied retroactively. *See, e.g., Alpha-Bella VI, Inc. v. Clinton Township*, 14 N.J. Tax 597 (1995).

Underlying these judicial prescriptions are notions of fundamental fairness. Administrative agencies, therefore, have been enjoined to use "caution when contemplating retroactive application of regulations" and to be "guided by principles of basic fairness" so as not to disadvantage the affected party by "application of twenty-twenty hindsight." *Lacey Mun. Utils. Auth.*, 162 N.J. at 40.

Our State Tax Court precedents are in accord with these fundamental principles, *i.e.*, disfavoring retroactive application of administrative regulations and applying the same retroactivity standards, whether the issue presented involves a statute or a regulation. *See, e.g., Richardson v. Director, Division of Taxation*, 14 N.J. Tax 356 (1994); *Chevron U.S.A., Inc.* v. *City of Perth Amboy*, 9 N.J. Tax 205 (Tax Ct. 1987); *Sorensen v. Director, Division of Taxation*, 2 N.J. Tax 470 (Tax Ct. 1981).

B. The Amended Regulation Does Not Meet This Standard and, Therefore, Cannot Be Applied Retroactively.

A regulation which does not satisfy the tests set forth in *In re Certain Amendments, supra,* will not be applied retroactively. Because retroactive application of the Amended Regulation (i) was not intended by the New Jersey Legislature, (ii) is neither curative nor ameliorative, (iii) does not harmonize with the parties' expectations, and (iv) will result in manifest prejudice to the affected parties, the Amended Regulation should not be applied retroactively.

The Division Did Not Express its Intent to Apply the Amended Regulation Retroactively.

The first factor to be considered is whether the Amended Regulation was intended to be applied retroactively. In *Richardson v. Director, Division of Taxation,* 14 N.J. Tax 356, the Tax Court struck down the retroactive application of a portion of the New Jersey Taxpayer Bill of Rights. The question before the court was whether the law in effect at the time of its decision, or the law in effect at the time of the conduct in question, should govern.

The court recognized that there has long been a tension between the "time-of-decision rule" and the "'generally accepted axiom that 'retroactivity is not favored in the law.'" *Richardson,* 14 N.J. Tax at 361-363. The court also recognized that the resolution of this tension lies in the intent of our Legislature. *Id.,* at 361, 365. If, therefore, the Legislature intended for the statute or regulation to apply retroactively, that intent will control. Such controlling legislative intent, however, may be found only from "an unequivocal expression" in the language of the statute or regulation, particularly when

the statute or regulation in question "changes...settled law and relates to substantive rights." *Id.*, at 365. As an example of an "unequivocal expression" of retroactive application, the court pointed to the following amendment to the Taxpayer Bill of Rights: "'This act shall take effect immediately and sections 3, 4, and 5 shall be retroactive to July 1, 1993 if enacted after that date.'" *Id.*, at 366 n.3 (*citing* L. 1993, ch. 331, § 6).

There is here no "unequivocal expression" of any intent by the Legislature *or by the Division itself* regarding retroactive application. *See N.J.A.C.* 18:7-1.9. To the contrary, the Amended Regulation is on its face conspicuously silent on this issue. *N.J.A.C.* 18:7-1.9; *see* 28 *N.J.R.* 4795(a). It neither recites that it will be applicable retroactively nor contains any finite period of retroactivity. Presumably the Division will seek to apply the Amended Regulation retroactively against foreign corporations for all open tax years. Yet, as in *Richardson*, the complete absence in the Amended Regulation of any expression of retroactive intent, unequivocal or otherwise, or of any fixed period of retroactivity, mandates its prospective application only.

The circumstances here are unlike those in *In re Progressive Cas. Ins. Co.*, 307 N.J. Super. 93, in which the Appellate Division upheld retroactive application of an administrative rule which had been enacted to formalize a commonly used standard within the insurance industry. The rule there at issue barred requests for recalculations of premium adjustments after two and a half years following the close of a calendar year. In applying the first prong of the test set forth in *In re Certain Amendments*--legislative intent--the court determined that retroactive application of the rule was

appropriate, given the history surrounding its adoption, including, in particular, an earlier decision and order of the Commissioner of Insurance denying retroactive application of the informal rule to a different insurer and directing that the disputed rule be formalized through administrative action. *Id.*, 307 N.J. Super. at 97-98, 101. The court also noted that not only had the appellant been on notice of the rule's adoption, but also that the rule merely formalized a practice which had been standard in the industry. *Id.*, at 101.

The Amended Regulation represents neither agency adoption of an informal rule nor an industry standard of which Lanco and other similarly situated foreign corporations were aware prior to its adoption. Unlike the circumstances before the court in *In re Progressive Cas. Ins. Co.*, there is here no regulatory history surrounding adoption of the Amended Regulation which would have placed a foreign corporation on notice of the impending regulation or its retroactive application. To the contrary, the Amended Regulation is a markedly new approach to the nexus doctrine which purports to tax foreign corporations which previously had not been subject to taxation in New Jersey. It was not until formal comments regarding adoption of the Amended Regulation were requested by the Division that any indication was given that the Division might seek to apply the Amended Regulation retroactively. *See* 28 *N.J.R.* 4795(a), 4797.

The Amended Regulation is Neither Curative Nor Ameliorative.

The second factor to be considered is whether the regulation is curative or ameliorative.[3] Under New Jersey law, a curative exception to the presumption against retroactivity occurs when an amendment brings a statute into compliance with the original legislative intent by correcting an error or inadvertent mistake. *Richardson*, 14 N.J. Tax at 369-370, *citing Kendall v. Snedeker*, 219 N.J. Super. 283 (App. Div. 1987). That an amendment might "better a statutory scheme" does not make it "curative." *Id.*, at 370, *quoting Kendall*, 219 N.J. Super. at 289. A curative retroactive amendment is, therefore, permissible only if it clarifies what was originally intended. It cannot effect a change in the law, because it then would no longer be "curative".

Although the Division may argue that the Amended Regulation, which broadens the definition of "doing business" to include the licensing of intangibles, is merely an interpretation of that term and, therefore, falls under the curative exception to the presumption against retroactive application,[4] the Division cannot deny that its interpretation is new and was never before articulated, expressly or impliedly, by the State Legislature. Indeed, the Division's own expert has conceded that "the general rule

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[3] The ameliorative exception applies "only in criminal law, in cases where the statute is intended to impose a lesser punishment," and, therefore, is here inapt. *Richardson*, 14 N.J. Tax at 370, *quoting Fasching v. Kallinger*, 227 N.J. Super. 270, 274 (App. Div. 1988), *certif. denied*, 114 N.J. 505 (1989).

[4] In responding to a comment that the Amended Regulation should be applied prospectively, the Division stated that the regulation "represent[ed] interpretation of long standing statutory provisions and d[id] not constitute a real change of direction" (28 *N.J.R.* 4795(a), 4797), a position belied by its concession that the Amended Regulation was "inspir[ed]" by *Geoffrey* (28 *N.J.R.* 4795(a), 4798), the holding of which, however questionable (*see* Point I, *infra*), was only possible after *Quill* had been decided in 1992—and, moreover, a position contradicted by the Division's own expert in *Lanco* (*see* note 5, *infra*, and the accompanying text).

today is that physical presence is required before a state can impose a corporate income tax" (Tr. II 82).[5]

The Amended Regulation expands the definition of "doing business" to include the licensing of intangible property without any physical presence in the State. Prior to adoption of the Amended Regulation in 1996, the definition of "doing business" in New Jersey required physical presence. *See N.J.A.C.* 18:7-1.9(b)(1)-(5). All of the indicia set forth in the pre-amended version of the rule for determining when a foreign corporation is doing business in New Jersey support this requirement, as they refer to the location of offices, the nature of activities within New Jersey, and the employment of officers within the State. *See N.J.A.C.* 18:7-1.9(b).

Similarly, the Tax Court recognized that nexus required physical presence in 1983 when it decided *Chemical Realty Corp. v. Taxation Division Director*, 5 N.J. Tax 581 (Tax Ct. 1983), *aff'd*, 6 N.J. Tax 448 (Super. Ct., App. Div. 1984), and there held that a foreign corporation having no employees or property in the State was not subject to New Jersey Corporation Income Tax: "The United States Supreme Court would seem to require more than...the taking advantage of New Jersey's economic milieu to sustain the tax at issue. It appears that, in addition, there must be a degree of physical presence." *Id.*, at 612. It is, therefore, evident that New Jersey then required physical presence before tax nexus could be found.

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[5] All references to "Tr. _" and "Tr. II _" are to the transcripts of the hearings held in *Lanco* on November 30, 1999 and May 15, 2000, respectively.

The Division has made no secret of the fact that its newly expanded definition of "doing business" is based not on any recently divined legislative intent or any intent to correct an error in the prior regulation, but primarily on the holding of the South Carolina Supreme Court in *Geoffrey*. 28 *N.J.R.* 4795(a), 4797, 4798 (the Amended Regulation "find[s] precedent in" and "take[s] some inspiration from" *Geoffrey*). Neither can the Division credibly claim that the Amended Regulation is an interpretation or clarification of the prior regulation, since it not only creates an entirely new standard for tax nexus but is expressly based upon a flawed 1993 decision in another taxing jurisdiction.

In its response to comments published with adoption of the Amended Regulation, the Division purports to dismiss the significance of *Chemical Realty* by claiming that its holding is no longer applicable in light of *Quill's* holding that the Due Process Clause no longer bars a state from imposing use tax obligations upon a corporation not physically present in the state. See 28 *N.J.R.* 4795(a), 4798. This argument misses the point. That *Chemical Realty* was decided on due process grounds does not compel the conclusion that a similar result would not be reached were the case to be decided today. As demonstrated in Point I, *supra*, the *Quill* Court did not abrogate the physical presence requirement under the Commerce Clause.

In any event, whatever the constitutional basis of the holding in *Chemical Realty*, the fact remains that in 1983 no New Jersey corporate tax was imposed on foreign corporations having no physical presence in the State and this remained the rule until 1996 when the Amended Regulation was adopted. It, therefore, blinks reality to

suggest that the Amended Regulation was enacted to correct a defect or error in, or as an interpretation of, the prior regulation.

The Expectations of the Parties Do Not Warrant Retroactive Application.

The third exception to the prospective application of statutes and administrative rules is in circumstances in which the "expectations of the parties warrant the retroactive application of the statute." *In re Certain Amendments*, 133 N.J. at 223 (citations omitted). For example, in *Brown v. State Department of Personnel*, 257 N.J. Super. 84, 90-91 (App. Div. 1992), the court refused to apply retroactively a statute which expanded the definition of "veteran" for civil service purposes, because the parties could not reasonably have expected such an expanded definition at the time they applied for the civil service jobs in question. Rather than clarify preexisting law, the amendment to the definition of "veteran" created "a new class of veterans . . . that did not previously exist." Similarly, in *Richardson v. Director, Division of Taxation*, 14 N.J. Tax 356, the court held that a taxpayer could not have expected in 1989 that the State Legislature would subsequently enact legislation providing for a full abatement of interest in the event that the taxpayer relied upon erroneous advice by the Division.

Likewise, neither Lanco nor any other corporation without physical presence in New Jersey could have had any expectation in 1983—the year in which the Tax Court held in *Chemical Realty* that physical presence was required, ten years before *Geoffrey* was decided, and thirteen years before the adoption of the Amended Regulation—that the definition of "doing business" would be expanded to encompass foreign corporations having no physical presence within the State of New Jersey. To the

contrary, as recently as 1994 the New Jersey Legislature had effectively confirmed that physical presence was a precondition to tax nexus.

In 1994, a bill was introduced in the New Jersey Legislature which would have taxed financial institutions having no physical presence in the State. *See* 1994 Bill Text NJ A.B. 2784. The bill would have imposed the CBT on those financial institutions "deriving receipts from sources within [New Jersey], or for the privilege of engaging in contacts within [New Jersey]" while having no offices, property or employees here. *Id.* In June, 1995, only four months before the Amended Regulation was proposed, the Legislature withdrew the bill from further consideration. *Id.*

The legislative history surrounding A.B. 2784 bolsters the Chamber's position that the parties' expectations up to the adoption of the Amended Regulation was that physical presence was required in order to constitutionally impose the CBT on a foreign corporation. Further confirmation of this position may be found in the fact that A.B. 2784, by its express terms, was to apply prospectively only. *Id.*

Retroactive Application Would Result in Manifest Injustice to the Affected Parties.

The final and overriding factor is whether retroactive application of the Amended Regulation would result in prejudice to the affected parties. Even if each of the exceptions to the prospective-only rule were found to apply—which they do not—a regulation may not be applied retroactively where manifest injustice would result.

Corporations commonly take into account their expected tax burdens when planning their business, setting their prices, and deciding in which markets to operate.

Had Lanco and other similarly situated foreign corporations expected to be subject to the CBT, they would have had the opportunity to factor these expected costs into their business plans, to incorporate them into their pricing structures and, ultimately, to decide whether to do business in New Jersey at all. Retroactive application back to 1983 of a new rule—which occurred to the Division only after *Geoffrey* was decided in 1993—forecloses this opportunity.

In *Lacey Mun. Utils. Auth.*, 162 N.J. 30, the Court stressed the use of "caution" and "principles of basic fairness" in determining whether to apply regulations retroactively or prospectively. *Id.*, at 40. Just as the *Lacey* Court eventually determined that "Lacey ought not be disadvantaged" by retroactive application of an administrative regulation, so should this Court conclude that Lanco and other similarly situated foreign corporations ought not be similarly disadvantaged. *Id.* If the Amended Regulation is to be applied at all, it should be applied prospectively only.

Cases Upholding Retroactive Application are Distinguishable.

While New Jersey courts have on rare occasions upheld retroactive application of regulations, the circumstances before this Court are not such occasions. Such rare occasions generally involved (i) circumstances in which disadvantaged parties are seeking the benefits of a literalized rule adopted by a government body after a problem has been recognized, as, for example, was the case in *Frank A. Greek & Sons*, 257 N.J. Super. at 106 (*upholding* retroactive application of a regulation permitting municipalities to validate prior conduct), and *In re Certain Amendments*, 133 N.J. at 216, 221 (*holding* that administrative action with procedural defects could be "cured" through subsequent

validating agency action, especially where the issue involved was solid waste disposal, "one of this state's most severe problems"), or (ii) circumstances in which the regulation on its face clearly was intended to be applied retroactively, as in *Seashore Ambulatory Surgery Center v. New Jersey Department of Health*, 288 N.J. Super. 87 (App. Div. 1996) (upholding retroactive application of a regulation which on its face expressed the intent to be applied retroactively). None of these exceptional circumstances here obtain.

C. Other Jurisdictions Have Similar Prohibitions Against Retroactive Application of Rules and Regulations.

Numerous other state taxing jurisdictions have similarly strong presumptions against the retroactive application of administrative rules and regulations. For example, New York courts have so held on the ground that "retroactive application of [an] administrative ruling would result in the taking of property arbitrarily."[6] *Linsley v. Gallman*, 329 N.Y.S.2d 486, 488 (3d Dep't 1972), *aff'd*, 307 N.E.2d 257 (N.Y. 1973). In *Linsley*, the court refused to apply an administrative ruling retroactively because it "enlarged that particular tax statute" by expanding the scope of what constituted an annuity for purposes of the personal income tax. *Id.*, 329 N.Y.S. 2d at 488; *see also In re Dominion Textile (USA), Inc.*, DTA No. 812248, 1997 N.Y. Tax LEXIS 189, at *31 (N.Y.S. Tax App. Trib., Apr. 14, 1997) (*refusing* to apply a tax regulation retroactively where the regulation represented a "distinct reversal of policy by the taxing authority" and would

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[6] New Jersey has often looked to New York's approach in administering the CBT, since the CBT is in many respects modeled after New York's counterpart tax statute. *See* Report, *Commission on Taxation of Intangible Property*, 31-32, 63, 78 (1958); N.J. Atty. Gen. F.O. 1960 - No. 2 (Feb. 10, 1960).

result in prejudice to some taxpayers by "grossly" increasing their allocation percentages).

Similarly, the Connecticut Supreme Court has stated that "[a]bsent specific authority to interpret retroactively, and because of the uncertainty, difficulties and hardship which could thus arise, we have never hesitated, on the ground of public policy, to curb the right of an administrative body to change its decision with retroactive effect." *Hartford Elec. Light Co. v. Sullivan*, 285 A.2d 352 (Conn. 1971) (*refusing* to apply a regulation retroactively which would have resulted in taxation of income earned before adoption of the regulation).

Likewise, Florida's Department of Revenue has stated that for an administrative rule to have retroactive application it "would have to have a clear statement" of retroactive application, particularly where application of the new rule would "bring about a result which differs from the decision made in keeping with statutes and rules in effect at the time the dispute arose." *Housing by Vogue, Inc. v. Florida*, No. 78-1637, 1981 Fla. Tax LEXIS 24, at *5 (Fla. Dep't of Revenue, June 9, 1981) (*refusing* to apply a regulation retroactively when it did not exist at the time the conduct occurred); *accord Kewanee Indus. Inc. v. Reese*, 845 P.2d 1238, 1244 (N.M. 1993); *Carco Rentals, Inc. v. Director of Revenue*, No. R-80-0158, 1982 Mo. Tax LEXIS 94, at *10 (Mo. Admin. Hearing Comm'n Apr. 19, 1982); *Harder v. Kansas Comm'n on Civil Rights*, 592 P.2d 456, 459 (Kan. 1979).

When an administrative position represents "a substantially new or change[d]...policy," Maryland courts not only have required that the position must be implemented through statutorily-prescribed rulemaking procedures, but have held

that, by statute, any such "regulation may only be promulgated prospectively." *SYL, Inc. v. Comptroller of the Treasury*, 1999 WL 322666, at *6; *see CBS Inc. v. Comptroller of the Treasury*, 574 A.2d 324 (Md. Ct. App. 1990).

What these jurisdictions share with New Jersey is the principle that administrative rules and regulations, like statutes, generally should be applied prospectively only. While retroactive application of administrative action may be allowed in certain limited circumstances, it should be done sparingly and only so long as no prejudice results to the affected party. Here, there is no question that the Amended Regulation would result in great prejudice to Lanco and other affected parties.

D. Retroactive Application of Administrative Rules and Regulations is Disfavored at the Federal Level As Well.

As a general proposition, federal courts do not favor retroactive application of legislation or administrative regulations. *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208, 109 S. Ct. 468, 102 L. Ed. 2d 493 (1988) ("[r]etroactivity is not favored in the law" (*citing Greene v. United States*, 376 U.S. 149, 160, 84 S. Ct. 615, 11 L. Ed. 2d 576 (1964) (*refusing* to apply retroactively a regulation promulgated by the Secretary of Defense since the "'first rule of construction is that legislation must be considered as addressed to the future, not to the past'" (citation omitted))); *Miller v. United States*, 294 U.S. 435, 439, 55 S. Ct. 440, 79 L. Ed. 977 (1935) (*holding* that administrative regulations are equally subject to the rule that "generally a statute cannot be construed to operate retrospectively unless the legislative intention to that effect unequivocally appears").

In *Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 59 S. Ct. 423, 83 L. Ed. 536 (1939), a case still cited today by advocates against retroactivity (*Sorensen* v. *Director, Division of Taxation*, 2 N.J. Tax at 477), the Supreme Court struck down the retroactive application of a Treasury Regulation enacted five years after the tax year in issue. The Internal Revenue Service had argued that Congress's reenactment of a Revenue Act demonstrated an intent to retroactively apply an amended regulation. The Court, however, held that constructive approval of the original wording of a statute did not give rise to the conclusion that Congress intended to sanction the retroactive enforcement of the amended regulation. *R.J. Reynolds Tobacco*, 306 U.S. at 117. Accordingly, the Secretary's retroactive application of the regulation was stricken.

R.J. Reynolds Tobacco confirms that the controlling factor in determining whether regulations may be applied retroactively is legislative intent. No such legislative intent to have the Amended Regulation applied retroactively can be here demonstrated. Not only did the New Jersey Legislature withdraw a similar bill which would have statutorily effectuated this changed approach to tax nexus on a prospective basis, *see supra* at 18, but nowhere in the proposed or final version of the Amended Regulation did the Division provide for retroactive application. *See* 28 *N.J.R.* 4795(a); *N.J.A.C.* 18:7-1.9. We, therefore, submit that the Amended Regulation cannot be applied retroactively.

CONCLUSION

For all of the foregoing reasons, the Chamber respectfully submits that the Amended Regulation is on its face violative of the Due Process and Commerce Clauses

of the United States Constitution and, therefore, must be invalidated; or, in the alternative, should this Court hold otherwise on the merits, that the Amended Regulation must be applied prospectively only.

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Dated: July 14, 2000

EXPERT OPINION OF PROFESSOR RICHARD D. POMP[1]
Lanco, Inc. v. Director, Division of Taxation

Introduction

You have contacted me as the former Director of the New York Tax Study Commission and as someone who for nearly 25 years has studied, lectured, taught, published, and consulted with, and testified on behalf of, state governments, regarding issues of state taxation.

You have asked my opinion about the policies that distinguish due process nexus from commerce clause nexus. In addition, you have asked whether physical presence or metaphysical presence is more compatible with the values underlying the commerce clause. Specifically, you have asked my opinion on whether physical presence or metaphysical presence is more consistent with sound tax policy.

Your inquiry grows out of an attempt by the New Jersey Division of Taxation ("Division") to tax an out-of-state corporation, Lanco. This corporation owns certain trademarks and service marks, which are licensed for use by Lane Bryant, Inc. (Lane Bryant), which does business in New Jersey. It is undisputed that Lanco has no physical presence in New Jersey. That is, it neither owns nor leases any tangible or real property in New Jersey. Further, it has no employees, representatives, or jobbers in New Jersey. Apparently, the position of the Division is that Lanco, an out-of-state licensor, has intangible property present in the State and that this intangible property provides sufficient nexus for New Jersey to assert jurisdiction over it.

Due Process Nexus and Commerce Clause Nexus: An Overview

As background for understanding the policy considerations that are relevant in analyzing the position of the Division, you have asked me the difference between due process nexus and commerce clause nexus. Due process nexus is concerned with the fundamental fairness of governmental activity. It requires a state to ask whether a person's connections with it are substantial enough to legitimate the state's exercise of power over that person. "Notice" or "fair warning" are the analytic touchstones of due process nexus.

In contrast, commerce clause nexus is informed by structural concerns about the effects of state taxation on the national economy. A state must ask whether its actions hinder, suppress, or

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unduly burden interstate commerce. Commerce clause nexus is a means for limiting state burdens on interstate commerce.

As this brief description suggests, due process nexus is a very different concept from commerce clause nexus and a person that has due process nexus with a state does not necessarily have commerce clause nexus. The Division's position regarding the taxation of the royalties raises questions concerning both types of nexus, but my opinion is limited to only the policy considerations surrounding commerce clause nexus.

There is no doubt that commerce clause nexus can be satisfied by a person's physical presence. This physical presence standard has the blessing of the U.S. Supreme Court and that of all state courts. As the name implies, physical presence or physical nexus refers to the presence in a state of tangible property or of personnel of the taxpayer. Physical nexus has a long history and tradition and provides a standard that in nearly all cases is unambiguous and easily applied. Moreover, physical presence provides a determinate solution to the issue of nexus because property or persons cannot simultaneously exist in more than one state.

The out-of-state corporation that the Division seeks to tax does not have any physical presence in New Jersey, and I do not believe the Division is challenging that proposition. Instead, the Division seems to be applying a new standard of commerce clause nexus: metaphysical nexus. Metaphysical nexus is an incorporeal standard, which does not require that a taxpayer have any physical presence in a state. Rather, a taxpayer is present under this theory because of various legal relationships that exist between itself and nonphysical, intangible property. In the present case, the Division's position seems to be that the out-of-state corporation is present in the State because of its license agreement with a taxpayer that is doing business in New Jersey.

A Policy Evaluation of Physical and Metaphysical Presence

You have asked me to evaluate from a policy perspective the merits of physical presence nexus versus metaphysical presence nexus. Various criteria exist for evaluating the relative merits of these competing nexus standards in the context of the values and goals that underlie the commerce clause. The criteria that are evaluated below ask which nexus standard is: (1) more consistent with a bright line test; (2) more consistent with settled expectations; (3) more likely to reduce litigation and foster interstate investment; (4) less likely to discriminate against the service sector; (5) less likely to lead to multiple taxation; and (6) more likely to be fairly or easily administered.

For the reasons explained below, I conclude that physical presence is clearly superior to metaphysical presence as a nexus standard when measured against any of these relevant, principled criteria.

Further, I conclude that the nexus standard for income taxes should be the same as the nexus standard for sales and use taxes.

1. Physical presence is more consistent with a bright line test

The U.S. Supreme Court has emphasized the need for a bright line rule for commerce clause nexus. The reason for a bright line rule is that a nexus standard operates in a stark, all or nothing fashion: a company will either be subject to an income tax or it will not. The need for a bright line test is especially acute where millions of dollars of income taxes can turn on whether nexus exists.

From this policy perspective, an overwhelming virtue of the physical presence standard is that it provides a bright line test. People or tangible property are visible and can be identified through physical observation. Their existence and presence is unambiguous; people or property are either in a state or they or not.

In sharp contrast, metaphysical presence is an amorphous concept, having no crisp edges. The essence of intangible property is that it cannot be perceived or physically located. As the dictionary recognizes, intangible property "cannot be easily defined, formulated, or grasped."[2]

Unlike persons or tangible property that can be identified geographically, intangible property cannot be located in any particular state except through legal fictions or doctrines. Various legal fictions include the doctrine of mobilia sequuntur personam, which treats intangibles as being attached to the person that owns them. Another legal fiction locates an intangible at the payor's residence. Yet another approach creates the fiction that an intangible has a business situs.

The problem that arises with these legal fictions is that they do not produce a unique solution to where an intangible is located. For example, the doctrine of mobilia sequuntur personam, when applied to a corporation, can assign intangibles to either the legal domicile of a corporation or its commercial domicile. Further, even the common rule that provides that certain types of intangibles, such as copyrights and patents, are located in the place in which the property is used, does not necessarily locate the intangible unambiguously in only one state. Consider, for example, a manufacturer that enters into a license agreement allowing it to use a secret process to produce and sell widgets. One state might locate the license agreement in the state of manufacturing whereas another might locate it in the state of sale.

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[2]Webster's New Universal Unabridged Dictionary (Deluxe 2nd ed.).

Intangible property is not capable of being observed and physically located in one unique state. By contrast, no one can dispute the location of a person or of tangible property. Compared with a physical presence standard, metaphysical presence not only provides no bright line rule, but also provides no determinate or unique answer to the nexus question. A rule that can locate an intangible simultaneously in more than one state is not a principle of nexus but rather an invitation to chaos.

2. Physical presence is more consistent with settled expectations

There is no U.S. Supreme Court case holding that metaphysical presence satisfies commerce clause nexus. All of the U.S. Supreme Court cases dealing with commerce clause nexus for corporate income tax purposes involved corporations that had a physical presence. Indeed, taxpayers have been very careful in structuring their activities to avoid having a physical presence in those states in which they did not wish to have nexus. In my opinion, the expectation of corporate taxpayers is that no nexus exists under the commerce clause without physical presence.

The metaphysical presence rule is obviously inconsistent with this expectation. If this expectation is to be frustrated by the imposition of a new, metaphysical presence rule, Congress is the only appropriate body to do so. Corporations relying on the physical presence standard have not filed income tax returns on the justifiable assumption that nexus did not exist. Without the filing of a return, the statute of limitations does not run in most states and localities. Consequently, enormous retroactive exposure exists if a new nexus standard is adopted by a jurisdiction. Congress is the ideal body to balance the interests of the various parties should it decide that the commerce clause nexus standard should be changed.

3. Physical presence will reduce litigation and foster interstate investment

The physical presence nexus standard has the weight of history and tradition behind it. It has been litigated over the years and its boundaries are well known and accepted. It provides a knowable and determinable standard. Long-standing precedent supports the standard, which furthers the stability and orderly development of the law. A long-standing doctrine like that of physical presence offers the kind of stability and predictability that fosters interstate investment.

Metaphysical nexus, by the very nature of intangible property, invites years of litigation. The very fact that intangible property does not physically exist in the way that tangible property or persons exist is an invitation to endless litigation and chaos. Metaphysical presence cannot be expected to have the same crisp, sharp edges as a concept as does physical presence, even after

years of litigation. The uncertainty and cloud over the concept of metaphysical nexus can only discourage certain types of interstate investment and thereby thwart the goals of the commerce clause.

4. Metaphysical presence discriminates against the service sector

The physical presence nexus standard has helped maintain tax parity between the service sector and the manufacturing and mercantile sectors of the economy. The manufacturing and mercantile sectors have been the beneficiaries of a special federal nexus statute, Public Law 86-272. The physical presence nexus standard complements Public Law 86-272 in a very significant way that helps maintain a level playing field between the manufacturing and mercantile sectors and the service sector.

Specifically, Public Law 86-272 provides a federal nexus standard by preventing a state from taxing the income of a corporation whose only business activities within the state consist of the solicitation of orders for *tangible personal property*. Public Law 86-272 is limited to tangible personal property and does not extend to services. This limitation is presumably explained by two factors. First, the law was enacted in order to overrule *Northwestern Portland Cement*,[3] which upheld the imposition of a tax on the income of a purely interstate taxpayer selling tangible property--not services.

Second, the law was adopted in 1959, at a time when the service sector was greatly overshadowed by the manufacturing and mercantile sectors. Further, the service sector tended to be intrastate in nature and not interstate. Accordingly, when Public Law 86-272 was adopted, Congress was focussing on the sale of tangible personal property and not on the relatively insignificant interstate service sector.

As interstate services grew in importance and significance, the physical presence rule allowed the service sector to achieve similar protection to that extended to the manufacturing and mercantile sectors under Public Law 86-272. Physical presence nexus is to the service sector what Public Law 86-272 is to the manufacturing and mercantile sectors.

The understanding and expectation of interstate service providers is that as long as they solicit in a state without having people or property in that state, no commerce clause nexus exists and no income tax can be imposed. The requirement of physical presence thus allows the service sector to achieve nearly the same treatment as those taxpayers that are protected by Public Law 86-272. Accordingly, the physical presence standard helps maintain competitive equity between taxpayers that provide services and

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[3]358 U.S. 450 (1959).

those competitors that provide tangible personal property.

A metaphysical presence rule would upset this balance and accommodation. Metaphysical nexus would exaggerate, rather than reduce, the competitive inequities of Public Law 86-272. The result would be to move away from a level playing field and discriminate against service providers, thus interfering unfairly and inequitably with the most rapidly growing sector in the U.S. economy.

5. Metaphysical presence will lead to multiple taxation

As discussed above, intangible property has no corporeal form and does not physically exist. Consequently, unlike people or tangible property, intangible property cannot be physically located in any particular state through physical observation. Intangible property can be located in a state only through arbitrary rules that can vary from state to state. Even worse, under the existing doctrines intangible property can be simultaneously present in more than one state, which can easily lead to multiple taxation.

Consider, for example, a corporation that licenses the use of a trademark from L, the licensor. L is incorporated in State I and has its commercial domicile in State C. The corporation agrees to pay a royalty for every good it manufactures and sells bearing L's trademark. Assume the taxpayer manufactures the goods in State M, and sells the goods in State S.

Suppose that State M considers the license to be located in the state of manufacture, that State S considers the license to be located in the state in which the goods are sold, that State C considers the license to be located at the licensor's commercial domicile, and that State I considers the license to be located at the licensor's state of incorporation. Under a metaphysical presence standard, L--the licensor--would have nexus with States M, S, I, and C. The same royalty payment would be taxed by each of these states, resulting in multiple taxation.

As another example, suppose an out-of-state vendor incorporated in State I, having its commercial domicile in State C, sells machinery to a corporation on an installment obligation. The sale is made in State S but later the customer removes the good to State R. Assume the vendor maintains a security interest in the good, which is filed in State R. The customer is incorporated in State D.

State S considers the installment obligation to be located in the state of sale, State R considers the obligation to be located where the security interest is filed, State D considers the obligation to be located at the payor's state of incorporation, State C considers the obligation to be located in the state of the payee's commercial domicile, and State I considers the obligation to be located in the payee's state of incorporation. Under a metaphysical presence

standard, the vendor would have nexus with States S, R, I, C, and D. Income attributable to the installment obligation would be taxed by each of these states, resulting again in multiple taxation.

Perhaps the most graphic way of illustrating the impact that metaphysical nexus would have on commerce clause values would be to imagine that each of the above states attempted to collect the tax due through a withholding mechanism. In other words, the payor would be required to withhold the taxes imposed by States S, R, I, C, and D. States watching their corporations being subjected to withholding taxes all around the country would be invited to retaliate by adopting their own withholding taxes. The widespread adoption of withholding taxes would be inconsistent with the philosophy of the free trade zone that characterizes the United States today. To the contrary, instead of serving as a model for the European Union, which is attempting to eliminate tax barriers to trade, we would be moving in the direction of becoming the United States of Europe.

6. Metaphysical presence cannot be easily or fairly administered as a nexus standard

Metaphysical nexus presents formidable administrative problems. An author receiving royalties from the sale of a book could be taxable in every state in which the book was sold. A television producer receiving royalties by a network for the use of a program could be taxable in every state in which the program was televised. An electronic data bank receiving payments for the use of its services could be taxable in every state in which its logo appeared on a computer screen. A start up company in Silicon Valley could be subject to tax in every state in which its software licensees operate. A bank purchasing mortgages could be subject to tax in every state in which the underlying mortgagors reside or in which the collateral were located. An athlete receiving royalties from the endorsement of a product could be taxable in every state in which the product was sold.

As these examples suggest, the compliance burdens for taxpayers and administrators would be immense under a metaphysical presence rule. Small and medium sized businesses would be saddled with the obligation to comply with the tax laws of states with which they would have no familiarity. Administrative considerations alone suggest that metaphysical presence is incompatible with the values and goals of the commerce clause.

The Commerce Clause Nexus Standard Should be the Same for Both Sales and Income Taxes

The U.S. Supreme Court has explicitly held that physical presence is the commerce clause nexus standard for sales and use taxes. Three policy considerations dictate that the same standard should apply for income taxes.

First, the commerce clause is concerned with the problem of multiple taxation. Yet the risk of multiple taxation is greater for income taxes than for sales and use taxes. In the case of the sales and use tax, typically there are only two states that can assert jurisdiction over the transaction: the state of origin and the state of destination. In the case of an income tax, however, a transaction may have contacts with numerous states, as the examples above illustrate. No reason exists to think that the Supreme Court is less concerned about multiple taxation when it occurs in an income tax than when it occurs in a sales tax. The same reasons that led the Court to endorse a physical presence standard for sales and use taxes apply even more strongly in the case of an income tax.

Second, treating income taxes the same as sales and use taxes is not only consistent with the policy values underlying the commerce clause, but also with the language of the clause. Nothing in the language of the commerce clause refers to specific taxes. There is not one commerce clause for sales and use taxes and another for income taxes. No reason exists, therefore, for a state to develop a different (and lower) nexus standard for income taxes than for sales and use taxes.

Third, the orderly development of the law requires that the same nexus standard should apply to both income taxes and sales and use taxes. If metaphysical presence were to apply to income taxes and physical presence to sales and use taxes, confusion would undoubtedly result because two bodies of doctrine would simultaneously develop side-by-side.

Consequently, policy considerations, the language of the Constitution, and the orderly development of the law require that physical presence be the nexus standard for both income taxes and sales and use taxes.

Conclusion

By any principled measure of comparison, physical presence is to be preferred to metaphysical presence as a nexus standard. Physical presence is more consistent with a bright line test, more consistent with settled expectations, more likely to reduce litigation and foster interstate investment, less likely to discriminate against the service sector, less likely to lead to multiple taxation, more easily administered, and more compatible with the growth of electronic commerce.

The Constitution does not distinguish between sales and use taxes and income taxes: there is only one nexus standard and the U.S. Supreme Court has endorsed physical presence.

The country has little experience with administering a metaphysical presence standard; the concept is amorphous and easily malleable.

Metaphysical presence is less a legal principle and more an invitation to chaos and multiple taxation, thus undercutting the very goals of the commerce clause that the concept of nexus is intended to further.

NEXUS AND STATE CORPORATE INCOME TAXATION

by

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NEXUS AND STATE CORPORATE INCOME TAXATION

I. Introduction and Summary

The issue of nexus for state corporation income tax purposes has potentially far-reaching implications. The resolution of this issue will affect not only individual states but the functioning of the economic system as a whole. It should be resolved in a way that recognizes both the legitimate economic interests of state governments and the national interest in sound economic policy. In a federal system like that of the United States, states must be able to utilize fiscal instruments that allow them to perform their essential economic functions; at the same time, they should not implement policies that impede the efficient functioning of the economic system or that impose inappropriate burdens on the rest of the nation. Policies that are in the interest of an individual state acting alone – in the present context, an excessively broad definition of nexus for corporation income taxation – may be harmful to the collectivity of all states. The taxing powers of the states should not be so constrained that they are unable to carry out their critical public functions, but at the same time they should be sufficiently constrained that the exercise of their powers is not harmful to the nation.

As will be shown below, it is inappropriate for states to use the licensing of intangibles as a basis for determining nexus for state corporation income tax purposes.[1] Rather, economic policy considerations support the use of a physical presence test for this purpose. A physical presence test allows states to use the corporation income tax, if they wish, to recover the costs of public service provision that corporations may impose upon them. This promotes economic efficiency by insuring that those whose presence requires the expenditure of state government resources share the burden of those expenditures. Corporations that are linked to a state through the licensing of intangible assets, however, do not impose public service provision costs on a state and, accordingly, should not have to share in those costs. Indeed, requiring them to do so creates adverse economic incentives for state policymakers to shift the burden of financing state activities away from households

[1] The discussion below considers whether the licensing of an intangible constitutes an appropriate basis for establishing nexus. The principles underlying this discussion, however, are equally applicable to other types of transactions involving intangibles; from the perspective of fiscal policy, there is no important distinction between the licensing of intangibles, their outright sale, or other contractual forms through which property rights in intangibles may be exchanged.

and businesses who impose real costs to those who do not. Moreover, such policies distort the organizational form of business activity and the structure of commercial transactions. While it may be in the interest of individual states to pursue such policies, they are harmful to national economic performance.

As detailed in this report, these conclusions are based on fundamental economic principles of fiscal policy. Section II outlines these principles, emphasizing the importance of economic efficiency considerations in the formulation of the policies of subnational (state and local) governments. The implications of these basic principles for the taxation of business activity are described in Section III. This section describes how subnational governments must take the geographic mobility of business activity into account in the formulation of fiscal and other policies, and how competition among these governments in such an environment tends to promote efficient economic policy choices. As discussed in detail in Section IV, these considerations show that a physical presence test is a sound basis on which to establish nexus for corporation income tax purposes. Finally, Section V reviews some of the adverse economic consequences that can be expected if a corporation with no physical presence in a state is exposed to income taxation because it sells or licenses intangible assets there.

Three appendices provide useful supplementary information. Appendix I describes and compares the revenue structures of Federal and state governments in the United States. Appendix II presents data on the composition of state and local government expenditures in New Jersey and for the United States as a whole, distinguishing between the burdens imposed on subnational governments by businesses that are physically present within a jurisdiction and those that are not. Appendix III describes the role of the provincial corporation income tax in Canada. The Canadian case is of interest in the present context because, under Canadian policy, corporations that are not physically present in a province are not subject to taxation there.

II. General Normative Principles of Fiscal Policy in a Federal System

A substantial body of economic research has been devoted to the normative analysis of fiscal policy in federal systems, and the basic principles of fiscal federalism that have emerged from the writings of numerous scholars can be used to guide the analysis of the nexus issue. From a broad normative economic perspective, the public sector as a whole should pursue fiscal and regulatory policies that promote economic efficiency, equity and fairness, and macroeconomic stability. No one level of government is uniquely best-suited

to manage all aspects of policy, however. State and local governments, for example, are not able to influence macroeconomic conditions effectively and it is appropriate, therefore, for Federal fiscal authorities and the central bank to take responsibility for macroeconomic policy.

From the viewpoint of economic efficiency, governments can play an important role in providing goods and services that yield real economic benefits but that are not provided at all, or that are provided inadequately, by the private sector. [2] Efficiency in public-sector provision of goods and services, as also in the private sector, requires a balancing of benefits (or demand) and costs (or supply). Lower-level governments are generally in a better position to assess and respond to demands for public services whose benefits are enjoyed primarily by households and firms located within their boundaries; they often have better information about the impact of the goods and services that they provide and they also have incentives to use this information effectively. By contrast, states and localities are not the appropriate levels of government to provide goods and services whose benefits are widely distributed throughout society, since it is difficult for them to ascertain what those benefits are and since it is the responsibility of state and local policymakers to pursue policies that promote the interests of their residents, not those of the nation as a whole. Rather, the Federal government should take primary responsibility for policies and functions whose benefits accrue widely throughout society. [3]

In addition to promoting macroeconomic stability and efficient provision of public goods and services, the public sector pursues policies that affect the distribution of income in society. For instance, at the Federal level, the personal income tax plays a major role in distributing the cost of financing the Federal government within the taxpaying population. Alternative specifications of Federal income tax policy – notably, the structure of tax rates and the definition of income for tax purposes – would distribute this cost differently. A more progressive rate structure, for example, would effectively redistribute income away from higher-income taxpayers toward those with lower incomes. The expenditure side of the Federal budget is also heavily engaged in the redistribution of income, for instance through programs of cash and in-kind transfers such as social security and health care

[2] For example, it can be excessively costly or even impossible to charge prices for access to thoroughfares or for public health and sanitation measures, which implies that private provision of these important goods and services may not occur at all or may be inadequate.

[3] These economic principles are of course generally reflected in the assignment of powers under the Constitution, and indeed could be viewed simply as a restatement and elaboration, in economic language, of constitutional principles.

finance for the elderly.

Government-directed redistribution of income almost invariably affects economic incentives. Very high personal income tax rates, for example, can discourage work effort and saving. These incentive effects disturb the efficient functioning of the economic system and limit the effective redistributive impact of fiscal policy. Redistribution by state and local governments can create even more severe harm to economic incentives than Federal government policies because households and firms are relatively mobile among subnational governments. A state or locality that imposes high tax burdens on some class of households or businesses will create incentives for existing taxpayers in that class to leave the jurisdiction and will discourage entry by new taxpayers; conversely, benefits derived from state or local government expenditures that are directed toward a particular class of households or businesses create fiscal incentives for existing resident-beneficiaries to remain in the jurisdiction and for new potential beneficiaries to enter. Thus, for example, a state that taxes its rich residents heavily in order to provide services or cash transfers for its poor creates fiscal incentives for rich households not to reside in the state and for poor households to gather there. These responses simultaneously (a) interfere with the efficient allocation of resources and (b) limit or negate the distributional impact of redistributive policies. They cause inefficiency because the allocation of resources among jurisdictions – especially the allocation of labor and capital – is determined not only by underlying economic benefits and costs, but in response to artificial fiscal incentives. They negate the distributional impact of redistributive policies because they drive away those households and businesses who are net fiscal contributors and attract those who are net fiscal beneficiaries, thus limiting the contributions by the former and dissipating the benefits among the latter. Normative economic analysis of multi-level government finance thus leads to the conclusion that subnational governments should not take significant independent responsibility for income redistribution; the redistributive role of the public sector is better assigned to the Federal government. Whereas it is relatively easy for households and firms to change their locations in response to state or local fiscal policies, doing so in response to Federal government fiscal policies entails much more costly and difficult relocation on an international scale. The efficiency cost of Federal redistributive policies is thus lower, and their effectiveness in altering the distribution of income is greater, than for lower-level governments.

In summary, economic analysis indicates that the policies of state and local governments should focus primarily on promoting efficient provision and financing of public goods

in accordance with the demands for and costs of these goods and services within their jurisdictions. Attempts to redistribute income (*i.e.*, to impose costs on some households and firms in order to provide benefits for others) interfere with economic efficiency and do not achieve the desired redistributive impact. The mobility of households and firms among subnational governments implies that these governments must "compete" for resources with other governments. State or local policies that create a mismatch between the provision of public services and the burden of financing those services imply that some households or firms are net beneficiaries of fiscal policy while others bear net fiscal burdens, and households and firms respond to these fiscal benefits and burdens through their locational choices. Competition among subnational governments for mobile resources tends to bring fiscal burdens and benefits more closely into alignment, which is the hallmark of efficient fiscal policy. Fiscal competition resulting from the mobility of resources, in other words, works to limit the extent of redistribution undertaken by subnational governments and, at the same time, to improve the efficiency of their fiscal policies. In a system like that of the United States with multiple levels of government, the major economic role of subnational governments is to improve the efficiency of resource allocation by providing valuable public goods and services to their residents and by using taxes, licenses, fees, and charges to apportion the costs of those goods and services among those whose presence is responsible for the public expenditures that must be financed.

III. State Business Taxation and Fiscal Competition

How do the foregoing principles apply to the taxation of business activities by state governments? First, it should be noted that states collect revenues from businesses in many ways. States (and localities, as well) rely heavily on prices or price-like charges and fees to finance many services provided to businesses and, in so doing, they generally enhance efficient resource allocation. [4] State-owned corporations or agencies may provide electrical power or water for business users and invariably charge for the use of these services. It is commonplace for state and local governments to charge for the use of highways through vehicle licensing, taxation of vehicles, or taxation of fuels. State and local agencies that manage harbors and airports charge users of these facilities, directly and indirectly, for the services that they provide. Underpricing or undercharging for the provision of these facilities and resources leads to their excessive (i.e., economically-inefficient) utilization.

[4] Appendix I provides a brief summary of the structure of government finance at the Federal, state, and local level in the United States, illustrating the relative importance of different types of revenue instruments for different levels of government.

The general principle of efficient public pricing is that prices, charges, fees, etc. should reflect the cost that a firm (or household) imposes on the public sector by virtue of its utilization of publicly-provided goods and services. Business activities that do not impose a service-provision burden on a state or locality should not be priced or taxed.

The process of fiscal competition among subnational governments generally promotes more efficient taxation and pricing. Some business activities impose far fewer costs on a jurisdiction than others, for instance because they do not congest public facilities or do little environmental damage. Some business activities may produce spillover benefits to a jurisdiction by providing attractive employment opportunities or by promoting desired patterns of economic development in other ways. States and localities face strong incentives to attract such activities because they do not impose high fiscal or other burdens on the jurisdictions where they reside. Subnational governments can compete for such activities in a variety of ways, for instance by instituting favorable tax policies or regulatory environments or by undertaking public expenditures that attract desired forms of business. By contrast, business activities that impose substantial costs on the jurisdiction where they locate – for instance in the form of heavy burdens on public infrastructure, public safety, or the local environment – are less attractive to states and localities. The process of competition among governments can be expected to result in heavier tax burdens, higher prices for licenses, and heavier regulatory burdens for such businesses. In either case, fiscal competition works to insure that businesses are made to pay for the costs that they impose on the jurisdictions where they locate, and this in turns promotes economically-rational resource allocation. Activities that are particularly burdensome to particular jurisdictions are likely to face fiscal incentives that make it unattractive for them to locate there, while more benign activities will face more favorable fiscal and regulatory incentives. Uniformity of policies among states and localities is not to be expected, as the benefits and costs of different types of business activity differ among jurisdictions and over time. The process of fiscal competition leads jurisdictions to structure their fiscal and other policies in ways that appropriately reflect local conditions and, in this way, it contributes to efficient patterns of business and other economic activity.

State corporation income taxes can certainly play some role in an efficient structure of business taxation. However, they are assessed on the basis of corporate profits rather than in relation to the demands that a corporation places on a state's public goods and services. [5] Furthermore, the corporate form of organization in itself does not generally

[5] For example, a corporation that is unusually innovative in the development or market-

imply that a business imposes higher costs on state and local governments than similarly-situated unincorporated enterprises. Of course, these normative considerations need not in themselves be taken into account by state policymakers in their determination of the fiscal treatment of business. However, the location of corporate business activity may be quite sensitive to state corporate income tax burdens, and state policymakers certainly do have reason to be closely concerned with this potential consequence of their tax policy choices. States can and should (and, under the Constitution, do) have the flexibility to adapt their tax and other fiscal policies in accordance with the interests of their residents, but they must also bear the consequences of their policy choices.

As described in more detail in Appendix I, corporation income tax policies differ quite substantially from state to state. Some states tax corporations quite heavily, perhaps enabling them to reduce their reliance on other types of taxes, or permitting them to increase funding for various public goods and services. Others dispense with the corporation income tax altogether. Still others – like Delaware – rely heavily on the corporation income tax, but find it advantageous to limit the tax burdens for corporations, like trademark protection companies, that impose minimal demands on public services within the state. A similar situation exists in New York under the subsidiary capital rules, which exclude from the taxable income of a parent corporation all income that it derives from subsidiary capital. The interstate variation in corporation income tax rates, accounting procedures, and apportionment rules that is observed in practice illustrates the fact that states can and do exercise a high degree of autonomy in adapting fiscal policies to local conditions, the external environment, and public policy desiderata. American federalism relies on the freedom of the states to review and adjust tax, expenditure, and regulatory policies on an ongoing basis, within broad constitutional constraints that prevent them from pursuing policies that harm the overall national interest.

In summary, the tax policies of state and local governments should promote efficient resource allocation in the United States economy. The location of business activity, including production and employment, should be determined in accordance with underlying economic conditions of cost and demand and should not be distorted by artificial fiscal incentives. Efficiency dictates that businesses should bear the costs that they impose on

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ing of new products or in finding less costly means of production may have substantially higher profits than one that is poorly managed; under a state corporate income tax, the former would have to make a larger fiscal contribution than the latter for reasons that have nothing to do with the costs that the business may impose on the state.

the state or local public sector, and the process of fiscal competition among subnational governments, each acting in accordance with the interests of their own residents, has led them to develop revenue structures that generally reflect these efficiency considerations.

IV. Nexus and the Physical Presence Test

As described above, efficient state and local taxation of businesses and households requires that they bear the costs that they impose on states and localities for the provision of public services. What does this imply about the issue of nexus for state corporation income taxation? In particular, should a corporation that licenses or sells intangible assets or products in a state be subject to that state's corporation income tax?

In practice, it is the physical presence of firms (and households) that imposes service-provision burdens on subnational governments. [6] The use of public facilities and services by businesses physically present within a state may necessitate the expenditure of additional state resources. Businesses that are physically present may cause harm to other residents in the form of congestion, noise, or other environmental disamenities. States and localities can and do utilize a wide variety of revenue (and regulatory) instruments to make businesses bear the costs that they impose on the public sector or on other residents. The mere transfer of intangible property rights to individuals or businesses within a state by an out-of-state enterprise, however, imposes costs upon the state that are zero or negligible. Such transactions do not, in themselves, crowd the highways, require fire and police protection, demand additional expenditures for universities or local schools, or in other ways impose burdens on state or local governments or residents within their jurisdiction. For this reason, there is no economic efficiency rationale for imposing corporation income taxes on corporations not physically present in a state. [7]

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[6] See Appendix II for an enumeration of expenditure categories for state and local governments in the US. A review of these categories makes clear that the public services provided and public expenditures undertaken by states and localities – whether in New Jersey, or, more generally, in any of the states – are not attributable to businesses not physically present within their jurisdictions.

[7] It could be argued that out-of-state corporations benefit from the protection of a state's laws and courts; even if the conduct of their business does not entail their physical presence in a state, circumstances might arise in which a corporation's employees are required to appear physically before a state's courts, and thus the corporation could be said to have a "contingent" form of physical presence. These exceptional cases do not form a valid basis for arguing that a corporation should be subject to state income taxation, however. First, states can impose charges for access to their courts, and such charges provide an economically-appropriate revenue instrument by which states can recover the costs imposed on them by litigants. Second, the taxation of a corporation's income merely

Of course, out-of-state firms may benefit indirectly, in numerous ways, from the services that a state provides to the households and firms located within its boundaries. Moreover, trade with out-of-state corporations may well promote economic development, population growth, and other economic, demographic, and social consequences that result in greater public service demands and expenditures at the state and local level. It might conceivably be argued that these consequences justify the imposition of corporate income taxes on businesses with no physical presence in a state. This argument, however, would be a misapplication of the principles of efficient taxation described above.

To see this, it may be useful to consider a simple example. It is obvious that local fire and police protection and state and local provision of roads may well protect and enhance the business activities of retail booksellers located within a particular state. Expansion and development of local retail enterprise in turn raise the demand for the goods and services that retailers handle, such as books provided by out-of-state publishers, and thus increase the revenues that these out-of-state firms derive from sales within the state. But local retailers and out-of-state publishers are really just intermediaries between authors and their readers. Authors, through their creative efforts, produce the fundamental intangible assets on which the businesses of retailers and publishers are based. Both authors and readers, of course, benefit from the efforts of publishers, local retailers, and other intermediaries because they facilitate access to the underlying intangible assets that authors create. State and local governments who provide services to local booksellers likewise indirectly provide important benefits to authors and to readers. In particular, the incomes of authors are certainly enhanced by state and local government policies that facilitate the effective distribution and marketing of the intangible assets that they create.

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because it might occasionally appear in a state's courts (indeed, might be *compelled*, even by the state itself, to appear in a state's courts), would be a grossly disproportionate fiscal burden; the occasional and contingent use of a state's courts fails to pass a reasonable *de minimis* test. Third, almost every corporation in the entire country (and individual, for that matter) could be deemed to have nexus for tax purposes under this test, which is therefore quite unreasonable. To illustrate, suppose that a corporation (or individual) located in state A is defamed by a malicious party located in state B, for instance in order to gain commercial advantage in some fashion. Suppose that the corporation in state A is engaged in no interstate commerce whatsoever. To protect itself, the corporation would have to bring suit in the courts of the state where the defamation occurs. The fact that it does so, or might under some future circumstances do so, cannot reasonably be used to establish nexus for corporation income tax purposes, since this would imply that every corporation (and, for that matter, every individual) would be liable for the payment of state income taxes in every state. The "protection of the courts" argument for establishing nexus might be justifiable if applied to firms that are physically present in a state but is certainly inappropriate when applied to corporations not physically present.

The fact that the creators, owners, and developers of intangible assets derive some indirect economic benefit from state and local government policies, however, does not imply that state taxation of their incomes is warranted. Rather, to the extent that firms like booksellers impose public-service provision costs on state and local governments, they should pay fees, charges, or taxes that reflect those costs. Such taxes and charges may indeed reduce the incomes accruing to the owners of intangible assets even though they are not physically present and are not subject to a state's corporation income tax. For example, corporation income taxes levied on booksellers physically present in a state may ultimately reduce the incomes of authors or raise the price of books to readers. [8] To the extent that this occurs, local booksellers function as tax collectors through which state and local governments recover costs that they incur for services that indirectly benefit authors and readers. And, from the viewpoint of economic efficiency, this is as it should be. All of the real economic costs involved in economic activities, including the costs of public services, should be reflected in the prices facing producers and consumers. Efficient state and local taxation of establishments physically present within their jurisdiction will insure that this is the case.

Note that the basic principles identified above – that corporation income or other business taxes should reflect the costs of public service provision, and that these costs are related to physical presence – are conducive to a structure of taxation that reflects underlying economic realities rather than technical (and sometimes almost metaphysical) distinctions that may otherwise arise in determining nexus for state corporation income tax purposes. In the preceding example, it is irrelevant whether an author prepares a manuscript on paper or, instead, uses a network to send the manuscript to the publisher as an electronic file, a minor distinction which should hardly be the basis of significant differences in tax treatment. It is irrelevant whether a large fraction of the price paid by a local bookseller to an out-of-state publisher reflects the physical cost of producing the book or whether it also reflects the value of other, possibly intangible goods or services that may be bundled, explicitly or implicitly, with the book. For instance, the purchase

[8] If retail booksellers were exempted from all state and local taxes, or, to make the point even more strongly, if they were directly subsidized by state and local governments, the prices paid by consumers for books would fall and the incomes that authors could obtain for their manuscripts would rise, reflecting a reduction in the effective cost of bringing authors' ideas to the marketplace. In this sense, it is the authors and readers of books who bear the burden of state and local taxes on retail booksellers. It is noteworthy that the distribution of the burden of these taxes does not depend on whether the authors (or readers, for that matter) are physically present in the taxing jurisdiction.

of a computer manual in a bookstore may authorize a consumer to access certain software or technical support services provided over a network by an out-of-state firm, which itself may or may not be a corporation and which may or may not have any linkage of ownership or control with the publisher that sells the book to the bookseller. None of these factors affect the costs that the local retail establishment imposes on the state or locality for the provision of public safety or transportation. The amount of income accruing to out-of-state enterprises, the extent to which this income reflects a mixture of returns to tangible and intangible goods and services, or the number of intermediate transactions and organizations that lie between the ultimate producer of a good or service and the ultimate consumer of it do not affect the cost of providing public goods and services to the enterprise that is physically present in the state and, on efficiency grounds, should not affect the taxes or charges assessed for the provision of those public services.

V. Basing Nexus on Intangibles: Adverse Economic Effects

As discussed in preceding sections, taxing the income of corporations not physically present in a state is not necessary for the states to recover from corporations the burden of providing public services to them. In fact, basing nexus for corporation income tax purposes on the licensing of intangibles in a state has several adverse economic consequences. First, allowing states to use the corporation income tax to capture a share of the income accruing to out-of-state corporations with no physical presence creates adverse incentives for states to shift fiscal burdens to non-residents. Second, exposing corporation income to state taxation solely because of the licensing of intangibles leads to intersectoral fiscal distortions and to distortions of the organizational structure of business. Third, taxing a corporation's income merely because it derives revenue from the sale or licensing of goods and services to purchasers who reside in another state erects a barrier to the freedom of commerce across state boundaries, inhibiting free trade within the internal market of the United States. Fourth, basing nexus on the fact that a corporation derives revenue from transactions involving intangibles would be inconsistent with the tax treatment of corporations that derive revenue from the sales of tangible goods. These adverse consequences are discussed in more detail in the present section.

A. Nexus and the Potential for Tax Exporting

A basic premise of the economic analysis of fiscal federalism is that subnational governments have incentives to advance the interests of their residents. This promotes economic

efficiency when these governments provide public services demanded by their residents and when they are motivated to do so in a cost-effective fashion. However, subnational governments are equally motivated to promote local interests at the expense of broader, national interests. In particular, they have incentives to shift fiscal burdens to non-residents if they can. The use of state or local tax policy to shift the burden of public finance to non-residents is known as "tax exporting", and it can take a variety of forms. By shifting tax burdens to unrepresented non-residents, tax exporting can distort the economic incentives facing subnational governments, inducing them to undertake expenditures and programs whose local benefits are not sufficient to outweigh their true economic costs.

In the present instance, it is clear that intangibles-based nexus for corporation income tax purposes would allow states to collect revenue from out-of-state corporations that do not impose public service provision burdens on them. From the viewpoint of the residents of a state and of the elected officials who represent their interests, this form of taxation offers the prospect of a true fiscal windfall. As such, the states have powerful incentives to attempt to exploit it. Normally, states are limited in their capacity to impose tax burdens on potentially mobile households and firms. As discussed previously, it is the ability of mobile households and firms to escape taxes in any one jurisdiction that gives rise to fiscal competition among subnational governments, inducing these governments to establish structures of taxation, public pricing, regulation, and expenditure that promote economic efficiency. However, to the extent that states have the power to tax income accruing to non-residents (whether households or firms) in ways that are unrelated to the cost of providing public services to them, they are able to create and maintain a mismatch between the costs of public service provision and the distribution of those costs. Allowing nexus to be based on the licensing of intangibles means that states can shift the burden of public service provision from those households and firms on whose behalf these costs are incurred to non-residents – specifically, the owners, employees, and customers of out-of-state corporate enterprises – who do not impose costs on the state.

As understandably attractive as such an arrangement may be from the perspective of an individual state, it is harmful to the national interest. Insofar as states acting individually can shift the costs of their public services to outsiders, they lack the incentive to provide public services at least cost and to provide only those services whose benefits are sufficiently great to warrant the diversion of scarce economic resources from the private to the public sector. Furthermore, when households and firms do not bear the costs of service provision that they impose on subnational governments, their locational decisions

are likely to be economically inefficient. When states tax the income of corporations not physically present, they pursue policies that distort locational incentives and produce an inefficient spatial distribution of households and business activity.

In summary, a physical presence test for state corporation income taxation appropriately constrains the taxing powers of states so that, in pursuing their individual interests, they enhance rather than harm the efficiency of resource allocation and thus improve rather than harm the functioning of the economic system as a whole.

B. Nexus, Organizational Form, and Intersectoral Resource Allocation

Basing nexus for state corporation income taxes on the licensing of intangibles creates incentives that impose economic harm by distorting the organization of business enterprise, the structure of intangibles-related transactions, and the allocation of resources among different sectors of economic activity.

To begin with, one should note that it is increasingly feasible and commonplace for business activities to be integrated over space, for instance by conducting different parts of an enterprise's activities (*e.g.*, production of industrial components, assembly, financial management and control, marketing, or purchasing) in different locations. There are numerous underlying economic reasons that determine the form of such arrangements (and their continuous adjustment and revision), including differences in product and input prices across regions, differences in the quality or availability of different inputs (*e.g.*, access to raw materials, pools of specialized labor, proximity to financial markets, *etc.*). Subject of course to the costs of coordinating and managing geographically-dispersed activities, there are great potential efficiency gains from such forms of business organization. Continued technological progress, including improvements in electronic communication, has resulted in substantial reductions in the costs of all types of communication and transportation and enhances the scope for new and more productive mechanisms of business coordination, control, production, and product distribution. Many of these potential developments involve intangibles transactions.

Especially in an environment where transactions costs are falling, the precise legal forms of organization through which economic activities are undertaken can be quite fluid. For example, a corporation may contract with other businesses, such as banks or accounting firms, to provide various financial services. Alternatively, it may hire its own financial and accounting staff in order to manage its financial structure. A firm that relies on

innovation and invention to develop new products may hire a staff of research scientists to develop new ideas or it may instead (or also) purchase patents from other incorporated or unincorporated firms or individuals. It may hire computer programmers to develop proprietary and firm-specific software or it may purchase software from firms that specialize in software development; if it uses in-house software developers, these individuals will almost certainly utilize operating systems and applications development tools that have been developed by other incorporated or unincorporated businesses or individuals. There is no one best or uniquely standard way of organizing these types of activities.

When taxes fall on specific types of transactional forms, they create burdens on particular ways of organizing economic activity and in doing so create fiscal incentives favorable to some forms of organization and, implicitly or explicitly, adverse to others. When these taxes appropriately reflect underlying economic factors (for example, the costs of public service provision, as described earlier) they encourage efficient resource allocation. If they are not directly or indirectly based on such economic factors, however, they impede the efficient functioning of the economy. In the present case, it is not difficult to see how determining nexus for corporation income tax purposes as a result of intangibles transactions can create perverse economic incentives. Suppose that two companies are deemed to be "sufficiently closely related" that the income that one, located in state A, derives from the licensing of intangibles to the other, located in state B, exposes it to corporation income tax in state B. This creates a fiscal incentive for the two firms to become "insufficiently" closely related. Depending on the activities in question, this could be done with greater or lesser ease.

For example, authors typically do not own their own publishing businesses but rather sell or license the right to publish their works. Publishers often do not operate their own retail establishments, relying instead on other firms to distribute their books. These layers of transactions between authors and readers (the publishing industry and retail booksellers) presumably have important economic advantages. They also create sufficient transactional and organization "distance" between authors and readers that authors do not have nexus, for state corporation or personal income tax purposes, in all of the locations where their works are sold.

In the case of authors and readers, it may appear obvious that the former should not have nexus for tax purposes in the states of residence of the latter and perhaps no state would attempt to exert tax jurisdiction over out-of-state authors. However, this case does not differ, in its economic essentials, from other cases where transactions involving intan-

gibles might be used to justify the exercise of state taxing powers. For example, suppose that an engineering firm based in state A provides various consulting services to businesses throughout the country. The firm may have branch offices, subsidiaries, or other affiliated firms located in several states. In providing its services, it uses various technological concepts and information which it acquires at considerable cost from numerous sources. Some of this information takes the form of databases provided by other "unrelated" firms for which the engineering firm pays subscription fees; these firms may be located in any other state. In the determination of the engineering firm's income for tax purposes, its payments for the acquisition of this information, which it ultimately recovers in the revenue it derives for its consulting services, are treated as a cost. If the firm provides consulting services in state B, and if intangibles provide nexus for business income tax purposes, the income accruing to the firm's operations in state A, as well as the income derived from it various in-state branch or subsidiary operations, might be subject to income tax in state B. The firms that provide the database services to the engineering firm, however, would not be reached by the corporation income tax in state B.

Now suppose as an alternative that the engineering firm in state A acquires the firms from which it previously purchased costly database services. These firms may have very unique capabilities to gather and process data and may be very profitable; the profits from these operations now accrue to the engineering firm in state A. Assuming that the other facts of the case are unchanged, the engineering firm's acquisition of database services that may be located in other states thus increases the amount of income that is exposed to the corporation income tax in state B. Clearly, this change in organizational structure has no impact on the burden that state B incurs in providing public goods and services to the branch offices or subsidiaries that have physical presence there and it provides no rational basis for a change in the exposure of a firm in state A to income taxes in state B. This example illustrates that basing nexus for state corporation income tax purposes on intangibles transactions brings fiscal incentives to bear on business considerations that have absolutely no connection to the state in which taxes are collected. The integration or disintegration of economic functions within a business enterprise should be driven not by such fiscal considerations but by underlying economic benefits and costs.

Examples of this type could easily be multiplied, but the essential economic principles should now be clear. Organizational and transactional forms can be influenced by tax considerations, and thereby become less effective in performing their fundamental economic functions. In some sectors or spheres of activity, it may be comparatively simple to redesign

the structure of firms or transactions so as to limit exposure to state taxes, whereas this may be much more difficult in other industries. If states can use the licensing of intangibles in determining nexus for corporation income tax purposes, some industries or sectors of the economy will be virtually unaffected as a result of offsetting organizational and legal adaptations, while others will face heavier fiscal burdens that are not so readily escaped. The distribution of fiscal burdens on this basis is arbitrary and, by imposing differential burdens on some sectors, it arbitrarily distorts production and consumption decisions.

In summary, an attempt to base corporation income tax liabilities on nexus as determined by the licensing of intangibles is very likely to lead to economically-inefficient changes in organizational or transactional forms that reduce tax exposure. Even under the most expansive interpretation of state taxing power, states cannot hope to reach large portions of the income that accrues to non-resident creators and developers of intangible assets. Their attempt to do so, however, can cause economic harm. Basing nexus for state corporation income taxes on physical presence allows states to recover the costs that they incur for business activities undertaken within their jurisdiction while inhibiting them from pursuing policies that distort the organizational and transactional form of commerce.

C. Nexus and Internal Free Trade

Preservation of free trade within the United States is of vital economic importance; it is also, of course, a fundamental constitutional principle. States should not be allowed to use fiscal or regulatory instruments that impede the free flow of commerce across state boundaries.

This principle does not mean, of course, that states cannot impose fiscal or regulatory burdens on business activity, even though these policies do affect the structure of interstate commerce. Sections III and IV above have described how a state may appropriately tax or regulate economic activity so that businesses that operate within its borders have to bear the cost of fiscal, environmental, or other burdens that they create. Obviously, such taxes would tend to reduce the amount of taxed business activity within the state, for instance by discouraging certain businesses from conducting operations within a state whose fiscal climate makes it unattractive for them. Appropriate taxes and regulations, however, improve rather than detract from the efficient functioning of the economic system, and do not erect artificial barriers to free internal trade. From the viewpoint of economic policy (not to mention constitutional principle), however, it is crucial that a state not

impose a fiscal burden on individuals or businesses *solely* because they engage in acts of interstate commerce. Furthermore, interstate economic activity should not be subject to discriminatory fiscal or regulatory treatment.

From the viewpoint of economic analysis, the real effects of taxes on the economy are determined by the ways that they affect economic incentives. In the case of the state corporation income tax, the formulae that are used to apportion a corporation's taxable income among states are of critical importance because these formulae determine precisely which aspects of a corporation's economic activities give rise to tax liabilities, and thus the structure of incentives facing a corporation. For example, a traditional three-factor apportionment formula that attaches equal weight to payroll, capital assets, and sales creates implicit tax burdens on employment, investment, and output. By reducing its employment in a state, a corporation can reduce the share of its income that is subject to taxation there, and thus the presence of the payroll factor in the apportionment formula creates incentives to limit employment. Similarly, the use of assets in the apportionment formula reduces the incentive for corporations to invest in a state. The state corporation income tax does not on this account have precisely the same effects as taxes on payrolls, assets, or sales alone, since the exact magnitude of the implicit tax on these factors depends on the profitability of the corporation. Under a true payroll tax, for example, the incentive to reduce employment is independent of the firm's profitability, whereas the strength of this incentive under the corporation income tax is high for highly profitable corporations but negligible for those with minimal profits. Nevertheless, the general effect of a state's corporation income tax is to discourage those activities that enter into apportionment formulae, such as employment, investment, and sales.

When payrolls and assets are included in a state's apportionment formula, the resulting adverse effects of the tax on employment and investment create incentives for state policymakers to limit their use of the tax. At the same time, the presence of workers and capital assets within a state may require the provision of additional public services, for example to provide public safety services for workers and business establishments, transportation infrastructure, and so forth. Because and to the extent that the state corporation income tax implicitly taxes workers and investments within a state, it provides one means by which state governments may be able to recover some of the costs that they incur for public service provision. The use of the payroll and asset factors in apportionment formulae thus present state policymakers with the task of striking an appropriate balance in the tradeoff between the benefits of employment and investment and the costs that these

activities may impose on a state's public services and resources.

Especially when applied to firms with no physical presence in a state, the economic implications of the use of the sales factor can be more troublesome. [9] Just as the use of payroll and capital asset elements in an income-allocation formula create implicit taxes on employment and investment, so the use of the sales factor creates an implicit tax on sales. In particular, if a firm has no physical presence in a state, as evidenced by employees, business establishments, or other assets in the state, the payroll and asset factors in an apportionment formula would allocate none of the corporation's income to the state. However, if the state includes the sales factor in its apportionment formula, and if sales alone is deemed to create nexus, then a firm's income is partially taxable in the state even if it has no physical presence there. In accordance with the principles described above, this implies that the state corporation income tax, in this case, has essentially the same economic impact as a tax on interstate sales, *i.e.*, the same impact as a tariff. Thus, for corporations that are not physically present in a state, the use of a sales factor becomes simultaneously the only means by which a state's taxing powers can be extended to business activities located outside of the state's jurisdiction and a means by which taxes are levied precisely and solely on interstate commerce.

In practice, as discussed in the next subsection, Federal statutes prevent interstate commerce in tangible goods from creating nexus. As a result, the use of a sales factor in state income apportionment formulae does not create an implicit tax on interstate commerce in *tangible* goods for firms with no physical presence in the states where they sell their products. [10] There is no Federal statute directly applicable to trade in intangibles, however. If a state uses the sales factor for income apportionment and if interstate sales in themselves are deemed to create nexus for corporation income tax purposes, then a corporation that licenses an intangible within a state but has no physical presence there

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[9] A crude argument could perhaps be made that the sales factor helps to provide a more accurate representation of the level of a corporation's activity in a state if it is physically present there; sole reliance on just one other factor, such as employment, might in some cases give rise to anomalous income apportionment, and using a variety of indicators might, on rough statistical grounds, provide a more balanced picture of corporate activity within a state. This argument is far from compelling since it is not based on any fundamental principles; insofar as it is given any weight, it should presumably be applied mainly in the context of firms whose total business activities are fairly evenly spread among the states in which they are physically present.

[10] Note, however, that use of the sales factor still gives rise to an implicit tax burden on trade in tangible goods for firms that do have some physical presence in a state.

is exposed to a fiscal burden *solely* because it is engaged in interstate commerce. Almost by definition, the licensing of an intangible asset for use in another state is nothing but a pure interstate exchange of property rights that, by virtue of its intangible character, can in itself have no ancillary impact (such as congestion of public facilities or the generation of environmental disamenities) on the states where a license is utilized. To expose a corporation to income taxation in a state because it derives revenue from licensing of intangibles there is thus to create a fiscal barrier to interstate transactions.

Indeed, these fiscal barriers are precisely the sorts of impediments to interstate trade that would impede the free flow of goods and services that typifies the internal common market of the United States economy. In its technical legal form, of course, taxation of an out-of-state corporation's income is not quite identical to a tax on the importation of goods and services, *i.e.*, a tariff, since it is based on the net income that a corporation derives from its interstate commerce rather than from the number or value of intangibles transactions, *per se*. Allowing states to tax the income of out-of-state corporations solely because they derive revenue from the licensing of trademarks, patents, or other intangible assets to businesses operating within a state, however, has substantially the same economic consequences as the imposition of a tariff. From the viewpoint of the non-resident owner of the intangible asset, it is the mere act of engaging in an interstate transaction that creates a tax liability, exactly as would be the case with a tariff, and economic incentives are distorted for the same reason. The exposure of corporations to state income taxation because of their licensing of intangibles reduces the value of interstate transactions, lowering the return to (and thereby discouraging) interstate commerce. The taxation of a corporation solely by virtue of the fact that it derives revenue (whether net or gross) from sales of intangibles in a state makes the state corporation income tax, in this respect, the functional equivalent of a tariff. This is inimical to free trade within the United States.

As described in Appendix I, the states are relying increasingly on the sales factor in their apportionment formulae. Indeed, a number of states attempt to use *only* the sales factor in apportioning income. This facilitates the efforts states to reach beyond their boundaries to capture income accruing to foreign corporations when the only contact between the corporation and the state is its trade in intangibles. From the perspective of an individual state, it may be appealing to shift the effective burden of the corporation income tax away from employment and investment and to impose tax burdens on corporations outside of the state. However, this trend accentuates the interference with free interstate commerce that results from state corporation income taxation. This tendency would be

curtailed, to some degree, if physical presence is required to establish nexus for corporation income tax purposes. [11]

From the viewpoint of economic policy, the increasing reliance on the sales factor for income apportionment is a cause for concern. Double-weighting of the sales factor increases the implicit burden of taxation on interstate commerce, and movement to a single-factor formula based solely on sales does so to an even greater degree. Especially for corporations with no physical presence in a state, the use of the sales factor makes the corporation income tax a tax on the only connection that the corporation has with the state, namely, its interstate sales. Indeed, one could conjecture that one reason for the growing use of the sales factor in apportionment rules is precisely that it provides the states with an indirect method of capturing revenue from out-of-state corporations via an implicit tariff on interstate commerce. Using physical presence as the basis for the determination of nexus would appropriately constrain the taxing powers of the states and obviate the resulting adverse economic effects of state corporation income taxes.

States are customarily understood to face constitutional prohibitions on the taxation of individuals and businesses located in other states and on the taxation of interstate commerce, *per se*. These constitutional prohibitions promote sound economic policy goals. As compared with other out-of-state firms whose sales and physical presence are entirely in other states, a firm that licenses intangibles for use within a state is different only insofar as it is engaged in a form of commerce – interstate sales – that the state is prohibited from taxing directly. It does not promote sound economic policy goals to allow one activity that states are prohibited from taxing directly – interstate commerce – to justify the extension of state taxing powers to otherwise untaxable entities – out-of-state corporations. This is particularly so when the states then impose a tax – the state corporation income tax, using sales as one (or the sole factor) for income apportionment – that, in its real economic effects, is broadly equivalent to a constitutionally-prohibited tax on interstate commerce.

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[11] It is interesting to note that this is precisely how the provincial corporation income tax is implemented in Canada. By statute, separate accounting is required for all corporations and nexus is based on the presence of business establishments (places where employment, distribution, production, or other business activities occur) within a province. Under these procedures, interprovincial transactions in intangibles cannot create nexus and the provincial corporation income tax does not give rise to any implicit tax on interprovincial trade in goods and services. See Appendix III for further discussion.

D. Consistency in Business Taxation: Tangibles vs. Intangibles

It has been argued above that a corporation should not be subject to corporate income taxation in a state merely because it derives revenue from the licensing of intangibles to businesses that are located within the state. A principal justification for this position is that corporations with no physical presence do not necessitate the provision of public goods and services and thus do not impose any costs on a state or locality. Clearly, for businesses that do have physical presence in a state, the extent of costs that they impose on the public sector will vary widely depending on the nature of the business activity in question. One can ask, in particular, whether a business that is only connected with a state by virtue of the fact that it sells *tangible* goods there ought thereby to be subject to corporate income taxation. Unlike businesses that have employees or real property in a state, a business that only sells its product in a state has a rather tenuous physical connection with the state, and it is not at all clear that it ought to be subject to income taxation there. Consider, for example, a catalogue-sales business that sells a high percentage of its goods in a certain state. This business might be liable for substantial amounts of income tax under standard apportionment rules, and yet its activities within the state – consisting of little more than the use of the delivery services of other companies, themselves already physically present and taxable in the state – would be so minimal that these tax liabilities would be grossly disproportionate to the burdens that its activities impose on state and local governments. On the other hand, the sale of certain types of tangible goods might in some cases entail more than the minimal degree of physical presence that one associates with mail-order sales. (For instance, a company might sell heavy industrial equipment or hazardous materials, the delivery of which disrupts the normal flow of transportation.) Arguably, then, the case for using the sales of *tangibles* to establish nexus for state corporate income taxation is stronger than for the case of intangibles.

Since the argument for nexus based on the sales of tangibles is less clear-cut than for the case of intangibles, it is perhaps appropriate that that issue has been decided by Federal statute, specifically, by PL 86-272. In this statute, the Federal authorities have evidently decided that the balance of considerations favors a freer flow of interstate trade and a limitation of the taxing powers of the states. This decision is certainly consistent with the economic policy considerations presented above. In view of this decision at the Federal level, it would certainly be anomalous and inconsistent for states to base nexus on the fact that a corporation derives revenue from the licensing or sale of *intangibles* where it would not, by statute, have nexus if it were selling *tangibles*. By the same token,

whereas conflicting considerations in the case of tangibles may warrant the resolution of the nexus issue by Federal statute, there are no such conflicting considerations in the case of intangibles. It is appropriate for the taxing powers of the states to be restricted, on constitutional grounds, by prohibiting them from taxing corporations that are not physically present within their jurisdiction. Doing so would contribute conceptual clarity to the definition of the taxing powers of the states in a way that would appropriately guide the decisionmaking of lawmakers at both the Federal and state levels and that would reduce the uncertainty about future tax policy that the private sector otherwise faces.

Appendix I

Federal, State, and Local Government Revenue

A. Overall Revenue Structure

Different levels of government in the United States have quite different structures of taxation. These reflect, in part, the differing economic functions of each level of government and the forces that constrain and shape policy at each level. A brief summary of some of the salient differences between Federal, state, and local governments is instructive.

The Federal government derives the bulk of its revenue from the direct taxation of individuals through the personal income tax and the payroll tax for social security; in recent years, these sources have accounted for about 80% of Federal revenue. The Federal government has also raised more than 10% of its revenue from corporation income taxes. By comparison, Federal excise taxes (some of which, like Federal taxes on fuels, may be viewed as a form of user fee or charge) account for less than 5% of Federal revenues. The Federal personal income tax has had a relatively progressive structure of marginal and average tax rates, with substantial personal exemptions and marginal rates that have often exceeded 35%.

States and localities, by contrast, rely much more heavily on charges, fees, licenses, and other similar sources of revenue to finance their activities. In recent years, these have accounted for around 23% of own-source revenue (or almost 20% of state and local revenue from all sources). States and localities also utilize individual income, sales, and property taxation as major sources of own-revenue, though at average and marginal rates far lower than those of the Federal government. Note that charges, licenses, and other revenues are roughly *ten times* the amount of revenue collected from the corporation income tax at the state and local level, whereas, at the Federal level, corporate income tax revenues are roughly twice as large as those obtained from excise taxes. [12] These simple summary statistics reveal clearly that the states and localities rely much less heavily on corporation income taxes and much more heavily on charges, fees, and other similar revenue sources than does the Federal government.

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[12] Although it is often formally described as a general revenue source, the local property tax also clearly functions substantially as a charge for locally-provided goods and services, accentuating the role of price-like revenue instruments in the structure of state and local finance.

The revenue structures of the states and localities reflect the fact that they provide many goods and services for which it is possible to collect revenues (directly or indirectly) from beneficiaries. Many of the charges and licensing fees collected by states and localities are assessed against businesses, illustrating that the corporation income tax is only one of several means – and, of those, not the most attractive – by which states and localities can collect revenue from businesses. Fiscal competition at the state and local level has thus led to a relatively high degree of matching of revenue sources with the service-provision burdens that households and firms impose on the public sector and with the benefits that they derive from public-sector services. The Federal government, on the other hand, imposes taxes for which the match between benefits and burdens is much weaker. Indeed, a primary purpose of many Federal fiscal policies is precisely to create a mismatch between benefits and costs, i.e., to redistribute resources from some individuals in favor of others. These basic observations illustrate how the allocative efficiency functions and redistributive functions of the public sector play very different roles at the Federal and subnational levels of government in the United States, as the normative principles of fiscal federalism, outlined in Section II, suggest ought to be the case.

B. Variations in State Corporation Income Taxation

As described above, the revenue structures of the Federal and state governments differ significantly. It is also of interest to note that there is a high degree of interstate variation in tax policy. In particular, the role of the state corporation income tax differs substantially among the states.

In 1998, the states, in aggregate, obtained about 6.5% of their revenues from corporation income taxes. However, three states (Nevada, Washington, and Wyoming) do not impose any corporation income tax at all, and thus of course obtain no revenue from this source. At the other end of the spectrum, three states – Alaska, Delaware, and New Hampshire – derived more than 10% of their tax revenues from corporation income taxes.

No less important is the state-to-state variation in the administration of corporation income taxes. Many states have a single corporation income tax rate, but several apply different rates depending on the level of corporate income. Rates in the range of 6–8% are common, but tax rates of 5% or less prevail in a dozen states while rates in excess of 9% can be found in as many others. Rates of taxation also vary by type of corporation; for instance, Delaware – a state which, as noted above, is remarkable for the high level of tax revenue that it obtains from corporation income taxes – distinguishes between

corporations that derive income solely from intangibles as compared with other sources of income. Accounting rules for corporation income taxes also differ widely. For example, some states require that related corporations file combined tax returns, while others permit separate accounting.

State policies with respect to income apportionment also vary widely and are changing substantially over time. Since policies vary so widely from state to state and across sectors within states (depending on the state, special provisions may pertain to manufacturing, transportation, construction, financial services, telecommunications, etc.) it is difficult to generalize about current or past practice in this area. Broadly speaking, however, one can say that some states continue to use a traditional three-factor apportionment rule, based on sales, payroll, and assets, in accordance with the precepts of the Multistate Tax Compact (Article IV: The Uniform Division of Income for Tax Purposes Act). In recent years, however, states have come to rely more and more heavily on the sales factor to apportion income. About 20 states normally double-weight the sales factor, rather than attaching the one-third weight that it would receive under the UDITPA equally-weighted three-factor rule. Some attach a weight of one-half to the sales factor, others, a weight between one-third and one-half. Several now use sales as the *sole* factor, or nearly so. A number of states have increased the weight attached to the sales factor in recent years or are in the process of doing so, sometimes through phased increments. Thus, it is fair to say that a three-factor apportionment formula is not in any sense a norm at the present time, and the trend toward heavier reliance on the sales factor is unmistakable.

PL86-272 effectively limits the power of a state to tax corporations that have no physical presence there and only sell tangible goods to customers within the state. For this reason, the fact that the states increasingly have come to rely on the sales factor in income apportionment formulae has a somewhat limited impact on interstate commerce in tangible goods. For interstate commerce in intangibles, however, the increased reliance on the sales factor is of critical importance, since the licensing or sale of intangibles in a state need not be and often is not accompanied by physical presence there.

APPENDIX II

Public Service Provision Burdens

By Expenditure Function and Business Type

Functional Categories of Public Expenditure (% of State/Local Expenditure, for NJ and for US, 1995–96)	Business Physically Present		Business Not Physically Present	
	Corporate	Non-Corporate	Corporate	Non-Corporate
Direct General Expenditure:				
Education (29.8, 28.6)	Yes	Yes	No	No
Libraries (0.5, 0.4)	Yes	Yes	No	No
Welfare (14.5, 13.9)	Yes	Yes	No	No
Hospitals (2.5, 5.1)	Yes	Yes	No	No
Health (1.6, 2.9)	Yes	Yes	No	No

Functional Categories of Public Expenditure (% of State/Local Expenditure, for NJ and for US, 1995--96)	Business Physically Present		Business Not Physically Present	
	Corporate	Non-Corporate	Corporate	Non-Corporate
Social Insurance Administration (0.2, 0.3)	Yes	Yes	No	No
Veterans' Services (0.0, 0.0)	Yes	Yes	No	No
Highways (5.3, 5.7)	Yes	Yes	No	No
Air Transportation (0.0, 0.6)	Yes	Yes	No	No
Parking facilities (0.1, 0.1)	Yes	Yes	No	No
Sea and Inland Port Facilities (0.1, 0.2)	Yes	Yes	No	No
Transit Subsidies (0.0, 0.0)	Yes	Yes	No	No
Police Protection (3.7, 3.2)	Yes	Yes	No	No
Fire Protection (1.2, 1.3)	Yes	Yes	No	No
Correction (2.3, 2.7)	Yes	Yes	No	No
Protective Inspection (0.5, 0.5)	Yes	Yes	No	No
Natural Resources (0.3, 1.1)	Yes	Yes	No	No

Functional Categories of Public Expenditure (% of State/Local Expenditure, for NJ and for US, 1995--96)	Business Physically Present		Business Not Physically Present	
	Corporate	Non-Corporate	Corporate	Non-Corporate
Parks and Recreation (1.4, 1.4)	Yes	Yes	No	No
Housing and Community Development (0.9, 1.6)	Yes	Yes	No	No
Sewerage (2.0, 1.8)	Yes	Yes	No	No
Solid Waste Management (1.7, 1.1)	Yes	Yes	No	No
Financial Administration (1.4, 1.6)	Yes	Yes	No	No
Judicial and Legal (2.0, 1.5)	Yes	Yes	No[1]	No[1]
General Public Building (0.6, 0.5)	Yes	Yes	No	No
Other Governmental Administration (0.7, 0.9)	Yes	Yes	No	No
Interest on General Debt (4.7, 4.2)	Yes	Yes	No	No

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Functional Categories of Public Expenditure (% of State/Local Expenditure, for NJ and for US, 1995--96)	Business Physically Present		Business Not Physically Present	
	Corporate	Non-Corporate	Corporate	Non-Corporate
Miscellaneous Commercial (0.0, 0.0)	Yes	Yes	No	No
Other and Unallocable (7.7, 4.2)	Yes (?)[2]	Yes (?)[2]	No	No
Other Direct Expenditure:				
Utility Expenditure (4.2, 6.6)	Yes	Yes	No	No
Liquor Store Expenditure (0.0, 0.2)	No	No	No	No
Insurance Trust Expenditure (9.9, 7.8)	Yes	Yes	No	No

Source: US Bureau of the Census

1. Other than contingent, as explained in text.
2. Insufficient information.

Appendix III

The Canadian Case: Provincial Corporation Income Taxation

This appendix briefly describes Canadian experience with provincial corporation income taxation and its relevance for the issues discussed in this report.

Like the United States, Canada is a large and diverse federation within which subnational governments exercise considerable fiscal autonomy. The provincial governments – which, in broad terms, carry out functions quite similar to those of states in the United States – rely on several different sources of revenue. The Canadian provinces also have revenue structures quite similar to those of US states. In 1997–98, they obtained about 15% of their revenue in the form of transfers from the central government. Taxes on personal income and on sales accounted for the bulk of own-source revenues (36% and 17%, respectively). Of note for present purposes, the Canadian provinces also tax corporate income, deriving approximately 11% of own-source revenue from this tax in 1997–98. The corporation income tax thus plays a somewhat more prominent role in the financing of the provincial governments in Canada as compared with US states.

The administration of the provincial corporation income tax is similar to that of the US in some important respects but differs significantly in others. For instance, as in the US, the provincial governments exercise a high level of independence in setting corporation income tax rates. Manufacturing firms in Newfoundland are taxed at a rate of only 5%, while both manufacturing and non-manufacturing firms in Saskatchewan, Manitoba, and New Brunswick are taxed at a rate of 17%.

On the other hand, accounting and apportionment rules are quite different. In the US, Congress and the courts have imposed relatively few specific constraints on state tax authorities, with the result that different states use different apportionment rules and follow different practices with respect to the taxation of related corporations. Thus, some states insist on combined reporting of income for related corporations, while others allow taxpayers to elect separate accounting; some use a traditional three-factor formula (based on payrolls, sales, and assets) to apportion income, some use a single-factor formula (for example, the increasingly-widespread single-factor formula based only on sales), and others use still different apportionment rules. In Canada, by contrast, accounting and apportionment rules are dictated by federal statute, so that the provinces must adhere to uniform accounting and apportionment procedures. Canadian practice requires that

the taxable income of each corporation be determined by separate accounting; combined accounting for related corporations is not allowed. Furthermore, apportionment must be based *solely* on a two-factor formula that gives equal weight to payroll and to revenues. Most importantly for present purposes, a corporation's income is taxable in a Canadian province only if it has an establishment there – that is, a place of business where physical assets and employees are engaged.

Canadian practice thus adheres, in effect, to a physical presence test for nexus. A corporation that has no physical presence in a province would have no establishments there, and so none of its income would be subject to that province's corporation income tax. Thus, in particular, a province may not impose a tax on the income of a corporation that derives income solely from the sale of goods or services in that province, whether the goods and services are tangible or intangible in nature, and whether or not the sales are to affiliated corporations, to other corporate or non-corporate unaffiliated businesses, or to consumers.

The Canadian situation clearly differs from that in the United States in many important respects, and there can be no general presumption that one country's policies are appropriate for another. The fundamental economic policy considerations that are relevant for determining nexus for corporation income tax purposes have already been discussed in the body of the present report. Nevertheless, the Canadian case is instructive. It demonstrates that the corporation income tax can be a workable, robust revenue instrument for subnational governments in a diverse, modern federation – one with economic, political, and legal institutions generally similar to those of the United States – when subnational authorities can tax only those corporations that are physical present within their jurisdictions. Indeed, if Canadian experience can be taken as a guide, the conceptual clarity of a physical presence test for nexus, and its associated ease of implementation, certainly need not undermine and might well enhance the role of the corporation income tax for state governments in the US.

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University of Iowa (Ph.D. Economics, 1976)
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University of Virginia (B.A. Economics, 1972)
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EMPLOYMENT:

Principal academic appointments (see pp. 40–43 for other affiliations and appointments) –

9/93 –

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Ph.D. Dissertation Committees:

Indiana University – 26 (6 chaired, 1 co-chaired)
Vanderbilt University – 3 (1 chaired); also 5 in progress
External examiner for dissertations: Australian National University; Queen's University (Canada); University of Magdeburg.

M.A. Thesis Committees: 1 at Indiana University.

B.A. Honors Thesis Committees: 2 at Vanderbilt University (1 chaired), 3 at Indiana University (2 chaired), 1 at Queen's University.

PUBLICATIONS:

– Published and forthcoming books/monographs:

1. *Public Sector Economics* (2nd ed.), with Robin W. Boadway (Boston: Little, Brown, 1984), pp. xii, 571.

   Spanish translation: *Economía del Sector Publico* (Madrid: Instituto de Estudios Fiscales, 1986), pp. 766, translated by José María Losano Irueste.

   Korean translation: *Kong Kong Kyung Jae Hak* (Seoul: Hyung Seol Publishing Co., 1988), pp. 595, translated by Jee Hyung Kim.

   Chinese translation in progress (Beijing: China Renmin University Press).

2. *Urban Public Finance.* (New York: Harwood Academic Publishers, 1986), pp. viii, 175. Volume 10 in the series Fundamentals of Pure and Applied Economics. Reprinted (with minor updates) in Richard Arnott (ed.), *Regional and Urban Economics*, Part 2 (Amsterdam: Harwood Academic Publishers, 1996), 561–730.

   Chinese translation in progress (Beijing: Publishing House of Economic Science).

3. Edited volume, *Fiscal Aspects of Evolving Federations* (Cambridge: Cambridge University Press, 1997), pp. xi, 288.

– Published and forthcoming articles:

1. "Local Government Decisions and Property Values: Some Implications for Welfare and the Theory of Public Choice – Abstract," *Journal of Economics* 2, 1976, 160.

2. "Distributional Neutrality and Optimal Commodity Taxation," *American Economic Review* 67(5), December 1977, 889-898.

3. "Public Expenditures Determined by Voting with One's Feet and Public Choice," *Scandinavian Journal of Economics* 79, 1977, 326-337.

4. "Some 'New' Results on Optimal Commodity Taxation," *Public Finance/Finances Publiques* 33(3), 1978, 345-357.

5. "Local Public Goods, Property Values, and Local Public Choice," *Journal of Urban Economics* 6(4), October 1979, 521-534; reprinted in J.-F. Thisse, K.J. Button, and P. Nijkamp (eds.), *Modern Classics in Regional Science: Location Theory* (Cheltenham, UK: Edward Elgar Publishing, 1996).

6. "Public Good Provision with Optimal and Non-Optimal Commodity Taxation: The Single-Consumer Case," *Economics Letters* 4, 1979, 59-64; to be reprinted in John Creedy (ed.), *Economic Welfare: Concepts and Measurement* (Cheltenham, UK: Edward Elgar).

7. "Locational Efficiency in a Federal System," *Regional Science and Urban Economics* 10(4), November 1980, 453-472.

8. "Distributional Neutrality and Optimal Commodity Taxation: Reply," *American Economic Review* 70(1), March 1980, 237-241.

9. "More on the Neutrality of Land Taxation," *National Tax Journal* 35(1), March 1982, 105-108.

10. "The Welfare Effects of Intergovernmental Grants in an Economy with Independent Jurisdictions," *Journal of Urban Economics* 13(2), March 1983, 147-164.

11. "The q Theory of Investment with Many Capital Goods," *American Economic Review* 74(1), March 1984, 203-210.

12. "On Public Good Provision with Distortionary Taxation," *Economic Inquiry* 22(2), April 1984, 227-243. Errata, 23(1), January 1985, 185.

13. "Comment" (on "Province Building and Industrial Structure in a Small Open Economy"), in Douglas D. Purvis (ed.), *Economic Adjustment and Public Policy in Canada* (Kingston, Ontario: John Deutsch Institute for the Study of Economic Policy, 1984), 227-229.

14. "The Welfare Effects of Intergovernmental Grants with Distortionary Local Taxes: A Simple General Equilibrium Analysis," *Journal of Public Economics* 25(1/2), November 1984, 103-126.

15. "A Note on the Analytics of the RFPS Equalization Formula," with Thomas J. Courchene, in *Equalization Payments: Past, Present and Future* (Toronto: Ontario Economic Council, 1984), 409-426.

16. "An Alternative Approach to Aggregate Surplus Analysis," with Richard Harris, *Journal of Public Economics* 26(3), April 1985, 289-302.

17. "On the Analysis of Labor and Capital Income Taxation in a Growing Economy with Government Saving," *Public Finance/Finances Publiques* 40(1), 1985, 114-132. Errata sheet distributed with Vol. 41(1).

18. "Income Taxes and Urban Spatial Structure," *Journal of Urban Economics* 18(3), November 1985, 313-333.

19. "Spatial Variation of the Marginal Utility of Income and Unequal Treatment of Equals," *Journal of Urban Economics* 19(1), January 1986, 125-129.

20. "Interstate Tax Competition: Comment," *National Tax Journal 39*(3), September 1986, 353-356.

21. "Randomisation of Commodity Taxes: An Expenditure Minimisation Approach," with Fwu-Ranq Chang, *Journal of Public Economics 31*(3), December 1986, 329-345.

22. "Federal-State-Local Fiscal Relations: A Review of the Treasury Report," *Public Finance Quarterly 15*(4), October 1987, 472-499.

23. "Theoretical Analysis of Local Public Economics," Chapter 29 in Edwin S. Mills (ed.), *Handbook of Regional and Urban Economics*, Volume 2 (Amsterdam: North-Holland, 1987), 429-476.

24. "Tax Exporting and the Marginal Cost of Public Expenditure," *Economics Letters 24*(4), 1987, 353-358.

25. "The Demand for Public Goods in the Presence of Tax Exporting," *National Tax Journal 40*(4), December 1987, 591-601.

26. "Nash Equilibria in Models of Fiscal Competition," *Journal of Public Economics 35*(2), March 1988, 229-240.

27. "Indirect Distributional Effects in Benefit-Cost Analysis of Small Projects," *Economic Journal 98*(392), September 1988, 801-807.

28. "The (Apparent) Demise of Sales Tax Deductibility: Issues for Analysis and Policy," *National Tax Journal 41*(3), September 1988, 381-389.

29. "Voting Models of Social Security Determination," with Robin Boadway, in Björn Gustafsson and Anders Klevmarken (eds.), *The Political Economy of Social Security* (Amsterdam: North-Holland, 1989), 29-50.

30. "Interjurisdictional Capital Mobility: Fiscal Externality and a Corrective Subsidy," *Journal of Urban Economics 25*(2), March 1989, 193-212.

31. "A Median Voter Analysis of Social Security," with Robin W. Boadway, *International Economic Review 30*(2), May 1989, 307-328.

32. "Demand Estimation for Public Goods: Distortionary Taxation and Other Sources of Bias," *Regional Science and Urban Economics 19*(3), August 1989, 353-379.

33. "Non-cooperative Behavior and Efficient Provision of Public Goods," with Robin W. Boadway and Pierre Pestieau, *Public Finance/Finances Publiques 44*(1), 1989, 1-7.

34. "Tax-Transfer Policies and the Voluntary Provision of Public Goods," with Robin W. Boadway and Pierre Pestieau, *Journal of Public Economics 39*(2), July 1989, 157-176.

35. "Tax Expenditures: The Personal Standard," in Neil Bruce (ed.), *Tax Expenditures and Government Policy* (Kingston, Ontario: John Deutsch Institute for the Study of Economic Policy, 1989), 135-180.

36. "Budgetary Pressures in the EEC: A Fiscal Federalism Perspective," *American Economic Review 80*(2), May 1990 (Papers and Proceedings), 69-74.

37. "Optimal Tax-Subsidy Policies for Industrial Adjustment to Uncertain Shocks," with Robin W. Boadway, *Oxford Economic Papers* 42(1), January, 1990, 105-134; reprinted in P.J.N. Sinclair and M.D.E. Slater (eds.), *Taxation, Private Information, and Capital* (Oxford: Clarendon Press, 1991), 105-134.

38. "Non-neutrality of Debt with Endogenous Fertility," *Oxford Economic Papers* 42(2), April 1990, 414-428.

39. "R.M. Haig: Pioneer Advocate of Expenditure Taxation?" *Journal of Economic Literature* 28(2), June 1990, 649-660.

40. "The Marginal Cost of Public Funds with an Aging Population," *Journal of Population Economics* 4, 1991, 111-135; reprinted in Dieter Bös and Sijbren Cnossen (eds.), *Fiscal Implications of an Aging Population* (Berlin: Springer, 1992), 23-47.

41. "Income Redistribution in a Common Labor Market," *American Economic Review* 81(4), September 1991, 757-774. To be reprinted in Wallace E. Oates (ed.), *The Economics of Fiscal Federalism and Local Finance* (Cheltenham, UK: Edward Elgar).

42. "Theoretical Issues in Local Public Economics: An Overview," with John Douglas Wilson, *Regional Science and Urban Economics* 21(3), November 1991, 317-331.

43. "Some Rudimentary 'Duopolity' Theory," *Regional Science and Urban Economics* 21(3), November 1991, 393-421.

44. "Public Facility Location and Urban Spatial Structure: Equilibrium and Welfare Analysis," with Jacques-François Thisse, *Journal of Public Economics* 48, 1992, 83-118.

45. "Relaxation of Barriers to Factor Mobility and Income Redistribution," in P. Pestieau (ed.), *Public Finance in a World of Transition*, a Supplement to Vol. 47, 1992 of *Public Finance/Finances Publiques*, 216-230.

46. "State Income Taxation of Mobile Labor," *Journal of Policy Analysis and Management* 12, Winter 1993, 51-75.

47. "Steady-State Welfare Effects of Social Security in a Large Open Economy," with Friedrich Breyer, in B. Felderer (ed.), *Journal of Economics/Zeitschrift für Nationalökonomie, Supplementum 7* (Vienna: Springer Verlag, 1993), 43-49.

48. "Fiscal Competition and Interindustry Trade," *Regional Science and Urban Economics* 23, 1993, 369-399.

49. "Long-Term Debt Strategy: A Survey," with Robin W. Boadway, in F. van Winden and H.A.A. Verbon (eds.), *The Political Economy of Government Debt* (Amsterdam: North-Holland, 1993), 37-68.

50. "Income Redistribution and Migration," *Canadian Journal of Economics*, 27(3), August 1994, 637-656.

51. "Taxation and Savings: A Survey," with Robin W. Boadway, *Fiscal Studies* 15(3), August 1994, 1-63; reprinted in M.P. Devereux (ed.), *The Economics of Tax Policy* (Oxford: Oxford University Press, 1996), 55-106.

52. "Optimal Transportation Policy with Strategic Locational Choice," with Jacques-François Thisse, *Regional Science and Urban Economics 25*(4), August 1995, 395–410.

53. "Factor Mobility, Risk, and Redistribution in the Welfare State," *Scandinavian Journal of Economics 97*(4), 1995, 527–546.

54. "Comments on Douglass C. North, 'Institutional Competition'," in H. Siebert (ed.) *Locational Competition in the World Economy* (Tübingen: J.C.B. Mohr (Paul Siebeck), 1995), 38–44.

55. "Comments on 'Fiscal Federalism and Decentralisation: A Review of Some Efficiency and Macroeconomics Aspects'," in M. Bruno and B. Pleskovic (eds.), *Annual World Bank Conference on Development Economics, 1995* (Washington, DC: The World Bank, 1996), 323–328.

56. "Decentralised Income Redistribution and Immigration," with Dietmar Wellisch, *European Economic Review 40*(1), January 1996, 187–217. (A German-language version of this paper appears as "Dezentrale Umverteilung und Einwanderung" in *Ifo Studien 42*(1), 1996, 101–133.)

57. "Imperfect Mobility and Local Government Behavior in an Overlapping-Generations Model," with John D. Wilson, *Journal of Public Economics 60*(2), May 1996, 177–198.

58. "Fiscal Aspects of Evolving Federations: Introduction," *International Tax and Public Finance 3*(2), May 1996, 121–136. A substantially revised and expanded version of this material appears in items 60 and 61 below.

59. "Income Distribution and Redistribution Within Federations," *Annales d'Economie et de Statistique 45*, Janvier/Mars 1997, 291–313.

60. "Introduction," in D.E. Wildasin (ed.), *Fiscal Aspects of Evolving Federations* (Cambridge: Cambridge University Press, 1997), 3–13.

61. "Fiscal Aspects of Evolving Federations: Issues for Policy and Research," in D.E. Wildasin (ed.), *Fiscal Aspects of Evolving Federations* (Cambridge: Cambridge University Press, 1997), 14–37.

62. "Factor Mobility, Risk, Inequality, and Redistribution," in D. Pines, E. Sadka, and I. Zilcha (eds.), *Topics in Public Economics* (Cambridge: Cambridge University Press, 1997), 314–339. (This is an expanded version of item 53 above.)

63. "James A. Mirrlees and William Vickrey: The Nobel Laureates and Their Contributions to Public Economics," *International Tax and Public Finance 5*(1), February, 1998, 63–66.

64. "Factor Mobility and Redistributive Policy: Local and International Perspectives," in P. B. Sorensen (ed.) *Public Finance in a Changing World* (London: MacMillan Press, Ltd., 1998), 151–192.

65. "Risky Local Tax Bases: Risk-Pooling vs. Rent Capture," with J.D. Wilson, *Journal of Public Economics 69*(2), August, 1998, 229–247.

66. "Taxation, Migration, and Pollution," with A. Sandmo, *International Tax and Public Finance 6*(1), February, 1999, 39–60.

67. "Public Pensions in the EU: Migration Incentives and Impacts," in A. Panagariya, P.R. Portney and R.M. Schwab (eds.), *Environmental Economics and Public Policy: Essays in Honor of Wallace E. Oates* (Edward Elgar), forthcoming.

68. "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition," *American Economic Review*, forthcoming.

– *Other publications, reports, and reviews:*

1. "Old Age Security and Fertility," report prepared for Futures Group, Inc. under contract to USAID, 1983. 89 pp. (A contribution to the Indiana University Fertility Determinants Project, George Stolnitz, director.)

2. Reading list for "Public Sector Economics II" (graduate level), Volume 11, 275–280; and "Urban Public Economics," (graduate level) Volume 25, 94–118, in *Economics Reading Lists, Course Outlines, Exams, Puzzles, and Problems*, compiled by E. Tower (Durham, NC: Eno River Press, 1990).

3. "The Economics of Urban Governance in South Africa," report prepared for World Bank Urban Mission to South Africa, 1992. 27 pp.

4. "Financing Urban Infrastructure from Local Government Resources," report prepared for World Bank Urban Mission to South Africa, 1992. 35 pp.

5. Review of C. Henry, *Microeconomics for Public Policy*, *Journal of Economics/Zeitschrift für Nationalökonomie* 52(3), 1990, 308–311.

6. Review of J. Owens and G. Panella (eds.), *Local Government Finance: An International Perspective*, *Journal of Economics/Zeitschrift für Nationalökonomie* 57(1), 1993, 123-126.

7. "Financing Local Government Capital Outlays in South Africa," report prepared for the World Bank, 1996. 25 pp.

8. "Review of *Tax Policy and Planning in Developing Countries*, A. Bagchi and N. Stern (eds.), *Journal of Development Economics* 53(1), June 1997, 219–227.

9. "Review of *Population Economics* by A. Razin and E. Sadka," *Economic Development and Cultural Change* 45(4), July 1997, 932–938.

10. "Financing Local Governments in Karnataka," report prepared for the World Bank, 1996, 25pp.

11. " Fiscal Crisis, Fiscal Reform, and Fiscal Centralisation in Brasil," report prepared for the World Bank, 1999, 29 pp.

WORK IN PROGRESS

1. *Public Sector Economics*, with Robin Boadway, third edition.

2. "Preference Revelation and Benefit Pricing for Differentiated Products and Public Goods: Competitive Clubs with Heterogeneous Consumers."

3. "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergovernmental Fiscal Relations"; World Bank Policy Research Working Paper No. 1843.

4. "Regional Development, Labor Mobility, and Local Public Finance in China."

5. "Economic Integration and Labor Market Institutions: Worker Mobility, Earnings Risk, and Contract Structure," with R. Schöb; Working Paper No. 167, Center for Economic Studies, University of Munich.

6. *The Economics of Agglomeration*, with M. Fujita and J.-F. Thisse.

7. *Selected Essays on Fiscal Federalism* (tentative title), to be published by Edward Elgar in the series "Studies in Fiscal Federalism and State-Local Finance."

8. State and Provincial Corporation Income Taxation: Nexus and Apportionment Issues.

9. Factor Mobility and Fiscal Policy in the EU: Policy Issues and Analytical Approaches.

10. Fiscal Decentralisation and Redistribution: Conflict or Compatibility?

OTHER AFFILIATIONS, GRANTS, and VISITING APPOINTMENTS

Spring 1977

College of Business Administration
University of Illinois at Chicago Circle
Chicago, IL
Faculty Released-Time Award

Summer 1977

University of Illinois at Chicago Circle
Chicago, IL
Graduate School Faculty Summer Fellowship

June 15, 1978 – February 28, 1981

"General Equilibrium Welfare Analysis of Intergovernmental Grants"
National Science Foundation
Grants SOC 78-05195 and SOC 79-20648
(Sole Principal Investigator)

November 3, 1981 – August 15, 1982

"Social Security as a Determinant of Fertility"
Research carried out for the Fertility Determinants Project,
contract between Indiana University and Futures Group, Inc.;
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August 1986 – August 1987

Center for Operations Research and Econometrics
Research Associate
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June – July, 1987

"Government Policy in a Credit-Rationed Economy"
Deutsche Forschungsgemeinschaft
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Indiana University
Summer Faculty Fellowship

January 1988 – November, 1989

"Fiscal Competition in the Great Lakes Region"
Ameritech Fellowship
Indiana University

Summer, 1989

"Fiscal Interactions in an Integrated Europe"
Department of West European Studies
Indiana University
Summer Faculty Research Fellowship

June, 1989

One-month visit, Center for Operations Research and Econometrics
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Summer, 1990

Andrew W. Mellon Travel Grant
Department of West European Studies
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Summer Faculty Research Fellowship

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Summer Research Fellowship
Deutsche Forschungsgemeinschaft
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Visiting Scholar in Regional Government Finance and Fiscal Federalism
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Stiftelsen Södertörns Sommaruniversitet
Royal Institute of Technology
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June, 1991
Visitor, Center for Economic Studies
University of Munich
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July, 1991
Visiting scholar, Faculty of Commerce and Business Administration
University of British Columbia
Vancouver, British Columbia
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World Bank Urban Mission
South Africa

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Lectures on "Public Expenditure and Efficiency"
Finnish Postgraduate Programme in Economics
University of Helsinki
Helsinki, Finland

June, 1994
Visitor, Institute of Economics
Norwegian School of Economics and Business Administration
Bergen, Norway

May, 1995
Visiting Professor
Groupe de Recherche en Economie Quantitative/Aix-Marseille
Ecole des Hautes Etudes en Sciences Sociales
Marseille, France

June—July, 1995
Lecturer
European Economic Association Summer School on "Local Public Finance, Urban Economics, and Economic Geography"
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July, 1995 – August, 1996
Consultant (in residence)
Public Economics Division
Policy Research Department
World Bank
Washington, DC

June, 1996
Visitor
Economic Policy Research Unit
Copenhagen Business School
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June, 1997

Nordic Doctoral Programme in Economics
Lecture series on "Open Economy Public Economics"
Uppsala University
Uppsala, Sweden

August, 1999 –

Research Fellow, CESifo
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Department of Finance, Canada.
Midwest Universities Consortium for International Activities (MUCIA).
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EDITORIAL WORK AND REFEREEING:

Associate Editor, *Regional Science and Urban Economics*, 1987 –

Book Review Editor, *Regional Science and Urban Economics*, 1987 – 1996.

Guest co-editor (with J.D. Wilson), *Regional Science and Urban Economics*, special issue on "Theoretical Issues in Local Public Economics," Volume 21, Number 3, November, 1991.

Associate Editor, *Journal of Regional Science*, 1989 –

Associate Editor, *Journal of Urban Economics*, 1991 –

Associate Editor, *International Tax and Public Finance*, 1994 –

Co-Editor, Policy Watch section, *International Tax and Public Finance*, 1997 –

Guest editor, *International Tax and Public Finance*, special issue on "Fiscal Aspects of Evolving Federations," Volume 3, Number 2, May, 1996.

Editorial Council, *Review of International Economics*, 1994 –

Editorial Board, *National Tax Journal*, 1998 –

Associate Editor, *Journal of Public Economic Theory*, 1999 –

Editorial Board, *Papers in Regional Science*, 1999 –

Editorial Board, *Journal of Public Economics*, 1999 –

Editorial Board, *German Economic Review*, commencing 2000.

Past/Present Referee for Professional Journals:

American Economic Review
Annales d'Economie et de Statistique
Annals of Regional Science
AREUEA Journal
Bulletin of Economic Research
Canadian Journal of Economics
Canadian Public Policy
Economica
Economic Inquiry
Economic Journal
Economic Record
Economics and Politics
Empirical Economics
European Economic Review
European Journal of Political Economy
Growth and Change
International Economic Review
International Regional Science Review
International Tax and Public Finance
Journal of Applied Econometrics
Journal of Development Economics
Journal of Economic Education
Journal of Economic Literature
Journal of Economics (Zeitschrift für Nationalökonomie)
Journal of Environmental Economics and Management
Journal of Human Resources
Journal of International Economics
Journal of Labor Economics
Journal of Macroeconomics
Journal of Money, Credit and Banking
Journal of Political Economy
Journal of Population Economics
Journal of Public Economic Theory
Journal of Public Economics
Journal of Real Estate Finance and Economics
Journal of Regional Science
Journal of Theoretical Politics
Journal of Urban Economics
National Tax Journal
Open Economies Review
Oxford Economic Papers
Papers in Regional Science
Public Finance/Finances Publiques
Public Finance Quarterly
Quarterly Journal of Economics
Regional Science and Urban Economics
Resource and Energy Economics
Review of Economics and Statistics

Refereeing for professional journals (continued)
Review of Economic Studies
Review of International Economics
Scandinavian Journal of Economics
Social Choice and Welfare
Social Science Journal
Southern Economic Journal
World Bank Economic Review

Refereeing of research proposals and manuscripts:

National Science Foundation; National Research Council; Social Sciences and Humanities Research Council (Canada); Center for Operations Research and Econometrics; Queen's University School of Policy Studies; Belgian National Fund for Scientific Research; National Council for Soviet and East European Research.

Cambridge University Press; Little, Brown and Co., College Division; MIT Press; Oxford University Press.

Welfare and Efficiency in Public Economics, ed. by Dieter Bös, Manfred Rose, and Christian Seidl (Heidelberg: Springer, 1988).

The Political Economy of Social Security, ed. by Björn Gustafsson and Anders Klevmarken (Amsterdam: North-Holland, 1989).

Tax Expenditures and Government Policy, ed. by Neil Bruce (Kingston, Ontario: John Deutsch Institute for the Study of Economic Policy, 1989).

PROFESSIONAL SERVICE AND AFFILIATIONS:

Program Committee, European Society for Population Economics, 1987 meetings.
First Vice-President, Midwest Economics Association, 1991–92; program committee, nominating committee.
Member, Executive Committee, International Seminar in Public Economics, 1992–present.
Member, external review committee, Department of Economics, Wayne State University, 1993.
Organizer of International Seminar on Public Economics conference on "Fiscal Aspects of Evolving Federations," Vanderbilt University, 1994.
Program Committee, International Seminar in Public Economics, conference on "Distributional Aspects of Fiscal Policy: The Implications of Economic Integration," University of Essex, 1995.
Program Committee, Conference on "Regional Strategies, Decentralisation, and Subsidiarity," University of Toulouse, 1996.

Association memberships:

1. American Economic Association.
2. Canadian Economic Association.
3. Econometric Society.
4. European Economic Association.
5. International Institute of Public Finance
6. National Tax Association-Tax Institute of America.
7. Regional Science Association.
8. (Occasional) European Society for Population Economics, Public Choice Society, Royal Economic Society, Southern Economic Association, Western Economic Association.

REFERENCES: Available on request.

SEMINAR AND CONFERENCE PARTICIPATION (1986 – present; extramural activities only.)

Invited presentations:

Copenhagen Business School (2)
Cornell University
Federal Reserve Bank of Atlanta
Florida State University
Gadjah Mada University (Yogyakarta, Indonesia)
Government Institute for Economic Research (VATT), Helsinki, Finland (2)
Harvard University
Indiana University (Bloomington).
Indiana University–Purdue University–Indianapolis
LEQAM (Laboratoire d'Economie Quantitative, Aix–Marseille)
London School of Economics
Michigan State University
New York University
Norwegian School of Economics and Business Administration
Northwestern University (2)
Ohio State University
Purdue University (2)
Simon Fraser University
Southern Methodist University
State University of New York–Buffalo
Syracuse University
Texas A&M University
Tulane University
University of Antwerp
University of Bonn (5)
University of British Columbia (3)
University of California, Santa Barbara
Université Catholique de Louvain (3)
University of Chicago
University of Cincinnati
University of Colorado
University of Dortmund (2)
University of Illinois at Chicago
University of Illinois, Urbana-Champaign (3)
University of Indonesia (2)
University of Kentucky
University of Liège
University of Mannheim
University of Maryland
University of Michigan
University of Munich (2)
University of North Carolina
University of Pennsylvania
University of Pittsburgh

Invited presentations (cont.):
University of Rochester
University of Tennessee
University of Texas
University of Tilburg
University of Tokyo
University of Toronto
University of Virginia
University of Wyoming (2)
Vanderbilt University
World Bank

Conference Participation:

1986:

1. National Tax Association – Tax Institute of America (Washington): Presented "Interstate Tax Competition: Comment."

2. European Economic Association (Vienna): attendance only.

1987:

1. Conference on "Economic Models and Distributive Justice," Facultés Universitaires Saint-Louis (Brussels) and Facultés Universitaires de Notre Dame de la Paix (Namur): attendance only.

2. Conference on "Research and Decisionmaking in Economics, Management, and Engineering," Université Cathlolique de Louvain: attendance only.

3. Presented a series of three public lectures sponsored by the Belgian Institute of Public Finance and the Fondation Gutt (Brussels): "The Public Finances of American Federalism."

4. Conference on "The Political Economy of Social Security," (Fiskebäckskil, Sweden): Presented "A Median Voter Model of Social Security" and discussed one paper.

5. Workshop on "Increasing Returns," Université Cathlolique de Louvain: attendance only.

6. European Economic Association (Copenhagen): Presented "Tax-Transfer Policies and the Voluntary Provision of Public Goods" and "Ex Ante vs. Ex Post Optimal Policies for Risky Activities."

7. Allied Social Science Association (Chicago): attendance only.

1988:

1. National Tax Association – Tax Institute of America (Washington): Presented "The (Apparent) Demise of Sales Tax Deductibility: Issues for Analysis and Policy."

2. National Bureau of Economic Research Summer Institute on International Taxation (Cambridge): attendance only.

3. Conference on Tax Expenditures, Queen's University: Presented "Tax Expenditures: The Personal Standard."

4. Allied Social Science Association (New York): Presented "Fiscal Competition and Interindustry Trade" and "Distortionary Taxation and Demand Estimation for Public Goods," organized and chaired session on "Urban Public Finance: Recent Developments."

1989:

1. Midwest Economics Association (Cincinnati): Presented "Market Failure in a Credit-Rationed Economy" and "Optimal Tax-Subsidy Policies for Industrial Adjustment to Uncertain Shocks" and discussed two papers.

2. Midwest International Economics and Mathematical Economics meetings (Purdue): Presented "Fiscal Competition and Interindustry Trade" and discussed one paper.

3. Canadian Economics Association (Québec): Presented "Distortionary Taxation and Demand Estimation for Public Goods" and discussed two papers.

4. Conference on "Taxation in Open Economies," Center for Operations Research and Econometrics, Université Catholique de Louvain: Presented "Fiscal Competition and Interindustry Trade."

5. European Society for Population Economics (Paris): Presented "Non-neutrality of Debt with Endogenous Fertility."

6. Conference on "Consumption Taxation," University of Heidelberg: attendance only.

7. Workshop on "Local Public Finance," Queen's University: Presented "Some Rudimentary 'Duopolity' Theory."

8. Allied Social Science Associations (Atlanta): Presented "Budgetary Pressures in the EEC: A Fiscal Federalism Perspective," discussed one paper, organized and chaired session on "Taxation and the Location, Accumulation, and Investment of Capital."

1990:

1. Midwest Mathematical Economics and International Trade meetings (Bloomington): Chair of session on "Public Economics."

2. International Seminar on Public Economics Conference on "Fiscal Implications of an Aging Population" (Vaalsbroek, The Netherlands): Presented "The Political Economy of Public Expenditure with an Aging Population" and discussed one paper.

3. Conference on "The Political Economy of Public Debt," sponsored by De Nederlandsche Bank (Amsterdam): Presented "Long-Term Debt Strategy."

4. Presented 2-day "Seminar on Public Economics," Brawijaya University (Malang, Indonesia): Presented "Fiscal Competition and Interindustry Trade" and "Long-Term Debt Strategy."

5. Conference on "Urban Economics: Theory and Methods for Policy Use," sponsored by the Royal Institute of Technology/Stiftelsen Södertörns Sommaruniversitet (Stockholm): Presented "feature lecture" on "The Theory of Urban Amenities and Public Finance" and "workshop session" on "Public Facility Location and Urban Spatial Structure."

6. Conference on "The European Integration of 1992 and Its Implications for the United States," University of Pennsylvania/Rutgers University: Presented "Fiscal Competition and Interindustry Trade."

1991:

1. Conference on "State and Local Taxes after TRA 86," National Bureau of Economic Research, Edgartown, MA: Presented "Interstate Fiscal Externalities Before and After Tax Reform."

2. Conference on "Tax Policy in Small Open Economies," Norwegian School of Economics and Business Administration, Bergen, Norway: Presented "Income Redistribution and Migration" and discussed one paper.

3. University of Munich, presented a series of 6 lectures on "Public Economics in Open Economies: A Microeconomic Perspective."

4. International Seminar on Public Economics, Conference on "Taxation in Open Economies" (Louvain-la-Neuve, Belgium): Presented "Income Redistribution in a Common Labor Market" and discussed one paper.

5. Western Economic Association, annual meetings, Seattle: Presented "Public Facility Location and Urban Spatial Structure" and discussed one paper.

6. Conference on "New Directions in Club Theory," University of Tampere, Tampere Finland: Presented "Preference Revelation and Benefit Pricing for Differentiated Products and Public Goods: Competitive Clubs with Heterogeneous Consumers" and discussed one paper.

7. Conference on "Aspects of International Taxation," National Bureau of Economic Research, New York, NY, attendance only.

8. Midwest International Economics and Mathematical Economics meetings (Indianapolis): Presented "Income Redistribution and Migration" and discussed two papers.

1992:

1. Econometric Society, Summer meetings, Seattle: Presented "Income Redistribution and Migration."

2. Conference on "The Role of Fiscal Decentralisation in Economic Development," Center for Institutional Reform and the Informal Sector, University of Maryland, College Park; Presented "Comments" on fiscal decentralisation in South Africa.

3. Regional Science Association, North American meetings, Chicago: Presented "Public Pensions in the EC: Migration Incentives and Impacts," and discussed two papers.

1993:

1. AREUEA meetings, Anaheim, CA: Presented "On the Destrability of Property Taxation Under Uncertainty."

2. Conference on "Environmental Policy with Economic and Political Integration: The European Community and the United States," University of Illinois, Urbana-Champaign: Discussed two papers.

3. Conference on "Enjeux et procédures de la décentralisation," ("Issues and Mechanisms of Decentralization"), Université des Sciences Sociales, Toulouse, France: Presented "Policy Issues in Fiscal Federalism" and "Current Research in Fiscal Federalism."

4. Regional Science Association, North American meetings, Houston: Presented "Asylum Policy with a Common Labor Market" and "Optimal Transportation Policy with Strategic Locational Choice," and discussed one paper.

1994:

1. ASSA meetings, Boston, MA: Presented "Taxation, Migration, and Pollution" and "Preference Revelation and Benefit Pricing for Differentiated Products and Public Goods," discussed two papers, and chaired two sessions.

2. Public Choice Society Meetings, Austin, TX: Presented "Asylum Policy in a Common Labor Market."

3. Conference on "Recent Advances in Urban Economic Theory," Tel Aviv, Israel: Presented "Imperfect Mobility and Local Government Behavior in an Overlapping-Generations Model."

4. European Society for Population Economics annual meetings, Tilburg, The Netherlands: Presented "Taxation, Migration, and Pollution" and "Public Pensions in the EC: Migration Incentives and Impacts."

5. Conference on "Decentralisation and the Economic Organisation of Space," Marseille, France: Presented "Risky Local Tax Bases: Risk Pooling vs. Rent Capture."

6. Conference on "Locational Competition in the World Economy," Institute of World Economics, University of Kiel, Germany: Discussed one paper.

7. International Seminar on Public Economics conference on "Fiscal Aspects of Evolving Federations," Vanderbilt University. Organised conference and discussed one paper.

8. Conference on "The Future of the Welfare State," Ebeltoft, Denmark: presented "Factor Mobility, Risk, and Redistribution in the Welfare State."

9. Regional Science Association, annual meetings, Niagara Falls, Canada: presented "Factor Mobility, Risk, and Redistribution in the Welfare State" and discussed one paper.

1995:

1. ASSA meetings, Washington, DC: Presented "Factor Mobility, Risk, and Redistribution in the Welfare State" and discussed one paper.
2. Conference on "Topics in Public Economics," Tel Aviv University; presented "Factor Mobility, Risk, and Redistribution in the Welfare State."
3. Annual Bank Conference on Development Economics (ABCDE), The World Bank, Washington: Discussed one paper.
4. Conference on "Fiscal Decentralization in Developing Countries," The World Bank: Chaired one session.
5. International Seminar on Public Economics conference on "Distributional Aspects of Fiscal Policy: The Implications of Economic Integration," University of Essex: Presented "Factor Mobility, Risk, and Redistribution in the Welfare State," discussed one paper, and chaired one session.
6. International Institute of Public Finance annual meetings, Lisbon, Portugal: Presented "Factor Mobility, Risk, and Redistribution in the Welfare State" (regular session) and "Income Distribution and Redistribution within Federations" (plenary session).
7. Conference on "Competition or Harmonisation: Fiscal Policy, Regulation, and Standards," Tutzing, Germany: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."

1996:

1. Conference on "The Multi-Tiered Public Sector: Fiscal Competition, Political Economy, Finance, and Mobility," Washington University, St. Louis: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."
2. Conference on "Public Policy and Private Incentives," Norwegian Research Centre in Organization and Management, Bergen, Norway: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."
3. Workshop on "New Directions in Public Expenditure Analysis," The World Bank (Washington): Presented "Fiscal Decentralisation and Public Expenditures."
4. Workshop on Local Public Finance, Aasgardstrand, Norway: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."
5. Conference on "Regional Strategies, Decentralisation, and Subsidiarity," University of Toulouse: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition" and chaired one session.
6. Conference on "The Welfare State and Local Public Economics," University of Tampere (Finland): Presented keynote address on "The Economics of Intergovernmental Fiscal Relations: Key Issues, Main Findings, and Policy Implications."

1997:

1. Allied Social Science Associations, New Orleans: Discussed three papers.
2. World Bank Workshop on "Decentralisation of the Social Services Sector," College Park, Maryland: Presented "Fiscal Aspects of Evolving Federations: Issues for Policy and Research."
3. Conference on "Immigration and Welfare," Program on Economy, Justice, and Society, University of California, Davis, California: Presented "Taxation, Migration, and Pollution."
4. Workshop on "Public and Urban Economics," University of Uppsala, Sweden; presented a series of four lectures on "Open Economy Public Economics."
5. World Bank workshop on " Promises and Pitfalls in Fiscal Decentralisation," Washington, DC: Presented "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergovernmental Fiscal Relations."
6. Summer Institute for Theoretical Economics on "Interregional Competition in Public Economics," Stanford University: Presented "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergovernmental Fiscal Relations."
7. National Tax Association annual meetings, Chicago: Presented "Factor Mobility and Redistributive Policy: Local and International Perspectives."
8. Southern Economic Association annual meetings, Atlanta: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."

1998:

1. Public Choice Society annual meetings, New Orleans: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."
2. World Bank, HD Week '98 workshop on "Decentralising Social Services: Principles and Approaches," Alexandria VA: Presented "Principles of Decentralisation."
3. International Conference on Public Economic Theory, Tuscaloosa, AL: Presented "Factor Mobility and Income Redistribution: Local and International Perspectives" (plenary lecture) and "Production Efficiency and Principles of International Taxation."
4. Summer Institute for Theoretical Economics on "Interregional Competition in Public Economics," Stanford University: Presented "State Corporation Income Taxation: A Normative Approach."
5. Fifth Annual Paul J. Hartman State and Local Tax Forum, Vanderbilt University School of Law: Attendance only.
6. National Tax Association, Austin: Presented "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergoveramental Fiscal Relations."

1999:

1. The World Bank, Annual Bank Conference on Development Economics, Washington: Presented "Fiscal Decentralization and Redistribution: Conflict or Compatibility?"

2. Canadian Public Economics Study Group, Annual meetings, Toronto: Presented "State and Provincial Corporation Income Taxation: Nexus and Apportionment Issues."

3. Center for European Economic Research (Zentrum für Europäische Wirtschaftsforschung), Mannheim: Presented "Factor Mobility and Fiscal Policy in the EU: Policy Issues and Analytical Approaches."

4. Econometric Society meetings, Cancun: Presented "Labor Market Integration, Investment in Risky Human Capital, and Fiscal Competition."

A-3285-03T1

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3285-03T1

LANCO, INC.

Plaintiff-Respondent,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Appellant.

Civil Action

ON APPEAL FROM A FINAL JUDGMENT OF THE TAX COURT OF NEW JERSEY

DOCKET NO. 005329-1997
Sat Below:
Hon. Peter D. Pizzuto

BRIEF OF PLAINTIFF-RESPONDENT LANCO, INC.

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On the Brief

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PRELIMINARY STATEMENT

The Preliminary Statement of the Appellant, the Director, Division of Taxation ("Director"), is long on advocacy and short on facts. Plaintiff, Lanco, Inc. ("Lanco"), which the Tax Court concluded could not be subjected to New Jersey's corporation business tax ("CBT") since it had no physical presence in the State - no office, no employees and no tangible property -- does not sell merchandise and does not have business activity in the State.

It is readily apparent from the Director's Preliminary Statement, however, that he has confused Lanco with the corporation to whom it licensed its intangible property (the "Licensee"). The Licensee (not Lanco) sold merchandise. The Licensee (not Lanco) had business activities in New Jersey. The Licensee (not Lanco) decided where, and to what extent, the intangible property it licensed from Lanco was to be used. Any use of the intangible property in New Jersey was the Licensee's use, not Lanco's use. Lanco merely received income from the Licensee for the Licensee's use of Lanco's intangible property. Further, Lanco never admitted that it benefited from "New Jersey's marketplace," directly or otherwise.

The Director's statement that Lanco is somehow not paying its "fair share" is misleading. If the tax statute imposes tax when a corporation has business activity in the State, and if the corporation has no business activity in the State, the corporation cannot be taxed. If the Constitution requires that there be substantial nexus before a state can impose a tax, and if substantial nexus does not exist, no tax can be imposed.

The Director would like this Court to circumvent United States Supreme Court precedent. That precedent requires physical presence in a state before tax jurisdiction can be asserted. The Director's entreaty is based on the identical arguments placed squarely before the United States Supreme Court - and rejected. Contrary to the Director's assertion, the United States Supreme Court has concluded that the United States Constitution can, and does, demand in-State physical presence (and not merely the employment by another of intangible property) as a prerequisite to taxation.

While the Director seeks to escape the confines of the Constitution, the Tax Court correctly understood that it was required to follow Supreme Court precedent. Its decision should be affirmed.

COUNTERSTATEMENT OF FACTS

The record here is clear. Most of the relevant facts were stipulated to by the parties. The Director called no fact witnesses at the trial to establish any additional facts, leaving no room for unsupported assertions, arguments and suppositions. The absence of record cites at the end of many allegations in the Director's statement of "Procedural History and Statement of Facts" provides this Court with a roadmap to identify the many "liberties" taken by the Director.

a. Lanco Had No Physical Presence in New Jersey

As the parties stipulated, Lanco owns no real or tangible property in the State (Da19, ¶¶ 17, 18), and has no officers or employees in New Jersey (Da19, ¶ 20).

b. Lanco Was Not Engaged in Activities in New Jersey

All of the activities regarding Lanco's licensing and protection of its Marks occur outside of New Jersey (Da19, ¶¶ 15, 25). Lanco had no agents in the State (Da19, ¶ 22).

c. Lanco Did Not Direct the Use of its Marks to New Jersey

The Director repeatedly misstates the record regarding Lanco's purported relationship to New Jersey (Db4-Db6). For example, the Director asserts that: "Plaintiff deliberately directs the use of its property in New Jersey"

(Db4). Lanco's agreement with its Licensee grants the right to use the marks on a non-exclusive basis "worldwide" (Da98). Lanco does not direct the use of its Marks to any particular jurisdiction (Da98-Da109). The decisions concerning where and to what extent the Marks are to be used are made by its licensee, Lane Bryant, Inc. ("Lane Bryant").

Despite the Director's continuous insertion of "New Jersey," in many of his recitations of the purported facts, the Trademark Protection Agreement never once mentions "New Jersey" (Da98-Da109). Repetition, regardless of how frequent, cannot change a wish into fact.

d. Lanco and Lane Bryant Are Separate and Distinct Corporations

The Director does not distinguish the activities of Lane Bryant from those of Lanco. Lane Bryant and Lanco are separate corporations (Da18, ¶¶ 4, 19). Lanco is in an entirely different line of business than Lane Bryant -- Lanco is a trademark protection company and Lane Bryant is a clothing retailer (Da19, ¶¶ 5, 10). The Director has acknowledged, moreover, that Lane Bryant is not Lanco's agent (Da19, ¶ 22) and its acts are its own and cannot be attributed to Lanco.

The Director stressed at several points in his brief that Marks were licensed to "sister" or "related" corporations (Db1, Db4, Db5, Db27). However, as Professor Kearl, the Director's own expert witness, acknowledged, that fact is not germane to determining whether or not Lanco has nexus with New Jersey (2T84, 2T85)[1]. The Tax Court agreed, stating that whether Lanco and Lane Bryant were related was "not material to the constitutional issue."

The Director also attempts to "supplement" the record. For example, although the record is virtually silent regarding the Licensee (Da18, ¶¶ 9-11, 14 providing the only factual statements regarding Lane Bryant), the Director asserts, without record support, that a "significant percentage of Lane Bryant's gross profits are turned over to Lanco for the right to use plaintiff's trademarks and service marks" (Db5), and that Lane Bryant has "numerous retail clothing outlets in the State" (Db4).

e. Whether Lanco Pays Tax to Another Jurisdiction is Irrelevant in Determining Whether Lanco Has Nexus to New Jersey

Additionally, contrary to the Director's assertion, Lane Bryant does not pay its profits to Lanco (Db6). The

[1] "1T" refers to the transcript of trial proceedings on November 30, 1999. "2T" refers to the transcript of trial proceedings on May 15, 2000.

royalties that Lane Bryant pays Lanco are part of Lane Bryant's cost of goods sold, just like the payments it makes to suppliers of tangible personal property. During the year at issue, New Jersey's Legislature imposed its CBT on net income and not on gross receipts.[2] The Legislature decided to have separate entity taxation, unlike California's "unitary" combined method. Under the Director's view, however, all bona fide expenses paid to affiliates are suspect simply because they reduce the amount of net income upon which the payor's CBT is computed.

Without citation to the record, the Director states that "Lanco pays no taxes to any State on the money it earns from retail sales in New Jersey" (Db8). First of all, Lanco makes no retail sales in New Jersey -- only Lane Bryant does. Second, the statement is false. The Director introduced no evidence to support its statement. There is nothing in the record to suggest that Lanco does not pay taxes. Most importantly, however, as the Director's own expert witness, Professor Kearl, testified, whether Lanco pays tax to another jurisdiction is totally irrelevant to

[2] In legislation enacted in 2002, an alternative method for computing the CBT, the Alternative Minimum Assessment ("AMA") was provided to target corporations that have economic presence in the State, but do not have entire net income. L. 2002, c. 40, § 6. The AMA is computed upon gross profits or gross receipts.

the issue here (2T42, 2T85). Professor Pomp agreed, stating that "a state's power to assert taxing jurisdiction does not expand based on whether the corporation is taxable by another state" (1T129).

Further, the only reason that Lanco "escapes" (Db9) taxation in its domicile state is that Delaware decided to exempt corporations that hold and manage intangible property from taxation. Del. Code Ann. tit. 30, § 1902(b)(8). This is a policy decision no different than the New Jersey Legislature's decision to provide a reduced basis of tax for investment companies. N.J.S.A. 54:10A-5(d).

The Director's statement that "New Jersey . . . collect[s] no corporate tax revenue on the profits generated in the State through the use . . . of plaintiff's property," is incorrect (Db8). There is nothing in the record to suggest that Lane Bryant is not subject to New Jersey's CBT on all of its income attributable to New Jersey.

f. Taxing Entities That Are Not Physically Present is Undesirable From An Economic Perspective

Dr. David Earl Wildasin was accepted by the Court as an expert in the field of economics with special expertise in state and local fiscal policy and public finance (1T23-

1T24). He testified regarding the circumstances where it would, or would not, be desirable from an economic perspective for a state or locality to tax the income of corporations (1T24-1T25). He analyzed the issue and concluded that there is no economic justification for the imposition of a corporate income tax on businesses that have no physical presence in the state or locality (1T54).

Dr. Wildasin found that businesses that are physically located within a jurisdiction require some publicly-provided services necessitating corresponding expenditures by the state or locality (1T41). However, he concluded that businesses that are not physically present do not require state or local expenditures since the businesses do not use the services the state provides (1T42).

The Director called Professor James Kearl to testify as an expert in applied microeconomics (2T28). Despite acknowledging that, from a legal perspective, physical presence is generally required before a state can impose a corporate income tax (2T82), he contended that, from an economic perspective, a corporation having economic activity within a state should be subjected to its corporate income tax (2T85). He believes, however, that individuals (e.g., professors who earn royalties from

books) having the same economic activity in a state should not be subject to an income tax (2T65-2T66).

Economic activity includes, in Professor Kearl's opinion, the exhibition of trademarks on signs or on other physical property, even though that property is not owned by the trademark owner (2T38, 2T49). "[D]rawing royalties" or collecting income without performing any activity is enough, in Professor's Kearl's view, for taxing a corporation (2T54).

While recognizing that Lanco would likely be litigating any trademark-related cases in federal court, he nonetheless cited the fact that New Jersey maintains a court system as a benefit received by Lanco (2T39). He acknowledged that it is the Lane Bryant stores that use the Lanco marks (2T48).

Professor Kearl admitted that he knew nothing about the constitutional standards that govern state taxation of corporations (2T58-2T59). He believes that states are free to impose their own nexus rules (2T66).

g. From a Tax Policy Perspective, Physical Presence Is A Superior Nexus Standard

Professor Richard D. Pomp was accepted as an expert in tax policy (1T81-1T82). Professor Pomp concluded that "physical presence [is] far superior to metaphysical

presence as a nexus standard from a [tax] policy perspective" (1T89-1T90).

The six tax policy criteria Professor Pomp considered in reaching his determination that the correct Commerce Clause nexus standard requires physical presence were: (1) which standard is more likely to provide a bright-line test for determining whether nexus exists (1T92-1T100); (2) which standard is more consistent with settled expectations (1T100-1T106); (3) which standard would minimize litigation and encourage interstate investment (1T106-1T109); (4) which standard does not discriminate against the service sector (1T110-1T112); (5) which standard has a higher risk of multiple taxation (1T116-1T120); and (6) which standard is easier to administer (1T120-1T123). With respect to each criteria, Professor Pomp reached the same conclusion - physical presence is a far superior nexus standard (1T95-1T98, 1T101-1T06, 1T109, 1T110-1T118, 1T120-1T21).

h. Only One Year is at Issue Here

There is only one year at issue here - the fiscal year ended January 31, 1998 (Da153) ("[t]he Complaint and Answer and all other filings should be deemed amended to reflect that the only year that is at issue in this action is the fiscal year ended January 31, 1998"). Yet, the Director

continually refers to Lanco's purported activities "[o]ver a period of more than twenty years" (Db20); "for two decades" (ibid.); "more than two decades" (ibid.); See also Db30. We believe that any reference by the Director to years other than Lanco's fiscal year ended January 31, 1998, is not relevant.

ARGUMENT

I.

THE TAX COURT CORRECTLY CONCLUDED THAT THE COMMERCE CLAUSE PROHIBITS NEW JERSEY'S IMPOSITION OF TAX ON LANCO

The Tax Court concluded that the Commerce Clause of the United States Constitution prohibited the Director from imposing the CBT on Lanco since Lanco is not physically present in the State. That decision is grounded in long-standing United States Supreme Court precedent and should be affirmed.

Article I, Section 8, Clause 3 of the United States Constitution provides that "Congress shall have Power . . . to regulate Commerce . . . among the several states." In drafting the Constitution, its framers recognized the importance of regulating commerce amongst the states.[3] In fact, James Madison foretold (in the context of the Import-Export Clause) the situation that continues today, with equal force, in contravention of the Commerce Clause:

> "[I]t must be foreseen that ways would be found out to load the articles of import and export, during the passage through their jurisdiction, with duties which would fall on the makers of the latter and the consumers of the former. We may be assured by past experience, that such a practice would be introduced by future contrivances; and

[3] The Federalist Nos. 6, 7, 11, 22 (Alexander Hamilton).

> both by that and a common knowledge of human affairs, that it would nourish unceasing animosities, and not improbably terminate in serious interruptions of the public tranquility."[4]

Justice Marshall correctly understood that the "power to tax involves the power to destroy,"[5] that states would not "respect the interests of others"[6] and that the Commerce Clause was necessary "[o]r what should restrain a State from taxing any article passing through it from one State to another, for the purpose of traffic? or from taxing the transportation of articles passing from the State itself to another State, for commercial purposes?"[7]

The Commerce Clause, whose language only grants powers to Congress, has a long-standing history of having a "negative" or "dormant" power to restrain states from interfering with or discriminating against interstate commerce.

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079, 51 L. Ed. 2d 326 (1977), the United States Supreme Court articulated a four-prong test to determine whether the imposition of a state tax is

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[4] The Federalist No. 42 (James Madison).
[5] McCulloch v. Maryland, 17 U.S. 316, 430, 4 L. Ed. 579, 607 (4 Wheat) (1819)
[6] Brown v. Maryland, 25 U.S. 419, 440, 6 L. Ed. 678, 686 (12 Wheat) (1827).
[7] Id. at 449, 6 L. Ed. at 689.

permissible under the Commerce Clause of the United States Constitution. Under this test, a tax will be sustained only if it: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. If a tax fails to meet any one of the prongs, the tax does not pass Commerce Clause muster.

In connection with the "substantial nexus" prong of the test, the Tax Court objectively scrutinized the United States Supreme Court's decision in Quill Corp. v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), which reiterated the Court's earlier conclusions that physical presence was a necessary element of "substantial nexus," in the context of use tax collection responsibility. The Tax Court also analyzed subsequent state decisions and commentaries addressing the applicability of Quill's physical presence requirement in the context of income and franchise taxes. Based on these analyses, the Tax Court concluded that "physical presence is a necessary element of Commerce Clause nexus for taxation." 21 N.J. Tax at 220.

Lanco is not physically present in New Jersey - a fact conceded by the Director. "[T]he state may not assert

nexus, absent physical presence, against a corporation that receives income from the use of trademarks or other intangibles employed in a New Jersey business conducted by an affiliated corporation" (21 N.J. Tax at 219). The Director's subjectivity notice issued to Lanco was properly invalidated by the Tax Court.

A. *Quill* Precludes Imposition of the CBT if Physical Presence in the State is Nonexistent

The Director's argument that entities that have no physical presence in the State can be subjected to the CBT without violation of the Commerce Clause (Db32) was rejected by the Tax Court based upon the United States Supreme Court decision in Quill. Quill concluded that the Court's earlier decision in National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967), remained vital and the Court refused to budge (even in the wake of a barrage of opposition from state taxing authorities) from the requirement that physical presence is a prerequisite for Commerce Clause nexus. Quill is the law of the land and, unless and until the U.S. Supreme Court overrules Quill or Congress legislates otherwise, it remains so. Neither the Director nor lower courts are free to ignore Quill.

The Director suggests, citing to Quill, that the Commerce Clause is so flexible that it no longer requires physical presence (Db33, Db47).[8] However "flexible" the Commerce Clause might be, the decision in Quill precludes tax nexus without physical presence under the Commerce Clause. Since Lanco has no physical presence in New Jersey, there has been no "wooden application of Quill to the facts of this case" (Db38), but rather an application of the law of the land to uncontested facts.

Each and every argument made by the Director was not only addressed by the Tax Court below, but was vigorously argued and extensively briefed before the Court in Quill, and was soundly and unequivocally rejected by both courts. As a review of the Director's brief here and New Jersey's amicus curiae brief to the United States Supreme Court in Quill establish, the Director is merely reiterating the arguments presented to and rejected by the Court in Quill:

	Director's Brief in *Lanco*	**Director's Amicus Brief in *Quill***
Physical Presence is an Obsolete Notion	"[A] constitutional standard based on the physical presence of a taxpayer's property is an obsolete notion." (Db3) The physical presence requirement "may have had some surface appeal in past	"Petitioner [Quill] and its amici have not advanced any good reason for preserving the erroneous, unfair, and outmoded rule laid down in National Bellas Hess."

[8] The Director confuses the "flexible inquiry" that the Quill Court found applicable to Due Process claims (Db35), with the Court's steadfast adherence to the bright-line physical presence requirement of the Commerce Clause.

	centuries, the modern business environment renders plaintiff's proposed test unrealistic and wholly unworkable." (Db2)	
Constitution Does Not Require Physical Presence	"Surely, the Constitution does not demand that a company that earns profits from the intentional use of its property in New Jersey can escape paying its share of corporate taxes merely because the assets employed in the State are intangible." (Db3)	"[T]he notion that physical presence is the essential precondition for a State to exercise authority over a person [has] now been clearly repudiated by this Court."
Physical presence requirement imposes an unwarranted restriction on tax collection	"The trial court's decision misinterprets controlling legal precedents and imposes an unnecessary restriction on the State's ability to collect taxes from businesses exploiting New Jersey's marketplace." (Db3)	The effect of ***Bellas Hess*** "is directly to threaten States' constitutionally rooted authority to ensure that all businesses that benefit from state services pay their way." "[T]he protections given to out-of-state direct marketers are manifold and manifestly substantial, and [...] states are entitled to 'ask return' for those protections by demanding collection of the use tax."
Purposeful Availment of Market	"Lanco has purposely availed itself of the benefits and protections afforded by its deliberate exploitation of the New Jersey retail sales market." (Db2)	"These direct marketers . . . derive substantial benefits from the organized markets that the State makes available to them."
New Jersey Provides "Benefits" to Entities Not Physically Present in the State	"The growth in retail sales burdens the State by increasing traffic, requiring police and fire protection, and imposing demands on the State's labor pool." (Db38)	"States provide a host of services and protections for the economy itself - that is, for consumers' very ability to buy goods... And consumers' homes and offices, where goods will be used, are protected by government fire, police and other services."
Current Advances in Communication Technology	"With current advances in communication technology, an entity's physical presence in a State is not at all	"Quite obviously, since 1967 there has been a revolution in information collection,

Render Physical Presence Moot	determinative of the corporation's ability to secure substantial economic benefits from the State's marketplace and to benefit from that State's services." (Db2-3)	processing, storage and retrieval. Computers have become ubiquitous and cheap. It is computer technology that has allowed direct marketers to target their potential customers, to conduct mass mailings, and to handle high volumes of business."
Provision of Court System	"That Lanco may not yet have needed to file suit in a New Jersey Court to preserve its rights under its licensing agreements does not vitiate the benefit that plaintiff is receiving from the maintenance of the New Jersey court system." (Db45)	"And if the commercial transaction gives rise to disputes, litigation and collection activities inevitably depend on the state courts for adjudication, sheriffs for execution, and commercial and other laws for substantive standards."

The Director suggests that time and technology have eroded the vitality of the physical presence requirement (Db55, Db57). He contends that the "Commerce Clause [should be] realistically applied in today's business climate" (Db55). This precise argument was prominently placed before the U.S. Supreme Court by North Dakota and the many briefs of *amici curiae*, including the State of New Jersey, that were filed in support of North Dakota's position -- and rejected by the Court. As the Court itself noted, the basis for the North Dakota Supreme Court's decision not to follow the physical presence requirement of Bellas Hess was because '"the tremendous social, economic, commercial, and legal innovations' of the past quarter-century have rendered it 'obsolete."' Quill, supra, 504 U.S. at 301,

112 S. Ct. at 1907, 119 L. Ed. 2d 91 (citation omitted). Quill, in fact, characterized the argument that '"things have changed'" as North Dakota's "major premise." Petitioner's Reply Brief in Quill.[9] New Jersey added its voice to North Dakota's argument, claiming then, just as it does here, that Bellas Hess was "outmoded" and based on "factual assumptions that are not today supportable." Brief Amicus Curiae for the State of New Jersey Supporting Respondent in Quill.

Despite having this argument placed squarely before it, the Quill Court refused to retreat from the bright-line physical presence requirement of Bellas Hess. The Director's attempt to resurrect the argument as a basis for overturning the Tax Court's decision and for subjecting Lanco to tax is unavailing. The Director's arguments have no more vitality in 2004 then they did in 1992 when Quill was litigated, or in 1967, when Bellas Hess was litigated. Having been placed to rest by Quill, these arguments cannot be resurrected here.

1. ***Quill's* Physical Presence Requirement Applies to Income Tax**

The Director states that the Tax Court's conclusion that the physical presence requirement applies to all taxes

[9] References are to the briefs filed with the U.S. Supreme Court in Quill Corp. v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) (No. 91-194).

is an "unwarranted extension of Supreme Court holdings" (Db28). The Tax Court's conclusion is sound as evidenced by the summation of its reasoning for its rejection of the Director's argument:

> This argument [by the Director that physical presence is only required to impose use tax collection responsibilities] is not persuasive. In the first place, it does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant as to justify a different rule for each concerning physical presence as an element of Commerce Clause nexus. Next, the Supreme Court cases decided before Quill strongly suggest that physical presence is a necessary element of nexus for income taxation. Finally, other state court cases decided since Quill do not follow the Geoffrey rule [nexus based solely on economic nexus].

21 N.J. Tax at 208.

In rejecting the Director's argument that the Commerce Clause does not require physical presence in the income tax context, the most significant authority relied on by the Tax Court was its analysis of the Quill decision. That analysis led the Tax Court to conclude that "[i]t is difficult to see distinctions that give virtue to physical presence as a necessary element in [the use tax] area and not for purposes of income taxation." 21 N.J. Tax at 209.

Recently, moreover, another Tax Court judge reached the same conclusion, finding "no reason to conclude that a franchise tax should be analyzed in a different manner [from use tax situations], [the Tax Court] will apply the standard in Quill." Home Impressions, Inc. v. Director, Div. of Taxation, No. 000099-2003, 2004 N.J. Tax LEXIS 14, at *13 (Tax June 7, 2004) (Bianco, J.T.C.).

The Tax Court did not mince words in addressing the Director's argument (Db40-Db43) that the use tax collection requirements (which merely require the remittance of taxes imposed on others) are more onerous than the direct imposition of an income tax liability: "The use tax collection obligation does not, to put it plainly, seem significantly more burdensome than the liability to pay income tax. If physical presence is a requirement for one, it is illogical that it should not be for both." 21 N.J. Tax at 209.

The Tax Court's decision is consonant with Justice Scalia's concurring opinion in Quill, joined by Justices Kennedy and Thomas, which indicated that the Court does not view the Constitution as providing different thresholds for validity based upon the *type* of tax at issue. As Justice Scalia noted, "[i]t is difficult to discern any principled basis for distinguishing between jurisdiction to regulate

and jurisdiction to tax. As an original matter, it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected that." Quill, supra, 504 U.S. at 319, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (Scalia, J., concurring) (emphasis added).

Further, the Commerce Clause's "substantial nexus" requirement has long been applied to all manner of taxes. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 51 L. Ed. 2d 326 (1977) (sales tax; Court noted that the four-prong analysis, which includes "substantial nexus" requirement, had been applied by the Court to approve "many types of tax"); Goldberg v. Sweet, 488 U.S. 252, 109 S. Ct. 582, 102 L. Ed. 2d 607(1989) (tax on telephone calls); Container Corp. of Am. v. Franchise Tax Bd. 463 U.S. 159, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983) (franchise tax). In Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626, 101 S. Ct. 2946, 2958, 69 L. Ed. 2d 884 (1981), the Court stated that "[u]nder this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied on it." It is evident that the substantial nexus applies whether the tax is directly applied against a

taxpayer, e.g., franchise or income tax, or if the taxpayer merely has collection responsibilities, e.g., sales tax.

In fact, the United States Supreme Court has suggested that, because of the risk of multiple taxation, a higher jurisdictional threshold should exist for the direct imposition of tax than for use tax collection. National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 557, 97 S. Ct. 1386, 1391, 51 L. Ed. 2d 631 (1977).

The Director's primary rationale for its argument is that while thousands of local taxing jurisdictions impose sales tax at various rates, exemptions and reporting requirements, there are fewer taxing jurisdictions in the income tax arena (Db40-Db41). There is nothing to suggest that this is a distinction with a difference. Further, in Quill New Jersey argued as amicus that computers "have become ubiquitous and cheap" making "instant access to up-to-date taxing information" possible and "[i]n short, the costs of complying with state tax laws, if relevant at all, are not a significant impediment to the conduct of direct marketers' businesses, especially for large companies like Quill." Brief Amicus Curiae for the State of New Jersey Supporting Respondent in Quill. Since the Division does not believe that it would be burdensome to impose use tax

collection responsibilities, such purported responsibilities cannot be a basis to argue that a distinction exists between imposition and collection responsibilities.

In support of its position that the physical presence requirement has no applicability outside of the sales and use tax context, the Director also cites to I Jerome R. Hellerstein & Walter Hellerstein, State Taxation ¶6.30[5] (hereinafter referred to as "State Taxation")(3d ed. 1998) (Db41). That same treatise, however, also acknowledged that "one would be hard put to justify a constitutional rule that applied only to one industry [mail-order]. It is after all, not an administrative code but 'a constitution we are expounding.'" Id. at ¶ 6.02[2] (citation omitted.)

The Director also cites to an article by James H. Peters, Lanco, Inc.: The Commerce Clause and Income Taxes, State Tax Notes, Vol. 31, No. 11 (Mar. 15, 2004), asserting that there were "flaw[s]" and "lapses of logic" in the Tax Court's decision (Db42). Interestingly, Mr. Peters represented Quill Corporation and was on the brief to the Supreme Court in which Quill argued that North Dakota's decision "overturns the precedents of this Court established during the last fifty years, precedents which mandate a physical presence to support a finding of tax

nexus." See Brief for Petitioner in Quill. Further, the notion of "tax nexus" without distinction between use tax collection responsibilities and tax imposition permeated Quill's briefs. Ibid.

The Tax Court's decision that physical presence was required for income tax imposition did not rest solely upon its critical examination of the Quill decision. It also undertook the task of analyzing the United States Supreme Court and state court decisions addressing the issue and found them unavailing. 21 N.J. Tax at 210-13.

a. Pre-*Quill* Cases Do Not Support a Finding of Income Tax Nexus Without Physical Presence

The Director cites the same raft of pre-Quill Supreme Court cases as it did below and as were cited in articles opining that Quill did not apply outside the use tax collection area[10] (Db47-Db49, Db51-Db52). However, even the Director acknowledges that "there may have been some form of physical presence in these instances" (Db49) and, as stated by the Tax Court, the articles "acknowledge the

[10] In fact, several pages of the Director's brief were lifted, virtually verbatim, from pages 18 and 19 of the Petition for Writ of Certiorari filed by the State of Tennessee to the decision rendered in J.C. Penney National Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999) (Db47-Db49). As discussed further herein, Tennessee's Court of Appeals concluded that Quill's physical presence requirement applied to income taxes and rejected Tennessee's bid, similar to the Director's bid here, to impose income taxes on an economic nexus theory. The Supreme Court denied the petition. 53 U.S. 927, 121 S. Ct. 305, 148 L. Ed. 2d 245 (2000).

absence of precedent at the Supreme Court level sustaining imposition of an income tax on an entity without tangible property or other physical presence in the taxing jurisdiction." 21 N.J. Tax at 210. In fact, physical presence existed in each of these cases. It therefore comes as no surprise that the Tax Court rejected reliance upon such early pre-Quill Supreme Court cases.

The two state court decisions cited by the Director (Db49n), In re Heftel Broadcasting Honolulu, Inc., 554 P.2d 242 (Haw. 1976), cert. denied, 429 U.S. 1073, 97 S. Ct. 811, 50 L. Ed. 21 791 (1977) and American Dairy Queen Corp. v. Taxation & Revenue Department of New Mexico, 605 P.2d 251 (N.M. Ct. App. 1979), were also pre-Quill, and thus any post-Quill vitality is highly suspect. Moreover, these cases provide no support since they involve taxes imposed on gross income, which operate like sales taxes, and Quill should be regarded as having overruled them. See Haw. Rev. Stat. § 237-13(9) ("there is . . . levied . . . a tax equal to four per cent of the gross income thereof"); N.M. Stat. Ann. § 7-9-4(A) ("an excise tax equal to five percent of gross receipts is imposed"). Indeed, both taxes provide credits for sales taxes paid to other states. N.M. Stat. Ann. § 7-9-79(A); Haw. Rev. Stat. § 238-3(i). Additionally, in In re Heftel Broadcasting Honolulu, Inc.,

554 P.2d 242 (Haw. 1976), cert. denied, 429 U.S. 1073, 97 S. Ct. 811, 50 L. Ed. 2d 791 (1977), the licensor had substantial tangible property in Hawaii and was thus physically present in the state.

In American Dairy Queen Corp. v. Taxation & Revenue Department of New Mexico, 605 P.2d 251 (N.M. Ct. App. 1979), the court did not address the Commerce Clause argument, referring only to its decisions in two other pre-Quill gross receipts tax cases, for support.

The Tax Court correctly analyzed the pre-Quill cases - both Supreme Court and state court - and found them wholly lacking in support for tax nexus without physical presence.

b. Post-Quill State Cases Do Not Support Income Taxation Without Physical Presence

The Tax Court fully dissected and properly refused to follow the South Carolina Supreme Court's decision in Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13 (S.C.), cert. denied, 510 U.S. 992, 114 S. Ct. 550, 126 L. Ed. 2d 451 (1993), which had concluded that income tax nexus does not require physical presence.[11] The Tax Court

[11] The Geoffrey decision suggests that the court might have been concerned about the viability of Geoffrey. 437 S.E.2d at 15, n.1. The business purpose and economic substance of Lanco, however, has not been contested by the Director. Moreover, the economic substance, validity of business purpose and the arm's length nature of the royalty rates charged by Lanco, have expressly been recognized after a hearing before an independent administrative tax tribunal. See In re Express, Inc., DTA Nos. 812330-812332 & 812334, 1995 N.Y. Tax LEXIS 493 (N.Y.S. Div. of Tax Appeals, Sept. 14, 1995)

recognized, as most state tax commentators have, that "[t]he authorities cited by the South Carolina Court do not support its conclusion that Commerce Clause nexus may be found absent physical presence ascribable to a taxpayer." 21 N.J. Tax at 212.

The Director relies upon Geoffrey as "the leading post-Quill case" (Db49). However, as the treatise the Director cites acknowledges, Geoffrey has "legal underpinnings . . . [that] may be questioned." State Taxation (3d ed. 1999) ¶ 6.11[2], at 6-34.[12]

The Director also cites this treatise as support for his argument that economic exploitation without physical presence should be enough to subject a corporation to a state's income tax jurisdiction (Db51). The Director's reference actually appears to be from the second edition of that treatise and is accompanied by a footnote warning the reader that this view had been "rejected in the Quill case" (emphasis in original).

Also pointed out by this same treatise was that in both Couchot v. State Lottery Commission, 659 N.E.2d 1225 (Ohio), cert. denied, 519 U.S. 810, 117 S. Ct. 55, 136 L. Ed. 2d 18 (1996), and Borden Chemicals & Plastics, L.P. v.

[12] Professor Pomp summed up his critique of the Geoffrey decision as "extremely shoddy" 1T102-1T04.

Zehnder, 726 N.E.2d 73 (Ill. App. Ct.), app. denied, 731 N.E.2d 762 (Ill. 2000), cases relied upon by the Director in support of his position that Quill does not apply to income taxes (Db52), the courts' statements regarding Quill were *dicta* since in both cases physical presence was found to exist. State Taxation (3d ed. 1999) at ¶ 6.11[2], at 6-34 n.140; 2001 Cum. Supp. No. 1, ¶ 6.11[3], at S6-12 n.161.13.

The Texas Court of Appeals, which addressed directly the issue of whether Bellas Hess and Quill apply to income taxes, said it well:

> This question seems to have little to do with whether the tax in question is a sales tax, an income tax, a franchise tax, a gross receipts tax, or some other form of tax. The issue is whether the state may impose any kind of tax in light of the Commerce Clause.

Rylander v. Bandag Licensing Corp., 18 S.W.3d 296, 299 n.8 (Tex. App. 2000). The court in Bandag recognized that "[w]hile the decisions in Quill Corp. and Bellas Hess involved sales and use taxes, we see no principled distinction when the basic issue remains whether the state can tax the corporation at all under the Commerce Clause. As construed in Quill Corp. and Bellas Hess, when the corporation conducts its activity solely through interstate commerce and lacks any physical presence in the state, no

sufficient nexus exists to permit the state to assess tax." Id. at 300.

The court's position in Bandag is consistent with that of many other states that have considered the issue. Decisions in Michigan, South Carolina, and Tennessee have rejected the notion that Quill's physical presence requirement applies only in the sales and use tax area. See, e.g., Guardian Indus. Corp. v. Department of Treasury, 499 N.W.2d 349 (Mich. Ct. App. 1993), app. denied sub nom. Cargill, Inc. v. Department of Treasury, 512 N.W.2d 846 (Mich. 1994); City of Charleston v. Government Employees Ins. Co., No. 93-CP-10-2567 (S.C. Ct. C.P. Sept. 15, 1997), rev'd on other grounds 512 S.E.2d 504 (S.C. 1999); J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999), cert. denied, 531 U.S. 927, 121 S. Ct. 305, 148 L. Ed. 2d 245 (2000).

For example, in J.C. Penney, the Tennessee Court of Appeals, which viewed whether Quill's physical presence applied to the franchise tax case before it the "only real issue," concluded:

> 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. . . . Any constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in Bellas Hess and Quill are not within the purview of this court to discern. As such, we feel that the outcome of this case is governed by Bellas Hess and Quill, as those decisions interpret the first prong [substantial nexus] of the Complete Auto test.

19 S.W.3d at 839.

The Tax Court analyzed both the pre- and post-Quill case law and the decisions upon which they relied in concluding that the argument that physical presence is not required for imposition of tax under the Commerce Clause "is not persuasive." 21 N.J. Tax at 208.

There is only one Commerce Clause and only one nexus standard under that clause. Quill applies equally to income tax and sales tax jurisdiction. The Tax Court got it right.

c. Lanco Had No Physical Presence in the State

The Tax Court correctly understood that Lanco had no physical presence in New Jersey (Da19, ¶¶ 16-19). In spite of its stipulation to the contrary, the Director suggests that the physical manifestation of Lanco's Marks in New Jersey "even if owned by Lanco's sister corporation" (Db47), supports its assertion that Lanco has nexus to New

Jersey. It does not. Nothing is being put to tangible use by Lanco in the State.

Further, if intangible property were physically present anywhere, it would no longer be intangible but would become tangible property. The representation of the intangible property -- the trademarks -- on physical assets does not convert the trademarks into tangible property, any more than a stock certificate converts a share of stock into tangible personal property. In any event, a physical representation of Lanco's trademarks by Lane Bryant on Lane Bryant's property does not convert ownership of Lane Bryant's physical assets on which the trademarks are depicted into Lanco's property.

Even if, arguenedo, there were some *de minimus* physical presence, such presence would be insufficient to create substantial nexus. Quill Corporation licensed to its North Dakota customers a software program and provided customers floppy diskettes which allowed its customers to have direct communication with it. Quill retained title to the diskettes and the software program that its customers used in North Dakota. See Brief for Respondent in Quill. North Dakota argued that, unlike the taxpayer in Bellas Hess, "Quill owned property physically present in the taxing jurisdiction." Id. The Court concluded that

Quill's licensing of software did not meet the substantial nexus requirement of the Commerce Clause. Quill, supra, 504 U.S. at 315 n.8, 112 S. Ct. at 1914 n.8, 119 L. Ed. 2d 91. The Court took pains to point out that in National Geographic Society v. California Board of Equalization, 430 U.S. 551, 556, 97 S. Ct. 1386, 1390, 51 L. Ed. 2d 631 (1977), it had expressly rejected a "slightest presence" standard of constitutional presence. Likewise, Tennessee's Court of Appeals has rejected the argument that the existence of thousands of J.C. Penney National Bank's credit cards constituted a sufficient physical presence to support a finding of substantial nexus, stating that such presence was not "constitutionally significant." J.C. Penney Nat'l Bank, supra, 19 S.W.3d at 840.

Intangible property is just that - intangible. The use of Lanco's intangible property by others in New Jersey does not transmute such property into tangible property.[13]

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[13] The Director cites to Kmart Properties, Inc. v. Taxation & Revenue Department of New Mexico, No. 21,140, 2001 STT 233-18 [State Tax Today](N.M. Ct. App. Nov. 28, 2001), cert. granted, 40 P.3d 1008 (N.M. 2002) and its finding of a "functional equivalent of physical presence" (Db54n). Under Rule 12-405C of New Mexico's Rules of Appellate Procedure, that decision cannot be cited as authority. More importantly, the New Mexico Court of Appeals' attempt to eviscerate the substantial benefit of the "bright-line" physical presence test and morphing it into a "virtual" physical test, is contrary to express language and intent of Quill. That decision is on appeal to the New Mexico Supreme Court.

2. Sound Tax Policy Supports the Physical Presence Standard

The Tax Court concluded that "[e]conomic and tax policy considerations are unquestionably valid material for the Supreme Court to consider in its task of constitutional adjudication." 21 N.J. Tax at 217. Since the Tax Court concluded that "the precedents continue to require physical presence for nexus" (ibid.), it found no need to address those considerations. While established precedent may not have required that tax or economic policies be addressed, courts routinely consider the tax policy implications of alternative positions. See, e.g., Quill Corp. v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992); New Jersey Transit Corp. v. Borough of Somerville, 139 N.J. 582, 589 (1995); GE Solid State, Inc. v. Director, Div. of Taxation, 132 N.J. 298, 309 (1993).

The Director suggests, without support, that it is his opinion as to tax policy that he is "entitled to prevail" where "reasonable minds can differ" (Db58n). The Director's tax policy is to generate revenue. However, here the national implications of a state's assertion of economic nexus theories is involved, requiring objective consideration.

The U.S. Supreme Court was faced with the policy implications of retreating from the objective, verifiable physical presence requirement in both Quill and Bellas Hess. In its Reply Brief to the Court, Quill urged the Court to reject North Dakota's "economic benefit" test and asked "Will advertising in a national magazine create tax jurisdiction in every state in which the magazine is circulated?" Petitioner's Reply Brief in Quill, at n. 20. Likewise, in Bellas Hess's Reply Brief to the Court, the far-ranging implications of an amorphous economic benefit were suggested:

> Upon this theory Massachusetts could tax Florida hotels because the prosperity it bestows upon Massachusetts residents enables them to visit those resorts. Minnesota could tax Michigan factories because her farmers are a market for Michigan tractors and cars. Idaho could reach out and tax the seller of gasoline in Utah where the property was to be brought into Idaho following the purchase. It was to prevent just such mutual aggressions and economic retaliation that the States entered into the federal union.

Reply Brief in Quill (citing Reply Brief for Appellant at 8-9, Bellas Hess, 386 U.S. 753 (O.T. 1966, No. 241)).

That standard would result in virtually limitless jurisdiction to tax anyone and everyone that receives income that is in any measure related to the State. For

example, authors, sports celebrities and teams, and actors who have never stepped foot into New Jersey, would be subject to tax because they are paid royalties based upon the fact that a book that they have written was sold in the State, that property bearing their trademarked likeness or logo is sold in the State, or a movie in which they have acted is being shown in New Jersey theaters. Likewise, under the Director's economic benefit theory, any holder of dividend-paying stock of a company that is physically present in the State would be subject to tax.

In connection with H.R. 3220, The Business Activity Tax Simplification Act of 2003, federal legislation attempting to end states' attempts to subject entities to tax based upon "economic nexus," an individual submitted a letter to the House Subcommittee urging its passage based upon his experience with New Jersey. This individual, the owner of a home-based South Carolina software development company, entered into seven licenses for the use of intangible property in the State, resulting in gross income (not net income) for a five-year period totaling about $6,000. The Director asserted nexus over the company resulting in the imposition of minimum taxes and fees (totaling $600 per year), even though no income tax would be due based upon the company's income and the asserted tax

exceeded the company's gross revenue for three of the five years. Rather than continue such a losing proposition, the company stopped accepting orders from New Jersey locations, and terminated all software licenses with New Jersey customers. The owners summed up their response to states' claims of revenue loss if the BATSA bill requiring physical presence were passed: "We do all work from our home; shouldn't we pay all our taxes to South Carolina? Shouldn't this apply equally to large businesses with no physical presence in a State? If a State's revenue drops due to passage of this bill, it is because the State is already engaging in unfair tactics; *and its revenue should and must drop.*" Letter to Honorable Chris Cannon & Honorable Melvin Watt, House Subcommittee on Commercial and Administrative Law, dated May 13, 2004, from Bo & Kathy Horne, available at http://commdocs.house.gov/committees/judiciary/hju93657.000/hju93567_0.HTM (emphasis in original).

The Tax Court's decision was grounded in United States Supreme Court precedent. The physical presence requirement provides a sound, bright-line standard for tax nexus.

B. New Jersey's Purported Provision of "Benefits" Without Physical Presence Does Not Establish "Substantial Nexus"

As it did below (and in its amicus brief filed in Quill in its bid to overturn Bellas Hess), the Director lays out a litany of purported benefits that Lanco allegedly receives -- the exploitation of commercial markets (Db44), the protection of New Jersey's judiciary (Db45), the availability of New Jersey's highways (Db46), the existence of New Jersey's educated workplace (ibid.), and police and fire protection (Db47), to support its position that Lanco has nexus in New Jersey. These same tenuous, theoretical, indirect benefits were presented to the Quill Court and were found by the Court not to give rise to substantial nexus. Moreover, these benefits were received by Lane Bryant, which pays tax to New Jersey, not Lanco.

In Quill, the United States Supreme Court reversed the North Dakota Supreme Court, which had emphasized that the State created '"an economic climate that fosters demand for"' Quill's products. Quill, supra, 504 U.S. at 304, 112 S. Ct. at 1909, L. Ed. 2d 91 (citation omitted). New Jersey asked the Court (as other *amici* and North Dakota did) to overrule its decision in National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 87 S.

Ct. 1389, 18 L. Ed. 2d 505 (1967), proffering the exact "benefits" argument the Director advances here:

> These direct marketers . . . derive substantial benefits from the organized markets that the State makes available to them. . . . [The] direct mail solicitations . . . impose[] enormous governmental costs, both directly in terms of waste disposal programs and derivatively in terms of environmental burdens. . . . [and should be] made to collect and remit their fair share of the taxes necessary to support the benefits that they derive from, and the costs that they impose on, the State.

Brief Amicus Curiae for the State of New Jersey Supporting Respondent in Quill.

One of the other purported benefits that New Jersey affords Lanco is its court system, which theoretically might be available to enforce trademark rights (Db45). The Director's own witness, Professor Kearl, acknowledged that any trademark-related case that Lanco might bring would be brought in federal court (2T39). Most importantly, potential resort to the court system is an insufficient basis to impose a tax (IT47-IT48, IT64-IT65). As Dr. Wildasin pointed out, if the provision of a court system were a sufficient basis to submit businesses and individuals to taxation, then all businesses would be taxable everywhere since all of them would potentially have

need to resort to the State's courts to enforce legal rights (Db48) The Director's expert, Professor Kearl, agreed, testifying that the existence of New Jersey's judicial system would be a sufficient basis to tax virtually anyone, including the Italian manufacturer whose products are sold in New Jersey and the remote seller who sells its goods on the Internet to customers in New Jersey (2T82-2T83).

The provision of a state court system was also one of the benefits that North Dakota asserted that Quill received. See Brief for Respondent in Quill ("North Dakota provides and maintains a judicial system for the enforcement of a direct marketer's property and contract rights, as well as for the collection of its debts. . . . [T]he state judicial system must remain open and available to Quill should it seek judicial recourse."). New Jersey also stressed the availability of state courts as one of "a host of services and protections." See Brief Amicus Curiae for the State of New Jersey Supporting Respondent in Quill ("if the commercial transaction gives rise to disputes, litigation and collection activities inevitably depend on the state courts for adjudication, sheriffs for execution, and commercial and other laws for substantive standards").

North Dakota also asserted that other services benefited Quill and were sufficient to invoke a use tax collection responsibility against Quill:

> [I]t is enough that a state "runs mass transit and maintains public roads which benefit [the taxpayer's] customers, and supplies a number of other civic services," makes possible "'the benefit of a trained workforce,'" or offers the taxpayer "other advantages of civilized society."

Brief for Respondent in Quill (citations omitted).

New Jersey, in its *amicus curiae* brief, again followed suit, stating that the existence of "roads provided by state government" and the fact that "consumers' homes and offices, where goods will be used, are protected by government fire, police and other services" are sufficient to warrant a finding of nexus. The Supreme Court decision in Quill rejected the states' allegations that these amorphous benefits are a sufficient basis to assert taxing jurisdiction under the Commerce Clause.

Without a scintilla of evidence in the record, the Director states that "Lanco requires the expenditure of resources by New Jersey far in excess than would be required for an out-of-State mail-order company that sends its catalogs to New Jersey residents" (Db39). In fact, in its *amicus curiae* brief in Quill, New Jersey stressed the

"problem of waste that state governments do and must address, through garbage collection, recycling, and disposal in land fills" that mail-order companies like Quill engender due to their catalogs. Brief Amicus Curiae for the State of New Jersey Supporting Respondent in Quill.

In its *amicus curiae* brief in Quill, the State of New Jersey complained of "enormous governmental costs" imposed by direct mail solicitations, and its argument was rejected by the Supreme Court. Id. (emphasis added). Lanco does not solicit customers in the State and the record does not support the conclusion that Lanco requires the expenditure of any resources by New Jersey. The Director has introduced no evidence whatsoever of expenditure of resources, and Dr. Wildasin testified that no additional expenditures by the State are generated by Lanco (1T42-1T44, 1T59-1T64).

The Tax Court understood that any purported provision of benefits to Lanco by New Jersey is no substitute for physical presence.

C. The Tax Court Correctly Concluded That Whether or Not Lanco Pays Tax on its Royalties to Another Jurisdiction is Irrelevant to the Determination of Whether Lanco Has Substantial Nexus to New Jersey

The Tax Court understood that the determination of whether a corporation has established nexus in a particular

jurisdiction is not affected by whether the corporation has nexus in or pays taxes to another jurisdiction. The Director, however, argues that whether or not Lanco pays taxes on its royalty income to some jurisdiction is significant in determining whether Lanco has nexus to New Jersey (Db8, Db44). The Director is wrong.

Lanco would pay taxes on its royalty income to Delaware, its commercial domicile, if Delaware's Legislature had not decided to exempt from taxation income earned by entities that manage and protect intangible property. Del. Code Ann. tit. 30 § 1902(b)(8). Delaware's decision to grant such exemption does not give another jurisdiction carte blanche to run roughshod over the Constitution.

Many states offer favorable tax climates to encourage business development. For example, New York offers very favorable treatment of income from subsidiary capital, which is explicitly excluded from the tax base. N.Y. Tax Law § 208.9(a)(1). New York's exclusion of such income does not give New Jersey the right to tax it. Likewise, New Jersey's favorable treatment of investment companies does not give other states the right to tax investment companies without nexus in those states. N.J.S.A. 54:10A-5(d). As Professor Pomp aptly concluded, "a state's power

to assert taxing jurisdiction does not expand based on whether the corporation is taxable in another state" (IT129).

The Tax Court recognized the time-honored principle that "[l]egitimate means to minimize taxation are, of course, the prerogative of any business and perhaps the dictate of market-place competition." 21 N.J. Tax at 219. Lanco's incorporation in Delaware was legitimate, as was any benefit that might accrue to it from the Delaware Legislature's actions and New Jersey's jurisdiction does not expand as a result of Delaware's tax policy.

II.

LANCO WAS NOT "DOING BUSINESS" IN NEW JERSEY

During the year at issue, New Jersey imposed its corporation business tax ("CBT") on every foreign corporation for "the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State." N.J.S.A. 54:10A-2. Lanco did not exercise its corporate franchise in New Jersey. Lanco was not doing business in New Jersey. Lanco had no office in the State. Lanco had no employees in the State. Lanco had no real or personal property in the state. Lanco granted to another corporation, Lane Bryant,

a license to use its intangible property worldwide. Lane Bryant determined whether, where and to what extent it would use the licensed intangible property.

By deciding the constitutional issue - whether imposition of the CBT upon Lanco violates the Commerce Clause - the Tax Court concluded that Lanco could not be taxed under the statute. However, since Lanco was not doing business under the CBT, a statutory basis also exists for declaring the subjectivity notice invalid.

"Doing," by its plain meaning requires activity, that is, the "performance of an act." American Heritage Dictionary of the English Language (4th ed. 2000). Lanco did nothing in New Jersey. It merely received revenue from a corporation that did business throughout the United States, including New Jersey.

The Director cites several cases for his "threshold" proposition that "plaintiff's challenge must be viewed in light of the presumptive validity of the Director's decision" (Db12). Each of the cases cited to support the Director's proposition refers to assessments of tax. However, as the Tax Court recognized, "this case concerns not an assessment, but a determination of responsibility to file." 21 N.J. Tax at 214. The Director's determination, moreover, is predicated upon a regulation, N.J.A.C. 18:7-

1.9(b) which, in the Tax Court's words, "reflect[s] a change in applicable law." 21 N.J. Tax at 218.

It is hornbook law that administrative agency regulations cannot extend a statute to give it greater effect than its language permits. GE Solid State, Inc. v. Director, Div. of Taxation, 132 N.J. 298, 306-07 (1993); Smith v. Director, Div. of Taxation, 108 N.J. 19 (1987); Fedders Fin. Corp. v. Director, Div. of Taxation, 96 N.J. 376, 392 (1984); Kingsley v. Hawthorne Fabrics, Inc., 41 N.J. 521, 528-29 (1964). Construing the phrase "doing business, employing or owning capital or property, or maintaining an office, in th[e] State" to include corporations that do none of the foregoing is an improper extension of the language of the statute beyond its plain meaning.

Further, it is also hornbook law that imposition statutes are to be construed against the government and in favor of the taxpayer. See, e.g., United States v. Isham, 84 U.S. 496, 21 L. Ed. 728 (1873); American Net & Twine Co. v. Worthington, 141 U.S. 468, 12 S. Ct. 55, 35 L. Ed. 821 (1891); Gould v. Gould, 245 U.S. 151, 38 S. Ct. 53 62 L. Ed. 211 (1917). New Jersey courts also abide by this precept. See, e.g., Fedders Fin., supra, 96 N.J. at 384-85; Hawthorne Fabrics, supra, 41 N.J. at 528; Sutkowski v.

Director, Div. of Taxation, 312 N.J. Super. 465, 475-76 (App. Div. 1998); IBM v. State, 141 N.J. Super. 79, 84 (App. Div. 1976); American Can Co. v. Director of Div. of Taxation, 87 N.J. Super. 1, 13 (App. Div. 1965).

The Director's expansive change to its regulation -- which purports to include within the definition of "doing business" corporations that have no activities within the state, own or lease no real or tangible property within the state and have no employees within the State -- is invalid because it is contrary to these basic precepts. If there are any doubts as to whether the regulation exceeded the scope of the statute or whether Lanco is doing business in the State, those doubts should be resolved in favor of Lanco.

The Missouri Supreme Court, in a closely analogous factual situation, i.e., the license of trademarks and tradenames to a related corporation that did business in that State, concluded that since there must be "some activity by the taxpayer in Missouri that justifies imposing the tax," the licensors were "outside the scope of Missouri taxation." ACME Royalty Co. v. Director of Revenue, 96 S.W.3d 72, 75 (Mo. 2002) (emphasis in original). The court recognized that the licensee made the sales that generated the Missouri source income, not the

licensors and the court concluded (as did the Tax Court here) that the licensors and licensee corporations were separate entities which should be treated as such. Ibid.

A. The 2002 Legislation Supports the Conclusion that Lanco Was Not Subject to CBT Prior to Its Enactment

In 2002, N.J.S.A. 54:10A-2, the CBT's subjectivity provision, was expanded for "privilege periods and taxable years beginning on or after January 1, 2002, to include within its grasp corporations "deriving receipts from sources within this State, or for the privilege of engaging in contacts within this State." L. 2002, c. 40 §§ 1, 33 (the "Business Tax Reform Act" or "BTRA"). Broad language was also added to the subjectivity provision to provide that a corporation's business activity will be subject to the CBT "if the taxpayer's business activity in this State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States." N.J.S.A. 54:10A-2. As the Director's Regulatory Services Branch acknowledged in its summary of the regulations promulgated in the wake of the 2002 legislation:

> N.J.A.C. 18:7-1.6 amends the subjectivity provision of the regulations to take account of the new statutory nexus standards of deriving receipts from New Jersey and engaging

> in contacts with New Jersey. The Corporation Income tax, N.J.S.A. 54:10E-1 et seq., was repealed by the BTRA. Its nexus standard of deriving income form New Jersey sources was effectively incorporated by the BTRA into the Corporation Business Tax Act ("CBT"). The new standard under the new law is explicitly limited by the terms of the United States Constitution.

Proposed Special Adoption and Concurrent Proposal, Summary at 4, Division of Taxation, Regulatory Services Branch. Likewise, the New Jersey Corporation Business Tax Study Commission, a bipartisan, nine-member committee created pursuant to the BTRA, agreed that "[t]he BTRA amendment to N.J.S.A. 54:10A-2 expands the nexus provisions of the CBT." Final Report, New Jersey Corporation Business Tax Study Commission (June 29, 2004), at 14.[14]

As this Court has found: "'[o]rdinarily a change in legislative language signifies a purposeful alteration of the substance of the law.' In fact, it has been said that such action is evidence that the previous statute meant the 'exact contrary.' This rests upon the theory 'that the legislature is not presumed to do a useless act.'" State v. Foglia, 182 N.J. Super. 12, 16 (App. Div. 1981), app.

[14] The Tax Court appears to suggest that the pre-2002 BTRA statute also subjected corporations to the CBT "to the full extent that is constitutionally permissible." 21 N.J. Tax at 214. However, as discussed above, if the pre-2002 subjectivity provision was that broad there would have been no need for the 2002 Legislation to expand the breadth of the CBT.

dismissed, 91 N.J. 523 (1982) (citations omitted.). See also Nagy v. Ford Motor Co., 6 N.J. 341, 348 (1951) (a change in statutory language "'ordinarily implies a purposeful alteration in substance of the law'" (citations omitted)).

As New Jersey's Supreme Court has recognized, '"[i]n seeking to discover the legislative intent, the statute must be read in the light of the old law, the mischief sought to be eliminated and the proposed remedy.'" Nobrega v. Edison Glen Assocs., 167 N.J. 520, 534 (2001) (citation omitted). This analysis supports but one conclusion - the Legislature intended to expand the subjectivity provision to address the precise issue here. It necessarily follows, therefore, that prior to the enactment of the BTRA, Lanco was not taxable under the terms of the CBT.

CONCLUSION

The Tax Court's decision, which determined that "physical presence is a necessary element of Commerce Clause nexus for taxation," 21 N.J. Tax at 220, and which invalidated the Director's determination that Lanco is subject to the CBT should be affirmed, with costs.

Dated: New York, New York
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Respectfully submitted,

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A-3285-03T1

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3285-03T1

Civil Action

LANCO, INC.

Plaintiff-Respondent,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Appellant.

ON APPEAL FROM A FINAL JUDGMENT
OF THE TAX COURT OF NEW JERSEY

DOCKET NO. 005329-1997

Sat Below:
Hon. Peter D. Pizzuto

BRIEF AND SECOND SUPPLEMENTAL APPENDIX OF PLAINTIFF-RESPONDENT LANCO, INC. IN REPLY TO BRIEF OF AMICUS CURIAE MULTISTATE TAX COMMISSION

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PRELIMINARY STATEMENT

This brief is submitted in reply to the brief submitted by the Multistate Tax Commission ("MTC") as amicus curiae ("MTC's Brief"), as permitted by this Court's order entered January 18, 2005.

The MTC is an organization that represents state tax authorities. The MTC has been criticized for taking positions that are "contrary to" statutory provisions and which attempt to give "the tax administrator carte blanche to reverse the statute." Jerome R. Hellerstein & Walter Hellerstein, State Taxation, ¶¶ 9.09[1][1], 9.18[2][b] (3rd ed. 2001).

The MTC weighed in before the United States Supreme Court in Quill Corp. v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), in supporting North Dakota's position that physical presence is an unnecessary prerequisite to impose a tax collection responsibility upon Quill. In the MTC's words, Quill's position was "absurd" given that Quill's "most important presence in North Dakota is its economic presence." Brief Amicus Curiae of the Multistate Tax Commission in Support of Respondent, Quill Corp. v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) (No. 91-194) (hereinafter, "MTC's Amicus Brief in Quill") (For the Court's convenience a copy

of the MTC's Amicus Brief in Quill is included in the Second Supplemental Appendix attached hereto.) The MTC's position was rejected by the Court.

It is evident from the MTC's Amicus Brief in Quill, that the MTC was advocating there - the same position it advocates here -- that corporations should not "exploit" a market "without bearing any of the [tax] burdens." The Court concluded that the amorphous benefit of exploiting a market was insufficient to impose tax collection responsibilities on Quill under the Commerce Clause.

ARGUMENT

THERE IS ONE COMMERCE CLAUSE AND IT APPLIES EQUALLY TO FRANCHISE AND INCOME TAXES AND SALES AND USE TAXES

The MTC overstates the purported support for its position that physical presence is not required to support the imposition of franchise or income taxes in several critical ways. First, it obfuscates the distinctions between Commerce Clause and Due Process nexus first set out in Quill, attempting to reinvigorate the pre-Quill cases, which obviously would not have addressed the newly-explained distinctions between the Commerce and Due Process clauses as applied to tax jurisdiction. The MTC also suggests that the motivations for the Quill decision limit its holding. As discussed below, all of the MTC's

arguments were considered and correctly rejected by the Tax Court and should likewise be rejected here.

A. Quill Set Out Distinctions Between Commerce Clause and Due Process Nexus, Which the MTC Seeks to Obfuscate By Relying upon Pre-Quill Cases to Support its Position

Prior to the decision in Quill, it was not clear that the standards for tax nexus were different under the Commerce Clause than they were under the Due Process Clause. Quill, however, made it absolutely clear that there were "different constitutional concerns and policies," 504 U.S. at 312, 112 S.Ct. at 1913, 119 L. Ed. 2d 91, underlying the two clauses, which justified a higher threshold - physical presence - under the Commerce Clause.

It therefore comes as no surprise that the MTC engages in a backward-looking analysis to support its position that economic nexus or, in the MTC's words, "[s]ource-based taxing" (MTC's Brief at 3), is an acceptable standard under the Commerce Clause. However, the Supreme Court made it clear that older cases relying solely on a Due Process analysis can no longer be relied upon.

The MTC cites to Shaffer v. Carter, 252 U.S. 37, 64 L. Ed. 445 (1920), to support its position that "[o]nly sourced-based taxation has the promise of imposing tax where income is earned." (MTC's Brief at 3.) However, in

Shaffer, the individual whom Oklahoma sought to tax owned and leased tangible property in the state. Also cited was New York ex rel. Whitney v. Graves, 299 U.S. 366, 57 S. Ct. 237, 81 L. Ed. 285 (1937), which was decided under the Due Process Clause. In Whitney, where taxation of the gain from the "intangible" - the New York Stock Exchange seat - was at issue, the Court recognized that the Exchange was an association, physically located in New York, and that each of its members - including the individual whose sale was at issue - "holds the beneficial ownership in the entire capital stock of the New York corporation which owns the building in which the business of the Exchange is transacted, with the land upon which it stands, situated in the city of New York." 299 U.S. at 370, 57 S. Ct. at 237-38, 81 L. Ed. at 285. Further, the Court recognized that whether the taxpayer or his agent transacted the business on the Exchange, someone had to be physically present at the Exchange in New York. 299 U.S. at 373, 57 S. Ct. at 239, 81 L. Ed. at 288. Thus, even pre-Quill cases understood the importance of more than mere economic nexus to support taxation.

Wisconsin v. J.C. Penney Co., 311 U.S. 435, 61 S. Ct. 246, 85 L. Ed. 267 (1940), International Harvester Co. v. Wisconsin Department of Taxation, 322 U.S. 435, 64 S. Ct.

1060, 88 L. Ed. 1373 (1944), and Wheeling Steel Corp. v. Fox, 298 U.S. 193, 56 S. Ct. 773, 80 L. Ed. 1143 (1936), were also cited by the MTC. Each of these cases was decided under the Due Process Clause and, after Quill, provides no basis to determine whether a tax could be imposed under the Commerce Clause. Given that Quill did not change the nexus standards under the Due Process Clause, it is not surprising that the MTC embraces the Due Process nexus standard while ignoring the Commerce Clause nexus standard (MTC Brief at 8-10).

The MTC also suggests that if all that a corporation is asked to do by a state from which it purportedly derives revenue is to pay its fair share - the MTC indicates that the three-factor formula would do the trick - the corporation should have nothing to complain about (MTC's Brief at 3-4). This argument confirms two entirely separate doctrines: the question of how much to tax does not arise unless a state has the power to tax -- a power lacking where physical presence is lacking.

In addition, the fairness of apportionment percentages is far from guaranteed. States routinely try to shift the burden of taxation from their citizens (particularly those who vote) to non-citizens and corporations (who do not vote).

B. It is the Court's Holding in Quill and Not Dicta that is Precedential

The MTC minimizes Quill's holding that physical presence is required for the substantial nexus prong of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977) and instead emphasizes the Court's dicta and "reasoning" (MTC's Brief at 14) in urging that this Court abandon Quill's precedent. It is irrelevant whether the Court "reluctantly" (MTC's Brief at 4) retained the physical presence requirement or enthusiastically retained the physical presence requirement. All that is relevant is that the Court retained the National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967) physical presence requirement after vociferous challenge by and consideration of the arguments raised by numerous amici -- including the MTC -- urging that the Court reject a physical presence standard.

Further, even if, arguendo, one were to give weight to the Court's dicta and "reasoning," the result would still be the same. As the MTC itself recognizes, the Court eschewed "artificial distinctions between 'direct' and 'indirect' taxation" (MTC's Brief at 11). Surely, having "completely abandoned formalistic distinctions of 'direct'

and 'indirect' taxes" in Complete Auto (MTC's Brief at 12), the Court is unlikely to resurrect distinctions based upon whether the tax is directly imposed against the taxpayer or requires that it act as a collection agent.

The MTC states that the Court's decision in Quill was predicated on two bases: (1) "undue burden" and (2) stare decisis (MTC's Brief at 15-24). While, as stated above, the motivation for the Court's decision is of little consequence given its holding, it is noteworthy that, in Quill itself, the MTC argued that Quill's burden argument was "frivolous." (Spa86). Further, the stare decisis concern of Quill is no less pressing - and indeed is more pressing -- in the instant case, after the passage of nearly another 13 years. After the Supreme Court announced in Quill that the bright-line physical presence test of Bellas Hess was alive and well and having confirmed that "it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected that." 504 U.S. at 319, 112 S. Ct. at 1916, 119 L. Ed. 2d 91 (emphasis added). The Supreme Court has thus solidified a settled expectation that states' income and franchise taxes will not be imposed unless the entity in question has

established a physical presence in the jurisdiction seeking to impose tax.

Additionally, the burden of paying an income or franchise tax is substantively greater than collecting and remitting a tax on behalf of others, even though the tax return compliance task may not be as complex. The MTC's statement that "[t]he burden at issue was not the burden of paying tax" (MTC's Brief at 19) misses a critical aspect of the proper constitutional analysis, the fourth prong of Complete Auto.

In addition to "substantial nexus," one of the four prongs of Complete Auto requires that any taxes imposed must be fairly related to the services provided by the state. New Jersey does not provide services to Lanco. Intangible property in a state does not travel the roads, and does not require police and fire protection. See American River Transp. Co. v. Bower, 813 N.E. 2d 1090 (Ill. App. Ct.), appeal denied, No. 98978 (Ill. Nov. 24, 2004).

In Quill, North Dakota and numerous amici argued to the Supreme Court that Quill's 3,000 in-state customers, from whom more than $1 million of revenue was generated, were sufficient to establish nexus under the Commerce Clause. During the oral argument before the Supreme Court in Quill, North Dakota's Attorney General was asked "[w]hy

does North Dakota deserve to collect the tax? That's the real -- sort of the question, I would think. What do you want for nothing?" Quill Corp. v. North Dakota, No. 91-194, 1992 U.S. TRANS LEXIS 189, at * 28 (U.S. Jan. 22, 1992). After the Attorney General mentioned some of the benefits he believed were provided, particularly "the customer base," Justice Rehnquist responded that "[t]hat's the argument that was rejected in Bellas Hess after being quite eloquently portrayed by the dissent." Id. Likewise, *Quill* rejected the North Dakota Supreme Court's conclusion that a constitutionally significant nexus was generated by North Dakota's creation of "'an economic climate that fosters demand.'" Quill, 504 U.S. at 304, 112 S. Ct. at 1909, 119 L. Ed. 2d 91 (citation omitted).

Lanco has not received anything from New Jersey which entitles the State to ask something from it in return. Further, the MTC is wrong in suggesting that Lanco has failed to "meet its burden to establish the existence of any undue burden on interstate commerce that would flow from its obligation to pay the New Jersey income tax" (MTC's Brief at 24n.10), citing Norton Co. v. Department of Revenue of Illinois, 340 U.S. 534, 71 S. Ct. 377, 95 L. Ed. 517 (1951), a case which stands for the proposition that taxpayers have the burden of establishing that they are

entitled to an exemption from taxation. Lanco is not seeking an exemption from taxation. This case is a subjectivity case.

The MTC's suggestion that "any taxpayer who consulted the scholarly commentary on the Quill decision would find little assurance that the same physical presence requirement applied to use taxes of mail-order sellers would be extended to income tax" (MTC's Brief at 17), is just another example of the MTC overstating its position. For every article the MTC is able to dredge up, there are an equal number of articles which come to the opposite conclusion. Even the treatise the MTC cites to in support of its proposition states:

> This is not to suggest that such a reading [that the physical presence requirement relates only to sale and use tax cases in the mail-order industry] is the only plausible reading of Quill that may be given. Indeed, as an original matter, one would be hard put to justify a constitutional rule that applied only to one industry. It is, after all, not an administrative code but 'a constitution we are expounding.'"

Jerome R. Hellerstein & Walter Hellerstein, State Taxation, ¶ 6.02[2] (3d ed. 1998) (emphasis in original; citation omitted.)

Another of the articles cited by the MTC, Richard D. Pomp & Michael J. McIntyre, State Taxation of Mail Order Sales of Computers after Quill: An Evaluation of MTC Bulletin 95-1, 11 State Tax Notes 177 (July 15, 1996), was co-authored by Professor Richard Pomp, an expert in this case. Professor Pomp concluded - as did the Tax Court - that "[t]he Constitution does not distinguish between sales and use taxes and income taxes: there is only one nexus standard and the U.S. Supreme Court has endorsed physical presence." Pa38.

That conclusion is sound and the MTC's position - rejected by the U.S. Supreme Court in Quill -- warrants rejection here as well.

CONCLUSION

The Tax Court's decision, which determined that "physical presence is a necessary element of Commerce Clause nexus for taxation," 21 N.J. Tax at 220, and which invalidated the Director's determination that Lanco is subject to the CBT should be affirmed.

Dated: New York, New York
February 17, 2005

Respectfully submitted,

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Second Supplemental Appendix

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QUILL CORPORATION, Petitioner, v. STATE OF NORTH DAKOTA, BYAND THROUGH ITS TAX COMMISSIONER, HEIDI HEITKAMP, Respondent.

No. 91-194

1991 U.S. Briefs 194

October Term, 1991

December 26, 1991

On Writ Of Certiorari To The Supreme Court Of The State OfNorth Dakota

BRIEF AMICUS CURIAE OF THE MULTISTATE TAX COMMISSION INSUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether a state may require an out-of-state retailer, whose direct sales into the state are facilitated and benefitted by the state, to collect its use tax?

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INTEREST OF THE AMICUS CURIAE n1

The Multistate Tax Commission ("MTC") is the administrative arm of the Multistate Tax Compact (the "Compact"). ALL ST. TAX GUIDE P701 et seq (Max. Mac. 1991); ST. TAX GUIDE P351 (CCH 1991). Nineteen States, including the District of Columbia, have adopted the Compact. In addition, fourteen states are associate members. The Compact seeks to facilitate proper determinations of state and local tax liability of multistate taxpayers, promote uniformity or compatibility of state tax systems, facilitate taxpayer convenience and compliance, and avoid duplicative state taxation. Article I, Compact, ALL ST. TAX GUIDE P701 (Max. Mac. 1991), ST. TAX GUIDE P351 (CCH 1991). The Court recognized the validity of the Compact in United States Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978).

n1 Counsel for Petitioner and Respondent have consented to the filing of this Amicus Curiae Brief. Their letters of consent have been filed with the Clerk of the Court.

As described in further detail in Part III.C of this Brief, the Commission, through its "uniformity" process, its National Nexus Program, and ongoing discussions of coordination and uniformity issues with direct marketers and their trade association, has been directly involved in the issue of collection of sales and use taxes by interstate direct marketers. The Commission expects these activities to continue and expand as additional state legislatures adopt laws like the North

Dakota law at issue here, in response to the growth of the direct marketing industry and its increasing share of retail sales in each state. By eliminating artificial distinctions among competing, functionally equivalent marketers, affirmance of the decision below will help to accelerate the process of coordination and cooperation among the states, and between states and taxpayers, which the Commission seeks to foster.

INTRODUCTION AND SUMMARY OF ARGUMENT: "THAT WAS THEN AND THIS IS NOW"

To a lay observer, the thought that a small out-of-state retailer with one travelling salesman visiting North Dakota would have to collect North Dakota taxes on all its North Dakota sales, but that Quill Corporation -- with a thousand employees, n2 over three thousand customers in North Dakota, and 24 tons of catalogues and a million dollars worth of products sent into the state in a year n3 -- would not have to collect any North Dakota tax from its customers, might seem absurd.

n2 QUILL SEMI-ANNUAL OFFICE PRODUCTS CATALOGUE, Nov. 1991-April 1992, at 363 (hereinafter "QUILL CATALOGUE"). Copies of all catalogues cited have been lodged with the Clerk, and selected excerpts are contained in the Appendices. See Bellas Hess, 386 U.S. at 761, n. 2 (Fortas, J., dissenting).

n3 North Dakota v. Quill Corp., 470 N.W.2d 203, 204, 218 (N.D. 1991); Appendix to the Petition for Writ of Certiorari at A2, A34 (hereinafter "Pet. App.").

To some direct-mail marketers, that anomaly is worth attempting to cast in constitutional concrete. It gives them a distinct competitive advantage over fellow direct mailers with multistate physical presence, and over all local marketers, who must collect state tax on their over-the-counter sales. In support of their position, they invoke a single case, National Bellas Hess, Inc., v. Illinois, 386 U.S. 753 (1967), repeating its words at every opportunity, in hopes that repetition will lend substance to their proposition that in-state physical presence is a constitutionally necessary condition for tax jurisdiction, even though it is not necessary for most other types of jurisdiction. See, e.g., Burger King v. Rudzewicz, 471 U.S. 462 (1989).

The legal response to their claim is not complicated:

1. Bellas Hess is the product of a different legal era when "the Commerce Clause was thought to prohibit the States from imposing any direct taxes on interstate commerce. [Citations omitted]. Consequently, the distinction between intrastate activities and interstate commerce was crucial to protecting the States' taxing power." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 614-15 (1981). See Goldberg v. Sweet, 488 U.S. 252, 265 n.16 (1989).

2. In Complete Auto Transit v. Brady, 430 U.S. 274 (1977), the Court "renounced the formalistic approach" of its earlier cases, and decided instead "to avoid formalism and rely upon a 'consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax.'" Trinova Corp. v. Michigan Dept. of Treasury, 111 S. Ct. 818, 828 (1991) (quoting Mobil Oil Corp. v. Vermont, 445 U.S. 425, 436-7 (1980)) (brackets in original). Since 1977 there has been no constitutional bar to state taxation of interstate commerce as long as it meets the four-prong test of Complete Auto.

3. Subsequent cases have driven home the obsolescence of Bellas Hess. Goldberg v. Sweet distinguished Bellas Hess and applied the Complete Auto test to sales of interstate communications services into a state, finding the test satisfied where the sales were billed or paid in the state. Goldberg, 488 U.S. at 263. The Goldberg holding applies a fortiori to the facts here: sales of tangible goods into a state. In Trinova, the Court emphasized the "value added" by sales into a state, and found jurisdiction to tax such value not because of, but in spite of, a minuscule physical presence of the seller in the state. Trinova, 111 S. Ct. at 830, 833-834.

4. Here, as in Goldberg, 488 U.S. at 254, the change in legal environment is complemented and fueled by a change in the technological environment, symbolized by the change in basic concept from "mail order" to "direct marketing," and facilitated by the universal availability of toll-free "800" numbers, inexpensive computers, overnight express service, computerized selective mailing lists, and bank credit cards.

These legal points are treated in scholarly detail in the briefs of North Dakota and its other amici, who collectively demonstrate that the Complete Auto tests are met here with flying colors. The Multistate Tax Commission will not duplicate their arguments. Instead, the Commission, a hands-on body of state tax administrators which deals with the practical realities of state tax policies and procedures, will focus its attention on the plea for equitable relief to which Petitioner and its allies, perhaps anticipating the strength of the legal arguments against them, appear to retreat.

In essence, Quill argues that it should not be subject to North Dakota's tax laws because it doesn't get much benefit from North Dakota. The fact is that Quill has so many contacts with the state, and every other state it sells into, that the Court could avoid confronting the obsolescence of Bellas Hess, by finding enough of what Petitioner calls "chimerical" presence, n4 to meet the facial standards of that case. Even apart from the catalogues and packaging and waste from its products strewn all over its customers' states, Quill has direct presence in each state, as shown in Section I below. It maintains in-state agents to set up equipment and service computers. It leaves its computer software in the hands of its customers, and it checks their credit through local banks. The fact that even Quill can be found to meet this supposed "bright line" test of physical presence, notwithstanding its efforts to remain isolated by eschewing "800" numbers n5 and, until recently, by refusing credit card sales from North Dakota, demonstrates why the test is meaningless, and why the Court should not rely on it to affirm the decision below. A decision on this narrow basis would merely postpone the inevitable and deprive the states and the direct marketing industry of definitive guidance based on the practical realities of direct marketing in the United States in the 1990's, and the predictable expansion of the industry in the years ahead. Quill's most important presence in North Dakota is its economic presence, not its computer disks or its repair people, and the case should be decided on that basis. n6

n4 Brief for Petitioner at 46 n. 43, Quill Corp. v. North Dakota, cert. granted, 60 U.S.L.W. 3257 (U.S. October 7, 1991) (No. 91-194) (hereinafter "Pet. Br.").

n5 Pet. Br. at 4.

n6 The principle that sellers from afar who want to exploit the local market must bear their share of local taxes is not a new one. It was recognized in ancient Jewish law: "In the Talmudic discussion, the ruling was quite clearly that foreign and out-of-town merchants cannot be excluded, provided that they pay the local taxes." M. Tamari, IN THE MARKETPLACE: JEWISH BUSINESS ETHICS 55 (1991). Tamari notes that "Non-payment of taxes gives the competitor an advantage which cannot be duplicated by the local merchants, no matter how efficient or cost-conscious they are." Id. at 61.

Quill's fallback equity argument is that compliance with North Dakota's use tax law would be too much of a burden. This argument requires the Court to believe that the direct marketers, who are at the frontier of computerized demographic research and data manipulation, using the most advanced database and telecommunications equipment and software to identify, contact, and sell to tens of millions of carefully selected Americans, are unable to keep track of 47 states' sales tax rates.

It should reassure Quill and the Court to know that the task of collecting multiple state taxes, which so frightens the Quills of the world, is one to which large numbers of its fellow direct marketers have accommodated. Moreover, the states, through the Multistate Tax Commission and individually, are just as anxious as the direct marketers to simplify and coordinate their tax collection activities. While these implementation issues are not of constitutional magnitude, Quill and the Court may also be comforted to know that this cooperative process has already begun between the states and marketers who now collect state taxes in multiple states.

Quill's ultimate defense is to assert that the principle it reads into Bellas Hess is subject to revision only by Congress. We show below that Congress, by both action and inaction, has signaled the opposite conclusion: this Court has the authority and responsibility to review and, if appropriate, revise its own decisions, especially where its prior statements are the source of serious conflicts.

Quill wants to have all the benefits of exploiting the North Dakota market without bearing any of the burdens. Exempting Quill from the well accepted business responsibility of assisting in sales and use tax collection would be unfair to the state and its taxpayers and unfair to Quill's competitors who do assist the state. Such an exemption is

neither required nor justified by the Constitution, by this Court's precedents, or by federal law. North Dakota's legislature and Supreme Court acted reasonably and lawfully in rejecting such an exemption and their actions should not be disturbed.

ARGUMENT

I. THE PRACTICAL EFFECT OF A PHYSICAL PRESENCE RULE WOULD BE TO ENSHRINE INEQUITABLE DISTINCTIONS AND ENCOURAGE AVOIDANCE OF TAX COLLECTION RESPONSIBILITIES

The general economic benefit from the "value added" by Quill's North Dakota sales, Trinova Corp., 111 S. Ct. at 830, and from its exploitation of the state's "civilized society", Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940), is more than sufficient to meet a constitutional nexus test. But the list of Quill's direct contacts with, burdens on, and benefits from North Dakota dramatizes why no reasoned distinction can be made between Quill and either the local merchants or competing direct marketers who happen to have sales agents or other physical presence in the state. Quill's "presence" includes:

-- the wear and tear on North Dakota's roads and the additional truck traffic and air pollution attributable to the delivery of 24 tons of catalogues and a million dollars worth of (frequently heavy) office supplies,

-- the police and fire protection for the goods in transit into and within the state,

-- the disposal of the huge volume of catalogues and many thousands of packages and wrappings containing the delivered goods, n7

-- the availability of North Dakota courts and collection agencies to collect overdue bills,

-- protection of Quill from unfair competition of unscrupulous marketers of office products by the consumer protection, law enforcement, and licensing agencies of North Dakota,

-- submission by Quill to North Dakota's jurisdiction in respect to any applicable laws on usury, fair credit practices, prohibited sales, fraud, antitrust, warranties, limitations of liability, environmental protection, and food quality, n8

-- the use of the state's banks to obtain credit references on customers, n9

-- the use of VISA and Mastercard accounts at local banks to establish immediate credit, n10

-- the provision of "'inside delivery' or 'carry-in with setup'" services at extra cost, n11

-- for purchasers of computers, continuing technical support by telephone and "free on-site service" for one year after purchase, n12

-- the leasing of computer software to North Dakotans, allowing them to access Quill's computer, n13

-- the use of demographic information and databases gathered in-state to generate solicitation lists. n14

n7 Pet. App. at A34.

n8 For examples of such limitations in other states, see J.C. PENNEY CATALOGUE, Fall and Winter 1991, at 750 (enumerating Ohio restrictions on credit, Wisconsin notice regarding credit obligations incurred by spouses, Hawaii notice of state credit sale law). See also VA. CODE ANN. § 46.2-1079 (1991) (prohibiting use or sale of radar detectors). See also Burger King v. Rudzewicz, 471 U.S. 462, 476 (1985) ("it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines thus obviating the need for physical presence within a State in which business is conducted").

n9 Quill's current order form asks new customers desiring to be billed to provide "Bank Name, Bank Phone #, Bus.[iness] Checking Account #, Person to Contact". QUILL CATALOGUE at 361.

n10 QUILL CATALOGUE at 361. Although it appears from the record that Quill for a time discriminated against North Dakota customers by denying them the use of credit cards, its current catalogue contains no such restriction.

n11 Id. at 365.

n12 Id. at 204.

n13 Pet. App. at A29.

n14 Direct marketers access lists segmented into a dizzying array of lifestyle, life-event, demographic, geographic, and previous purchasing characteristics. Direct Marketing magazine each month carries an annotated listing of newly available lists, numbering anywhere from 25-30 entries and encompassing market segments ranging from "Texas Liberals" ("file contains 33,398 . . . Texas residents who have contributed to the campaign of Gov. Ann Richards and other democratic candidates"), New List Bank, 54 DIRECT MARKETING 1, May 1991 at 63, to the "Portable Technology Database" ("last 12 months buyers' list contains 26,397 names at $100 [per thousand names]. These top corporate officers are large volume buyers of portable computers.") New List Bank 53 DIRECT MARKETING 12, April 1991 at 56. The effort to add names of potential consumers can start on the day of their birth. See Miller, Data Mills Delve Deep to Find Information About U.S. Consumers, Wall St. J., March 14, 1991, at A-1. Raw name lists can then be enhanced and sorted by zip code, income level, residence rates and social position. See Advertisement, 54 DIRECT MARKETING 6, October 1991 p. 15. For those, like Quill, selling mainly to businesses, lists are available by discrete business type (e.g. dishwashing machine dealers), size of business (e.g. sales volume, number of employees) or new business entries updated through telephone directories, and can be sorted on a nationwide or individual state basis. See AMERICAN BUSINESS INFORMATION: LISTS OF 9 MILLION BUSINESSES (January 1991).

The fact is that most of this list would apply to every direct marketer who substantially enters the North Dakota market, whether or not it has a store, an agent, a warehouse, or an office in the state. These are not factors which show that Quill is unique in having the requisite presence. Rather they show generically why "direct marketers" are exactly what their self-selected name implies, marketers who enter the local markets massively and directly to do from a distance, with economies of scale and modern telecommunications, precisely what local marketers do in person: make sales to local citizens. A rule which ignores this purposeful and pervasive economic presence and focuses exclusively on physical presence no matter how slight or how separate from the target of the tax, or which depends on a case by case weighing of discrete contacts, will merely perpetuate a tax dichotomy based on no functional difference.

Quill obviously cares about its customers, offering them its own "Bill of Rights." n15 But its customers have no right to avoid payment of their state's sales or use taxes, when they order office furniture shipped from manufacturers in Michigan, Florida, California, New Jersey, Delaware, or Tennessee, n16 whether they order it from Quill by phone, fax, or mail, or from another direct marketer who sends a salesman to drop catalogues and take orders, or from a local office supply store. n17 Quill's exemption from the use tax laws would not only place Quill at an unfair competitive advantage over its in-state and out-of-state rivals who collect the state's tax, it would force these competitors and their customers to generate the tax revenues to pay for the state's direct and indirect contribution to Quill's profit-making activity in the state.

n15 QUILL CATALOGUE at 363.

n16 QUILL CATALOGUE at 291, 308-309.

n17 See Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 366 (1941) (". . . respondent is in no position to found a constitutional right on the practical opportunities for tax avoidance which its method of doing business affords Iowa residents").

Quill and its amici argue that a physical presence rule is desirable, if not required, because it offers a purportedly "bright-line" test. Even putting aside the fact that litigation all over the country demonstrates that the present line is murky at best, n18 what the "physical presence" test does is invite "formalistic" gaming of the system to avoid state tax responsibilities. For example, Saks & Company, the parent of the Saks Fifth Avenue retail stores throughout the nation, conducts its mail order activities through a corporate subsidiary with physical presence only in New York and California. Its "Saks Fifth Avenue Folio" mail-order catalogues are intimately connected with its store operations. n19 Nevertheless it continues to resist collecting use tax anywhere outside those two states. If the Court does not update Bellas Hess, Saks Fifth Avenue may continue to find itself on different sides of the line in different states. n20 On the other hand, if this Court affirms the North Dakota decision, Saks Fifth Avenue Folio will collect any appropriate taxes from all its customers, just as its stores do. The fact that Saks Fifth Avenue might not continue to attract some customers who wish to escape state tax is not an argument for maintaining the status quo. See, e.g. Nelson v. Sears Roebuck & Co., 312 U.S. 359, 366 (1941). It is, rather, evidence of the unfair advantage some sellers currently enjoy, and an argument for changing the status quo. Surely any interpretation of the commerce or due process clauses which encourages or assists tax avoidance, fosters unfair competition between sellers of the same goods to the same customers, and erects barriers to expansion of sellers' physical facilities into other states should not be endorsed by this Court.

n18 Compare Boswell v. Paramount Television Sales, Inc., 282 So. 2d 892, 893, 896-897 (Ala. 1973) (lease of films sufficient nexus to out-of-state lessor) with Cally Curtis Co. v. Groppo, 572 A.2d 302, 303, 306 (Conn.), cert. denied, 111 S. Ct 77 (1990). Compare L.L. Bean, Inc. v. Department of Revenue, 516 A.2d 820, 823, 825-826 (Pa. Commw. Ct. 1986) (state visits by customer service representatives sufficient) with Proficient Food Co. v. New Mexico Taxation and Revenue Department, 758 P.2d 806, 807, 808-809 (N.M. Ct. App. 1988). Compare Good's Furniture House, Inc. v. Iowa State Board of Tax Review, 382 N.W. 2d 145, 146-147, 150 (Iowa) cert. denied, 479 U.S. 817 (1986) (noting local advertising as a significant link) with Book-of-the-Month Club, Inc. v. Porterfield, 268 N.E. 2d 272, 274 (Ohio 1971) (local advertising insufficient to establish nexus).

n19 Each item lists the store department where it can be purchased, except for certain items which are listed as not available at stores or at all stores. Saks Fifth Avenue Folio accepts Saks Fifth Avenue credit cards, uses Saks' New York City office for certain mail, and, as is clear solely from the catalog cover, exploits the Saks name and good will. See SAKS FIFTH AVENUE, FOLIO: RESORT 1991 at 4, 50, Order Form following p. 46.

n20 Compare SFA Folio Collection, Inc. v. Bannon, 585 A.2d 666 (Conn. 1991), cert. denied, 111 S. Ct. 2839 (1991), with SFA Folio Collection, Inc. v. Huddleston, No. 89-3015-III (Tenn. Ch. App. March 11, 1991).

II. COLLECTING STATE USE TAXES IS NOT AN IMPERMISSIBLE BURDEN ON COMMERCE; IT IS A NORMAL BUSINESS FUNCTION WHICH QUILL NOW PERFORMS FOR THREE STATES, AND MANY OTHER CATALOGUE SELLERS PERFORM FOR MANY MORE STATES.

Petitioner and its numerous amici complain that the "burden" they would have to bear if they are subject to North Dakota's use tax law would cause "economic chaos," Pet. Br. at 9, and drive mail order companies out of business. Brief of Amicus Curiae Direct Marketing Association at 16, Quill Corp. v. North Dakota, cert. granted, 60 U.S.L.W. 3257 (U.S. October 7, 1991) (No. 91-194) (hereinafter "DMA Br."). Their claim echoes this Court's concern 24 years ago that collection of taxes for multiple states would draw mail order companies into a bookkeeping morass. Bellas Hess, 386 U.S. at 759-760. But neither the commerce clause nor due process guarantees immunize businesses from all "burdens" in the states whose economies they are exploiting. On the contrary, this Court has said that "'[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.'" n21

n21 Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-624 (1981) (quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975) quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

Even if "burden" were a triggering mechanism which invokes the commerce or due process clauses, n22 or a factor in a "weighing" process with "contacts", Pet. Br. at 7, in today's business environment this case does not raise a serious

"burden" issue. For the fact is that the additional procedures which the decision below requires of Quill and others who are resisting their state tax collection responsibilities are ones which many of their competitors and fellow multistate marketers have long accepted.

n22 This appears to be the argument of at least one of Petitioner's amici. See, e.g. Brief Amici Curiae of American Council for the Blind et al. at 22, Quill Corp. v. North Dakota, cert. granted, 60 U.S.L.W. 3257 (U.S. October 7, 1991) (No. 91-194).

The Court's pre-Bellas Hess decisions in Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941) and Nelson v. Montgomery Ward, 312 U.S. 373 (1941), established fifty years ago the requirement of tax collection from catalogue customers by those with local retail outlets. In 1944, Justice Frankfurter, who was quite concerned about the administrative burdens on taxpayers, n23 upheld Iowa's requirement that out-of-state sellers without local offices, warehouses, or general agents collect its use tax, and said, "to make the distributor the tax collector for the State is a familiar and sanctioned device." General Trading Co. v. Iowa, 322 U.S. 335, 338 (1944). n24 The decision fifteen years ago in National Geographic v. California Board of Equalization, 430 U.S. 551 (1977), confirmed that local presence of any type is a sufficient condition for tax collection responsibility. Thus, many direct marketers are fulfilling these tax collection responsibilities in multiple states today, without "economic chaos" and without being driven out of business. In fact, Quill itself is collecting use taxes for the three states in which it has facilities. QUILL CATALOGUE at 361.

n23 See Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 474 (1959) (Frankfurter, J., dissenting).

n24 Justice Frankfurter thought that the existence of retail stores in-state in Sears and Montgomery Ward was "constitutionally irrelevant", General Trading, 322 U.S. at 338, and placed no particular emphasis on the fact that General Trading used travelling salesmen to solicit orders filled from out-of-state. In this pre-Complete Auto case, the dissent said that the holding was "that a state has the power to make a tax collector of one whom it has no power to tax." Id. at 339 (Jackson, J. dissenting).

MTC's review of over 150 recent catalogues (selected randomly but unscientifically), discloses at least 33 which require buyers in 15 or more states to remit use tax, including 9 which call for remittance of tax for all 47 states (including D.C.) with use taxes. See Appendix A. Another 30 of these catalogues collect taxes for 3 or more states, as does Quill. Among those who collect for only one or two states are such large, well-known marketers as Saks Fifth Avenue Folio, and L. L. Bean. Id. Justice Frankfurter's "familiar and sanctioned device" is thus already part of the normal business environment for many interstate marketers, and there is no showing that those who have so far avoided it are any less capable of fulfilling this obligation than those who are meeting it now.

Some of Petitioner's amici complain that they would be forced to use costly catalogue space to inform customers of their tax obligations. n25 Quill's own order form, typical of the middle ground used by many multistate marketers, rebuts that argument. It merely has a small space in its computation form for "State Sales Tax", and in an effort to be helpful to its customers, lists the tax rate in each of the three states where Quill has facilities. Quill Catalogue, at 361. Some direct sellers assume that their customers know the tax rates in their own states, and merely instruct them to "add applicable state sales tax". See e.g., LORD & TAYLOR: SIGNATURE SAVINGS, Order Form following p. 34 (1991). Others list the states in which tax is due, e.g. GREENPEACE CATALOG, Order Form following p. 8 (1991-1992) (listing 34 states), see App. B, or the states which do not have sales taxes. E.g., EDDIE BAUER: ALL WEEK LONG, Order Form following p. 24 (1991). Some give additional information to assist the customer in calculating the tax. See, e.g., BARRIE PACE, LTD.: WINTER SALE 1991, Order Form following p. 24 (1991) (clothing exemptions); HARRY AND DAVID: 1991 HOLIDAY BOOK OF GIFTS, ORDER FORM FOLLOWING P. 18 (1991) (FOOD EXEMPTION); BUSINESSLAND, POWERFUL PRODUCTS POWERFUL SOLUTIONS, Order Form following p. 130 (1991) (instructing exempt companies to include their tax exempt certificate with their order). Sears does not list any tax rates, but instructs customers to call its "800" number to obtain calculation of shipping and handling charges and taxes. SEARS at 950B (Spring/Summer 1991). At the other extreme, J.C. Penney provides a comprehensive set of instructions: on its chart of shipping information and return centers for each state, it also lists the state sales tax rate, and

other state-specific information relevant to Penney merchandise (e.g. "omit tax on footwear and clothing"). J.C. PENNEY, FALL & WINTER 1991 at 742, see App. C. The entire tax listing adds one column to the six other columns on the chart. n26

n25 See, e.g. DMA Br. at pp. 18-20; Brief of Amicus Curiae Coalition for Small Direct Marketers at 19, Quill Corp. v. North Dakota, cert. granted 60 U.S.L.W. 3257 (U.S. October 7, 1991), (No. 91-194).

n26 Although not at issue in this case, Petitioner repeatedly invokes its apprehension at the prospect of complying with myriad local sales tax laws. As with state tax collections, different direct marketers have chosen different ways to deal with this issue. J.C. Penney, for example, notes to its customers the states in which there are such taxes and leaves it to the customer to apply them. See App. C. As noted below, if a marketer wished, it could use modern computer printing technology to print local tax instructions on each catalogue cover or order blank. In any event, this concern will be addressed in the first instance by the marketers themselves, by state and local tax authorities, and if disputes arise, by the state courts. Only if some issue of constitutional moment arises will it reach this Court. Certainly it should not be decided here in the first instance, as a hypothetical matter and without a record.

Of course, like Sears, most sellers have phone agents who will compute the state tax and shipping charges, or check the customer's computation, when the order is taken or while the customer is filling out an order form. Businessland, for example, offers to "confirm" the computation for the customer. See BUSINESSLAND, supra, Order Form following p. 130. Just as Quill informs its customers that "shipping charges, if applicable, will be added to your total" by Quill (QUILL CATALOGUE at 361), Penney tells its customers that overpayment of sales taxes will be refunded, that late changes in taxes will be reflected in a corrected invoice, and that on credit orders, "we'll figure the tax and add it to your account." J.C. PENNEY, supra at 741.

Each of these marketers has made its own market-driven decision on how much space, detail, and help to provide for this purpose. But the fact is that a marketer who collects tax in all or most states can, if it wishes, meet the need with no more order blank space than Quill now provides. Moreover, the phone agents, who answer questions about hundreds or thousands of catalogue items and prices and shipping rules, have no difficulty answering questions about a state's tax rates. Whether they look at Penney's chart or type a zip code into their computers, the information can be readily available.

Similarly, the claim that accounting for many states' taxes would be beyond the bookkeeping capacity of a direct marketer like Quill is frivolous. The large direct marketers keep track of hundreds of thousands of customers, orders, and items in stock on large computers. They use the most sophisticated technologies to identify the most desirable demographic targets for their wares, and to decide how many and which catalogues to send them. n27 They buy, sell, sort, and refine huge mailing lists, and compare them to individualized data bases with detailed information on each prospective customer. n28 Many already personalize the order forms in their catalogues with ink-jet printed names and addresses of the recipient, n29 and could undoubtedly add state-specific information on sales taxes if they wished. n30

n27 See Egol, Personalized Production, CATALOG AGE, October 1991 at 78. See also discussion n. 14, supra.

n28 Id.

n29 As the "P" column in App. A indicates, the vast majority of the catalogues reviewed by MTC contained personalized order forms.

n30 It is now fairly common for mass magazines to contain computer generated inserts containing the name of the subscriber and localized information such as the location of the nearest store of a national chain. See, e.g., TIME, Nov. 18, 1991, insert following p. 55, containing personalized message with name of subscriber and location of nearest Radio Shack. "At present, Fingerhut uses its merchandising/publishing system to version [sic] its outer wraps based on the customer's geography," to accommodate each state's "credit rules that have to be expressed differently." Egol, supra note 27.

In fact, Quill prides itself on its sophisticated computer capacity. Its "integrated order fulfillment system," based on a 700 terminal "Unisys 110/1200 mainframe," provides its operators with "instant on-line access to customer files and product information, . . . [and] credit checking. . . . It determines which . . . warehouse will handle the shipment and generates detailed picking instructions for each order, complete with carton size and weight." It offers same-day shipment for orders received by 4 p.m., and as soon as the personal computer at the warehouse detects from the bar code on each package that an order has been shipped, it signals the mainframe to generate an invoice the same day. n31 Clearly, for Quill, going from 3 states to 47 will not be a significant problem. n32

n31 Smith, The New Frontier, DIRECT MARKETING, September 1991 at 37.

n32 It is interesting to note that part of Quill's product line includes tax forms. QUILL CATALOGUE at 362.

Even for the smaller direct marketer, computers capable of calculating and keeping track of tax receipts and payments are readily available and inexpensive. At the time of Bellas Hess, it was probably still true, as Senator Keating said in discussing Pub. L. No. 86-272, n33 that "[s]mall firms simply cannot afford the electronic gadgets now used by giant corporations for such purposes." 105 CONG. REC. 16,362 (Aug. 19, 1959). Now a fast, large capacity personal computer which did not even exist in 1967 can be purchased by mail from Damark for $899.99, monitor and basic software included. n34 Several well reviewed business accounting programs can be purchased for under $100, and more sophisticated programs for under $300. n35 Even if a marketer sets up its own sales tax record-keeping system on a simple spreadsheet program for its own state, the cost of adding additional states after the first one is literally nil for hardware and software. It takes only a few minutes' time per state to copy the initial spreadsheet and substitute each additional state's tax rate.

n33 See discussion Part III, Section B. infra.

n34 Damark Advertisement, USA Today, Dec. 6, 1991 at 5b ("In MN add 6.5% sales tax").

n35 See, e.g., Peachtree Accounting Advertisement, PC MAGAZINE Dec. 31, 1991 at 254 (offering accounting package with multiple taxation feature for $298); Software Add-Ons Advertisement, PC MAGAZINE Dec. 31, 1991 at 431 (listing several accounting programs retailing for as little as $29). One such program, Pacioli 2000, provides capability for creating up to 1000 different sales tax codes. PACIOLI 2000 USER'S MANUAL at 127 (1990).

Whether for large direct sellers with large computers and large numbers of sales in each state, or smaller sellers with small computers and small numbers of sales in most states, this is hardly an issue of constitutional significance. As more marketers collect for more states the task can only get easier, for the software providers (after designing programs to meet the needs of their own direct mail sales) will compete to offer these programs at low cost to all comers. Almost every direct marketer must have some system for collecting and remitting sales and use taxes for at least one state now. It is hardly a burden at all, let alone a burden of constitutional proportions, to require that, as they and their markets grow, their responsibility for collecting state use taxes grow as well.

III. CONGRESS, RATHER THAN PREEMPTING COURT OR STATE ACTION BY ITS INACTION, HAS LEFT THE FIELD TO THE STATES AND THIS COURT.

Petitioner argues that the states are precluded from enacting legislation like North Dakota's, and that the Court is precluded from allowing them to do so, because of what Petitioner seems to think is Congress' exclusive responsibility to define the scope of state tax powers. Petitioner quotes approvingly a commentator's statement that "making state tax law . . . is best left to Congress". Pet. Br. at 45 n. 40. Fortunately for the nation's federal system, that view is not reflected in the Constitution, the acts of Congress or the opinions of this Court. Making state tax law is best left to the states. The Tenth Amendment says so. U.S. Const. amend. X. And this Court has repeatedly said so. See, e.g., Trinova, 111 S. Ct. at 836; Moorman v. Bair, 437 U.S. 267, 279-80 (1978); Wisconsin v. J.C. Penney, 311 U.S. 435, 445 (1940).

Bellas Hess was not a provision of the Constitution or a Congressional enactment. It was the Court's best interpretation of the Constitution's requirements given the surrounding constitutional and factual framework at the time. Whether or not the present members of this Court would have assessed the then prevailing facts and constitutional environment the same way as their predecessors did twenty-four years ago, the Court must decide the present case in the light of today's constitutional and factual context. Particularly in the field of state taxation, the Court has never ceded to Congress the Court's constitutional responsibility to clarify and modernize prior case law. On the contrary, in such cases as Complete Auto and Goldberg, it has moved the law forward with the economic realities of business and technology.

A. This Court Has Made Clear That Congress Will Not Be Deemed To Pre-empt The States In The Absence Of Clear Legislative Pre-emption Or Complete Occupation Of The Field.

Petitioner cites no congressional enactment through which Congress in the exercise of its power over interstate commerce has directed the states or the Court to refrain from action in this field. Instead it cites Congress' failure to produce legislation on the subject of this case over the past six years. Pet. Br. at 35 n. 26.

But the silence of Congress, at least in the absence of a comprehensive legislative framework inherently occupying the entire field, is not a barrier to state action or to this Court's action. In Puerto Rico Department of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 504 (1988), this Court said "preemption, if it is intended, must be explicitly stated." There cannot be "a preemptive grin without a statutory cat." Id. The Court demands "clarity and manifestness", id. at 500, before it will find that Congress intended to supersede the powers of the states. Thus, in the absence of some affirmative action by Congress, the states are free to do whatever the Court finds is not barred by some constitutional constraint.

B. Congress' Conscious Exclusion Of Sales Taxes From Its 1959 Legislation On Out-Of-State Solicitation, Its Silence After Statutorily Mandated Studies In 1964-65, And Its Inaction Since 1985 On The Bellas Hess Issue Show That Action Here Must Come From The States And The Court

In general, Congress and the courts have historically recognized the importance to federalism of non-interference by the federal government with state taxing authority. See California v. Grace Brethren Church, 457 U.S. 393, 410-11 nn. 23, 24 (1982). As a matter of common law, comity, and long-held statutory policy, federal courts have refrained from interjecting themselves into the state tax enforcement process. See e.g. Franchise Tax Board v. Alcan Aluminum Limited, 110 S. Ct. 661 (1990); California v. Grace Brethren Church, 457 U.S. 393 (1982); Rosewell v. LaSalle National Bank, 450 U.S. 503 (1981). See also Tax Injunction Act, 28 U.S.C. § 1341. Of course, once state remedies have been exhausted, this Court has met its responsibilities to apply the constraints of the Constitution, but always with due respect for the proper role of the states in designing their own tax systems. Trinova, 118 S. Ct. at 836; J.C. Penney, 311 U.S. at 444.

Three times in the postwar years, Congress has examined the scope of state taxing power over interstate businesses. But rather than signifying a legislative decision to occupy the field or to pre-empt either state or Court authority, Congress' action each time shows that Congress itself has left the issue in this case to the states, subject only to the limits this Court may impose.

The Court has previously considered Congress' 1959 action on the state income tax implications of sales solicitations by out of state businesses. See Heublein Inc. v. South Carolina Tax Comm'n, 409 U.S. 275 (1972); United States Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978). See also Wisconsin Dept. of Revenue v. William Wrigley Jr. Company, 160 Wis. 2d 53 (Wis. Sup. Ct. 1991), cert. granted 60 U.S.L.W. 3257 (U.S. October 7, 1991) (No. 91-119). In that year, after this Court's decision in Northwestern States Portland Cement Company v. Minnesota, 358 U.S. 450 (1959), a precursor of Complete Auto Transit, 430 U.S. 274 (1977), many large interstate businesses, correctly anticipating that the Court was heading towards eliminating its proscription of state taxes on interstate transactions, went to Congress for anticipatory relief. The result was Pub. L. No. 86-272, 15 U.S.C. § 381 et seq., which prohibits imposition of state net income tax on corporations based solely on solicitation of orders in the state, where acceptance is outside the state. See Heublein, 409 U.S. at 280; United States Steel Corp., 434 U.S. at 455.

It is clear from the text and legislative history of the statute that Pub. L. No. 86-272 did not apply to sales taxes because the framers of the statute intended that the states continue to have full authority to levy sales taxes in accordance with the Court's broadening view of state tax powers over interstate commerce. n36

n36 See 105 CONG. REC. 16,362 (1959) (colloquy between Senators Bush and Bennett).

For the next sixteen years, Congress was aware of these issues but did nothing. As the Court later noted, Congress in 1959

also authorized a study for the purpose of recommending legislation establishing uniform standards to be observed by the States in taxing income of interstate businesses. Although the results of the study were published in 1964 and 1965, Congress has not enacted any legislation dealing with the subject. [Court's Footnote: "There have been several unsuccessful attempts." [citing bills in 1965, 1966, 1971, 1973, 1975, including post-Bellas Hess bills that covered sales tax issues]].

United States Steel Corp. v. Multistate Tax Commission, 434 U.S. at 455-6.

As Petitioner points out, Congress again took up the Bellas Hess issue beginning in 1985, and regularly thereafter. Pet. Br. at 35. But again there was no congressional action, despite the proliferation of so-called "anti-Bellas" state laws, n37 enforcement of those laws, increasing voluntary compliance with those laws, n38 and state court decisions construing them. n39 It should be pointed out that the same interests which now claim that the legislative branch is the only appropriate authority to act on Bellas Hess fought vigorously to prevent congressional action to close the Bellas Hess loophole during this period. In a massive lobbying campaign, they enlisted their catalogue customers to provide grassroots opposition to the pending legislation. n40 In fact, contradicting their present position that only Congress, and not the Court, can act to update Bellas Hess, their expert witness testified before the House Judiciary Committee in 1988 that Congress was precluded from acting because this Court had based Bellas Hess on the due process clause, over which Congress had no legislative authority, rather than solely on the commerce clause, over which Congress has "plenary power". n41

n37 Brief of National Conference of State Legislatures et al. on Petition for Writ of Certiorari at 7 n. 6, Quill Corporation v. State of North Dakota, cert. granted 60 U.S.L.W. 3257 (U.S. October 7, 1991) (No. 91-194).

n38 Morse and Zimmerman, Efforts to Collect Sales Tax on Interstate Mail-Order Sales, Recent State Legislation, 12-13 and n. 35 (1990) (prepared for presentation to the National Conference of State Legislatures).

n39 North Dakota v. Quill Corp., 470 N.W.2d 203 (N.D. 1991); Bloomingdales By Mail Ltd. v. Huddleston, No. 89-3017-II (Ch. App. March 21, 1991); appeal filed No. 01-SO1-9016-CH-0047 (Tenn. April 19, 1991); SFA Folio Collection Inc. v. Huddleston, No. 89-3015-III (Tenn. Ch. App. March 11, 1991).

n40 See Federal Report, GOVERNING, at 24 (August 1989): The Direct Marketing Association" . . . held a summit meeting to plot strategy, and 300 companies contributed to a $1.5 million war chest, according to Robert Levering, vice president for government affairs of the Direct Marketing Association. . . . In addition 30 to 40 companies printed letters opposing the plan at their own expense and have begun inserting them in merchandise shipments to millions of customers." Opposition to Sales Tax Idea Arrives in the Mail, Baltimore Sun, April 2, 1989, at 1A, 14A.

n41 Testimony of Lucas A. Powe, Jr., on behalf of Direct Marketing Association and Magazine Publishers Association on H.R. 1242 and H.R. 3521, Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearing on H.R. 1242, H.R. 1981 and H.R. 3521 Before the Subcommittee on Monopoly and Commercial Law of the Committee on the Judiciary, 100th Cong., 2d Sess. at 72-75 (1988): "The Court said, due process, and Congress cannot change due process decisions. Congress can change commerce clause decisions." Id. at 72.

This history leaves no doubt that Congress has not occupied the field of state taxation of interstate commerce, nor in any way preempted state or Court action in the field of state sales taxes. On the contrary, each of Congress' three ventures into this area have left the legal landscape either untouched, or with a specific congressional statement that it did not intend to affect sales taxes.

Of course, if the Court affirms the decision below, and Congress wishes to address issues left open by the Court, or anticipate and resolve potential implementation issues, Congress can do so within the scope of its power over interstate commerce, as it did in 1959. See, Pub. L. No. 86-272. The possibility that Congress might some day act to improve on or supersede the Court's action, however, is no reason for the Court not to act at all, when faced with a clear constitutional controversy, especially one generated by its own prior ruling.

C. The States, Individually And Through Multistate Action, Have A Mutual Interest With Taxpayers In Implementing The Economic Presence Test Reasonably And Efficiently.

In such post-Complete Auto cases as Trinova, Goldberg, and Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dept. of Treasury, 196 U.S. 66, 72 (1989), this Court has emphasized that it will not attempt to impose a particular tax formula on the states, even if that may result in minor inconsistencies and inconveniences to taxpayers. As long as the states are reasonable and non-discriminatory in their tax structures, the Court will allow them to choose their own tax rates, rules, and procedures.

Of course the states have a shared interest in making their tax systems as compatible and convenient as possible, and they have done so frequently in the past. Through such mechanisms as the Multistate Tax Compact, n42 which became effective in 1967, the Multistate Tax Commission, established by the signatories to the Compact, and the Uniform Division of Income for Tax Purposes Act, adopted as part of the Compact by its signatories, many states have demonstrated their interest in "promoting uniformity and compatibility in state tax systems" and "facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration." n43

n42 Considered and upheld by the Court in United States Steel Corp. v. Multistate Tax Commission, 434 U.S. 452 (1978).

n43 United States Steel Corp., 434 U.S. at 456 (paraphrasing Multistate Tax Compact).

The MTC has already focused on the need for uniformity and consistency in the sales and use tax area. Through its "uniformity" process, proposals for multistate action to coordinate state sales and use tax laws and enforcement are developed, circulated for taxpayer and other public comment, and recommended by the full Commission for adoption by the states. See MULTISTATE TAX COMMISSION REVIEW, Vol. 1991, No. 1 at 21-22 (March 1991). n44

n44 The states have undertaken similar cooperative efforts to simplify compliance with state law in other fields. For example, the North American Securities Administrators Association and the National Association of Securities Dealers have jointly developed a Central Registration Depository which receives and processes state registration applications and fees for brokers and their representatives for all states. See NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., AN INTRODUCTION TO THE NASD, 13 (1990).

In addition, twenty-six states have joined MTC's National Nexus Program, which began in December 1990. This multifaceted project provides assistance to states in securing taxpayer compliance and to taxpayers in complying with state tax laws. A key element is a central repository of information on the states' tax filing requirements. This information is available for distribution to any company that needs to determine the filing requirements in several states. Where taxpayers are concerned about potential past liability, the Program enables them to discuss their exposure and to fashion settlements anonymously, before they register. n45

n45 Davis, The National Nexus Program: An Innovative Approach to Multistate Tax Compliance, 1 STATE TAX NOTES, 450, 451 (Nov. 25, 1991).

It is well known to the parties and many amici in this case that for the past year MTC and other state organizations have also been involved in discussions with the Direct Marketing Association and individual direct marketers in an effort to coordinate and simplify the administration of sales and use taxes, regardless of the outcome of this case. This Court's affirmance of the decision below would undoubtedly give new impetus to this process, which allows the industry as a whole to bring its concerns and suggestions directly to the responsible tax officials of a large number of states.

At the same time, affirmance will give clear guidance to the individual states as they update and conform their own statutes to accommodate developments in this Court, and thus make unnecessary what will otherwise be the continuing state experimentation with new ways to address the Bellas Hess problem. Although this Court need only decide the specific case presented to it - involving collection of one state's use tax - its analysis of North Dakota law, including the de minimis standard adopted by regulation, will substantially inform the other states' process of implementing the decision.

The Court can and should decide this case on the constitutional merits with assurance that it will be in the interest of each state, and of the states as a group, to identify and address sub-constitutional inconveniences which the Petitioner speculates may result from affirmance of the decision below.

IV. CONCLUSION

For the reasons stated herein, the decision of the Supreme Court of North Dakota should be affirmed.

Respectfully submitted,

JAMES F. FLUG *, MARTIN LOBEL, LEE E. HELFRICH, LOIS M. McKENNA, LOBEL, NOVINS, LAMONT & FLUG, 1275 K Street, N.W., Suite 770, Washington, D.C. 20005, (202) 371-6626

* Counsel of Record

Counsel for Amicus Curiae Multistate Tax Commission

December 26, 1991

APPENDIX A

Catalogues Ranked By Number of States for which Use Tax Is Collected

["P" indicates whether order forms are personalized]

# Jurisd.	Company	P.
47	All Week Long Eddie Bauer	Y
47	Businessland	N
47	Eddie Bauer Home	Y
47	Honeybee	Y
47	J.C. Penney	N
47	Laura Ashley	Y
47	Sears	N
47	Spiegel	Y
47	The Ultimate Outlet - Spiegel	Y
35	Victoria's Secret	Y
34	Greenpeace Catalog	N
34	Talbots	N
33	The Disney Catalog	Y
29	Godiva Direct	Y
27	Egghead Discount Software	Y
27	Sharper Image	Y

26	Coach	Y
25	Barrie Pace, Ltd.	Y
24	Williams-Sonoma	Y
23	Nature Company	Y
22	Brooks Brothers	Y
22	Carroll Reed	Y
22	Harry & David	Y
17	FAO Schwartz	Y
16	Bachrach by Mail	Y
16	Lord & Taylor	N
16	Neiman Marcus by Mail	Y
16	Pottery Barn	Y
15	Chambers	Y
15	Hold Everything	Y
14	Gardener's Eden	Y
13	REI	Y
12	Horchow	N
12	Rand-McNally	Y
10	Bloomingdale's By Mail Ltd.	Y
9	Care Package Catalog	N
9	National Wildlife	Y
9	Orvis	Y
9	Tiffany & Co.	N
8	Crate & Barrel	Y
8	Laurel Burch	Y
8	Unicef	Y
7	Nordstrom	N
6	J. Crew	Y
5	Clifford & Wills	Y
5	Global Computer Supplies	N
5	Just for Kids	Y
5	Metropolitan Museum of Art	Y
5	Performance Bicycle Shop	Y
5	Playclothes/Child Craft	Y
5	Sesame Street, The Catalog	N
4	Chelsea	Y
4	Day-Timers	Y
4	Diamond Essence	Y
4	Domestications	Y
4	Hammacher Schlemmer	Y
4	Land's End	Y
4	Land's End Kids	Y
4	Mark, Fore & Strike	Y
4	Night & Day	Y
4	Tapestry	Y
3	Bike Nashbar	Y
3	Community Kitchens	Y
3	MacWareHouse	Y
3	Quill	N
3	Raleighs	N
3	Salvatore Ferragamo	N
3	Showcase of Savings	Y
2	After the Stork	Y
2	Bits & Pieces	Y
2	Brielle Gallaries	N
2	Brightscreek	Y

2	Exposures	Y
2	Grill Lover's Catalog	Y
2	Lillian Vernon	Y
2	Museum of Fine Arts	Y
2	Saks Fifth Avenue Polio	Y
2	Smythe & Co.	N
2	The Ben Silver Collection	Y
2	The Jewish Book Guide	N
2	The Right Start Catalogue	Y
2	Touch of Class Catalog	Y
2	Toys to Grow On	Y
2	Troll Learn & Play	Y
2	Tweeds	Y
2	World Wide Games	Y
1	Airline International	Y
1	Anticipations-Ross Simmons	Y
1	Aristoplay	N
1	Art Institute of Chicago	Y
1	Attitudes	Y
1	BILA	Y
1	Caly & Corolla	Y
1	Casual Living	Y
1	Christina Stuart	Y
1	City Spirit	Y
1	Claudia Christy	Y
1	Coldwater Creek	Y
1	DAK	N
1	Damark	Y
1	Down's	Y
1	Edgar B	N
1	Eximious	Y
1	Flax	Y
1	Fortune's Almanac	Y
1	Health Source	Y
1	Hearth Song	Y
1	Initials	Y
1	J. Jill Ltd.	Y
1	Jean Grayson's Brownstone Studio	Y
1	Jennifer Austin	Y
1	John Deere	Y
1	Keeping In Touch	Y
1	L. L. Bean	N
1	Lady Smith	Y
1	Lew Magram	Y
1	Lewis & Roberts	Y
1	Musuem of Modern Art	Y
1	Mystic Seaport Museum Stores	Y
1	Namark Funwear	N
1	Oriental Trading Co, Inc.	Y
1	Pepperidge Farm	Y
1	Play Fair Toys	Y
1	Pleasant Co. New Baby Collection	Y
1	Potpourri	Y

1	Scope	Y
1	Scully & Scully, Inc.	Y
1	Selfcare Catalogue	Y
1	Signals	Y
1	Source for Everything Jewish	Y
1	Sporty's	Y
1	Storybook Heirlooms	Y
1	Sundance	N
1	T. Anthony Ltd.	Y
1	The Anatomical Prod. Premier	Y
1	The Competitive Edge	Y
1	The Cottage Shop	N
1	The Mind's Eye	N
1	The Music Stand	Y
1	The Paragon	Y
1	The Personal Touch	Y
1	The Pet Catalog	Y
1	The Very Thing	Y
1	The Writewell Co.	Y
1	What on Earth	Y
1	Wintersilks	N
1	Wireless	Y
1	Wolferman's	Y
0	A.B. Lambdin	Y
0	CitiDollars	N
0	Garnet Hill	Y
0	Hanna Anderson	Y
0	Herrington	Y
0	Norm Thompson	Y
0	Solutions	N

Total Number of Companies: 155

APPENDIX B

[SEE FORM IN ORIGINAL]

CERTIFICATION OF SERVICE

The undersigned, an attorney-at-law of the State of New Jersey, hereby certifies as follows:

On February 17, 2005, two copies of the within Brief and Second Supplemental Appendix of Plaintiff-Respondent were served by UPS overnight delivery upon the following:

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I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Dated: February 17, 2005

Michael A. Guariglia

NWK3: 868977.02

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I. PRELIMINARY STATEMENT

The Investment Company Institute (the "Institute"), the national association of the American investment company industry, respectfully submits its brief *amicus curiae* to assist the Court in its consideration of issues presented on appeal in this matter. Founded in 1940, the Institute is the national association of the American investment company industry. Its membership includes open-end investment companies (commonly known as "mutual funds"), closed-end investment companies, investment advisers, and principal underwriters and sponsors of unit investment trusts.

The Institute is concerned about efforts by the New Jersey Division of Taxation (the "Division") to tax nonresident entities that do not have a "physical presence" in New Jersey. Specifically, application of New Jersey's corporation business tax (the "CBT") to entities that provide management and other services to Institute members from a location outside of New Jersey would disrupt longstanding expectations and exceed the State's authority to tax under the Commerce Clause of the United States Constitution. For the reasons set forth herein, the Institute urges that the Court acknowledge and confirm the "physical presence" requirement under the Commerce Clause as applied to the New Jersey corporation business tax.

Like the New Jersey Chamber of Commerce that filed a Brief of Amicus Curiae in the Tax Court proceeding, the Institute supports in every respect Lanco's positions as expressed in the proceedings below. However, the principal interest of the Institute's members relates to the efforts of the state of New Jersey to tax a foreign corporation without physical presence under Commerce Clause jurisprudence. Accordingly, this amicus brief will focus primarily on that issue.

II. FACTUAL BACKGROUND

A. *Regulated Investment Companies.*

As indicated above, the Institute's membership is comprised largely of regulated investment companies ("RICs") and the organizations that provide services to RICs. A RIC is an entity that gathers assets from investors (who own the RIC's shares) and collectively invests these assets in stocks, bonds, or money market instruments. Through the collective investments of the RIC, each investor shares in the returns from the RIC's portfolio while benefiting from professional investment management, diversification, liquidity, and other benefits and services. RICs are among the most common investment vehicles for investors, particularly small investors. They are

frequently the investment vehicles for retirement and 401(k) plans (including state retirement plans), and for Section 529 education plans.

RICs typically do not have employees of their own, although they do have officers and a board of directors or trustees. One responsibility of the board of directors or trustees is to enter into contractual arrangements with third parties for management and related services. Among the services provided to a RIC by contractual arrangement with a service provider are investment advisory/asset management services relating to the RIC's portfolio securities. However, RICs also typically have contractual arrangements with one or more service providers to provide for the sale and distribution of RIC shares to investors and accounting and shareholder services.

The RIC's assets typically are limited to its portfolio securities; these assets are usually maintained at a custodial institution with which the RIC has a contractual relationship. RICs are registered under the Securities Act of 1933 and the Investment Company Act of 1940 and are classified as corporations for both federal income tax purposes and New Jersey CBT purposes. The Investment Company Act of 1940 and related rules adopted by the Securities and Exchange Commission ("SEC") require the vast majority of RICs to have a majority of directors on their board who are independent of the RIC's

investment adviser and other affiliates. A RIC board is required to annually review and approve the RIC's contract with its investment adviser.

B. The Attempted Expansion of Tax Authority in New Jersey.

This case involves the interpretation of a New Jersey CBT regulation, which was amended by the New Jersey Division of Taxation (the "Division") in 1996. N.J.A.C. 18:7-1.9, amended by R. 1996, d. 518, 28 N.J.R. 4795(a) (Nov. 4, 1996) (the "Amended Regulation"). During the period at issue, the New Jersey CBT was imposed on every foreign corporation "doing business. . . in th[e] State." N.J.S.A. 54:10A-2. The Amended Regulation includes as an addition to N.J.A.C. 18:7-1.9(b) the following example:

> Foreign corporation R holds trademarks that were assigned to it by its parent corporation. R receives fees as a result of licensing those trademarks to certain New Jersey companies for use in New Jersey. R is subject to the corporation business tax on its apportioned income as a result of its trademark licensing activities.

The Amended Regulation reflects the affirmative effort by the State of New Jersey to expand the scope of its taxing authority beyond permissible territorial limits. These efforts have recently been perpetuated to an even greater extent in other regulatory action taken by the Division under the New

Jersey Business Tax Reform Act, P.L. 2002 c.40 (the "BTRA") that was approved on July 2, 2002. The BTRA revised the nexus provisions of the CBT to provide, in part, as follows:

> Every domestic or foreign corporation . . . shall pay an annual franchise tax for each year . . . for the privilege of having or exercising its corporate franchise in this State, or for the privilege of deriving receipts from sources within this State, or for the privilege of engaging in contacts within this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State.
>
> . . .
>
> A taxpayer's exercise of its franchise in this State is subject to taxation in this State if the taxpayer's business activity in this State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States.

N.J.S.A. 54:10A-2.

Incident to the BTRA, the Division adopted other regulations that seek to extend the reach of the CBT far beyond permissible Constitutional boundaries. Of particular concern to the Institute and its members are provisions of CBT regulations that would purport to tax RIC service providers, such as asset managers, that perform services wholly outside of New Jersey for RICs (that also may be wholly outside of New Jersey), as long as the RIC has shareholders that are located in New Jersey.[1] Thus, like the regulation at issue in this case, the Division is

[1] N.J.A.C. §§18:7-1.6 and -8.10(e).

attempting to expand the scope of the CBT to taxpayers that not only do not have a physical presence in New Jersey, but whose revenues have virtually no or at most only a remote connection to New Jersey.

The Division takes the position that an entity no longer need be "physically present" in New Jersey in order to be subject to New Jersey income tax. This vague definition of "nexus" cannot possibly pass Constitutional muster and threatens to inject confusion and inconsistency into the state tax landscape.

In a typical situation, services are provided to a RIC that is not located in New Jersey (irrespective of whether the RIC has New Jersey shareholders) by a separate service provider that has no physical presence in New Jersey. The RIC may or may not be located in New Jersey. The majority of the Institute's RIC members are not in New Jersey. In such situations, the nonresident service provider is neither deriving receipts from sources within New Jersey nor engaging in contacts within the state.[2] This is the case irrespective of whether the RIC has New Jersey shareholders.[3]

---

[2] N.J.A.C. §§18:7-1.6(a)vii and viii.

[3] The typical RIC, regardless of whether it has a New Jersey presence or purchases service from a New Jersey vendor, will have shareholders who are residents of New Jersey, since RIC shares are widely held.

To the extent that the Division seeks elimination of the "physical presence" requirement, however, the Division presumably would seek to tax any nonresident corporation (including those with no contacts to New Jersey) that provides services to another corporation (also possibly including those with no contacts to New Jersey) based solely on the fact that the corporation purchasing the services has New Jersey shareholders (or possibly as long as some amount of the corporation's receipts can find their origin in New Jersey). Were shareholder presence sufficient to establish jurisdiction, virtually every public corporation would be subjected to the CBT.

The application of the CBT as sought by the Division in this case can and, if sustained, will likely produce illogical and inappropriate results. Application of the CBT to taxpayers that have no contact with New Jersey other than contractual relationships with New Jersey customers or corporations with New Jersey shareholders is an unconstitutional exercise of the State's taxing authority. Under such an interpretation, any investment advisor that is hired by a New Jersey resident potentially would be subject to the CBT irrespective of the location of the advisor. Not only would such an imposition be unconstitutional, it would be nearly impossible to comply with since the service provider may not

know the location of its customer (such as where an investment advisor manages the assets of a pool of portfolio securities, possibly held by an independent entity in "street" name).

As stated in the amicus brief filed by the New Jersey Chamber of Commerce in the Tax Court, extension of the CBT to taxpayers with no physical presence in New Jersey has broad policy implications that could have a negative effect on virtually every industry.

III. ARGUMENT

A. *The Commerce Clause And State Taxing Authority.*

The Commerce Clause of the United States Constitution authorizes Congress to regulate commerce with foreign nations and among the several states. Article 1, Section 8, cl.3. The Commerce Clause concerns the effects of state regulation on the national economy, and prohibits discrimination against interstate commerce. See Quill Corp. v. North Dakota, 504 U.S. 298, 309, 112 S.Ct. 1904, 1911, 119 L.Ed.2d 91 (1992). Even in the absence of Congressional action, the Supreme Court has noted that "[t]he . . . clause by its own force, prohibits discrimination against interstate commerce, whatever its form or method . . . ." Id. (quoting Justice Stone in South Carolina State Highway Dept. v. Barnwell Brothers, Inc., 303 U.S. 177,

185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938)). This is sometimes referred to as the "dormant" or "negative" commerce clause.

The trial court in this case correctly concluded that the Division's attempt to tax the income of nonresident entities providing services outside the State of New Jersey exceeds the State's taxing authority under the Commerce Clause. Elimination of the "physical presence" requirement with regard to certain (but not all) kinds of taxes (as advocated by the Division) would introduce uncertainty into an area of the law that the United States Supreme Court has long criticized as a "quagmire" and unduly confusing. Quill, 504 U.S. at 315, 112 S.Ct. at 1915, 119 L.Ed.2d 91; Northwestern States Portland Cement Co. v. State of Minnesota, 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959).

The analysis of when a state can impose a tax on a foreign taxpayer has long focused on whether the subject tax is apportioned to the taxpayer's "local activities within the taxing State forming sufficient nexus to support the same." Northwestern States Portland Cement. 358 U.S. at 452, 79 S.Ct. at 359, 3 L.Ed.2d 421. In Complete Auto Transit, Inc. v. Bradley, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), the United States Supreme Court enunciated the four essential criteria in determining whether a state tax that affects interstate commerce passes Constitutional muster:

1. There must be a sufficient connection (i.e., substantial nexus) between the activity to be taxed and the state seeking to impose the tax;

2. The tax must be fairly apportioned to the activities conducted by the taxpayer within the taxing state;

3. The tax must not discriminate against interstate commence; and

4. The tax must fairly relate to the services provided by the state.

430 U.S. at 279, 97 S.Ct. at 1079, 51 L.Ed.2d 326.

In Quill, the Supreme Court held that while the due process clause did not bar a use tax collection duty for a mail-order vendor that was engaged in continuous and widespread solicitation of business within North Dakota, there was insufficient nexus under the Commerce Clause to impose such an obligation. 504 U.S. at 317, 112 S.Ct. at 1916, 119 L.Ed.2d 91. In discussing the Complete Auto Transit factors, the Court noted that the second and third prongs of the analysis, which require fair apportionment and nondiscrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. Id. at 313, 112 S.Ct. at 1913, 119 L.Ed.2d 91. The first and fourth prongs, which require a substantial nexus and a

relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce. Id. The Quill Court stated:

> the Commerce Clause and its nexus requirements are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation of the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills.
>
> Thus, the "substantial-nexus" requirement is not, like due process' "minimum-contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly . . . a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause and yet lack the "substantial nexus" with that State as required by the Commerce Clause.

Id. at 312-313, 112 S.Ct. at 1913, 119 L.Ed.2d. 91.

B. "Physical Presence" Is A Prerequisite To Taxation.

Much of the controversy regarding the application of the Commerce Clause in the area of state taxation has revolved around whether a taxpayer must have a physical presence with the taxing state. Prior to Quill, the Supreme Court had held in National Bellas Hess, Inc. v. Department of Revenue of Ill., that an Illinois statute requiring an out-of-state mail order seller to collect use tax under facts similar to Quill violated

both the due process and commerce clauses. 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d. 505 (1967). Recognizing that due process jurisprudence had evolved substantially in the 25 years since Bellas Hess, particularly in the area of judicial jurisdiction, the Quill Court concluded that physical presence is no longer a requirement for state tax jurisdiction under the due process clause. 504 U.S. at 308, 112 S.Ct. at 1911, 119 L.Ed.2d. 91. However, for purposes of the Commerce Clause, the Court held the physical presence requirement enunciated in Bellas Hess still applies.

Both Bellas Hess and Quill involved issues of state tax nexus for sales and use tax purposes. With respect to other taxes, such as business activity taxes, the Court stated that "although 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, that silence does not imply repudiation of the Bellas Hess rule." 504 U.S. at 314, 112 S.Ct. at 1914, 119 L.Ed.2d. 91. In other words, the Court stated that it may apply a physical presence standard like that of Bellas Hess to other taxes. The Court noted that a "bright line" physical presence requirement "furthers the ends of the dormant Commerce Clause." Id.

The Court in Quill observed that the furthest extension of a state's taxing authority was recognized in

Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), in which the Court upheld a use tax collection obligation despite the fact that all of the seller's in-state solicitation was performed by independent contractors. Quill, 504 U.S. at 306, 112 S.Ct. at 1910, 119 L.Ed.2d 91. Other cases that validated state tax nexus all involved some sort of physical presence in the state, either directly or through agents or representatives. Id. (citing Scripto).

It is puzzling that the Division now takes the position that the physical presence requirement set forth in Quill is limited to sales and use taxes. Each year, the Division submits its Annual Report to the Governor and the Legislature of New Jersey. Part of that report traditionally includes a description of each tax administered by the Division. In each of its reports for the past 7 years, the Division has stated that the corporation income tax (repealed in 2002) "has become practically obsolete due to Corporation Business Tax regulations as well as New Jersey's adoption of the Multistate Tax Commission's guidelines and the U.S. Supreme Court decision, *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992) . . . ." See, e.g., 1996 Annual Report of the Division of Taxation, at 28 (January 1997) (emphasis added);[4] see also, Annual Division

[4] 1996 Annual Report at p. 28, http://www.state.nj.us/treasury/taxation/pubs.htm.

Reports for 1997 through 2003.[5] This statement in the Division's annual report reflects its unequivocal acknowledgement that the principles set forth by the Supreme Court in Quill apply to business activity (i.e., income) taxes as well as sales and use taxes.

Case law subsequent to Quill has made clear that a remote (even economic) relationship with a state is not sufficient to establish the substantial nexus mandated by the Commerce Clause. Thus, for instance, the State of Tennessee did not have jurisdiction to impose its franchise and excise taxes on an out-of-state taxpayer with no presence in the state notwithstanding that the taxpayer derived revenue from Tennessee customers from its credit card operations in that state, including through the solicitations for credit cards that were sent on its behalf. J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999). The court in that case concluded that the taxpayer's relationship with the State of Tennessee was insufficient to satisfy the "'substantial nexus' requirement found in the first prong of the Complete Auto Transit test." Id. at 838. The court in J.C. Penney also noted

[5] 2003 Annual Report at p. 25; 2002 Annual Report at p. 25; 2001 Annual Report at p. 24; 2000 Annual Report at p. 30; 1999 Annual Report at p. 28; 1998 Annual Report at p. 28; 1997 Annual Report, at p. 32. All of the Division's Annual Reports for the period 1996 to 2003 can be accessed at http://www.state.nj.us/treasury/taxation/pubs.htm.

that "the Commissioner [of Revenue for the State of Tennessee could] point[] to no case in which the Supreme Court of the United States has upheld a state tax where the out-of-state taxpayer had absolutely no physical presence in the taxing state." Id. at 842.

C. *Geoffrey Is Of Questionable Validity.*

The Division places great reliance on the decision of the South Carolina Supreme Court in Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C.) , cert. denied, 510 U.S. 992, 114 S.Ct. 550, 126 L.Ed.2d 451 (1993). For the reasons correctly expressed by Judge Pizzuto below, Geoffrey is of questionable value. As Judge Pizzuto noted, Geoffrey was decided by the Supreme Court of South Carolina and has no precedential effect in New Jersey. More importantly, the premise of Geoffrey, that the burdens associated with collecting a sales and use tax are materially different from those from those involved with collecting an income tax, is suspect, particularly in this age of computerized data processing capabilities. (Da133-134). Judge Pizzuto addressed the distinction made by the court in Geoffrey and observed that

> . . . it does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant as to justify a different rule for each concerning physical

> presence as an element of Commerce Clause nexus. . . . The Supreme Court cases decided before Quill strongly suggest that physical presence is a necessary element of nexus for income taxation. Finally, other state court cases decided since Quill do not follow the Geoffrey rule.

(Da133). Judge Pizzuto concluded that "[t]he use tax collection obligation does not, to put it plainly, seem significantly more burdensome than the liability to pay an income tax. If physical presence is not a constitutional necessity for one, it is illogical that it should not be for both." (Da134).

The Division in its brief argues that the differences in the nature of use taxes on the one hand and income/franchise taxes, such as CBT, on the other are sufficient to justify a physical presence requirement in the case of the former but not in the case of the latter. One difficulty with such distinctions is that they require subjective determinations regarding the nature of each tax and the burden associated therewith. As noted above, such determinations would further confuse and complicate an already complicated body of law. It would be directly in opposition to the benefits of a clear rule such as that espoused by the Court in Quill in the context of use taxes.

As Judge Pizzuto observed, the cases cited by the South Carolina Supreme Court in Geoffrey in the context of the Commerce Clause do not stand for the proposition that "physical

presence" no longer is necessary for a state to impose its income or franchise tax on a nonresident. See International Harvester Co. v. Wisconsin Dept. of Taxation, 322 U.S. 435, 64 S.Ct. 1060, 88 L.Ed. 1373 (1944); Curry v. McCanless, 307 U.S. 357, 59 S.Ct. 900, 83 L.Ed. 1339 (1939). In fact, as Judge Pizzuto noted, those cases did not directly address the Commerce Clause, and physical presence was an essential factor in each in finding jurisdiction for taxation. (Da137).

The Division cites several cases in its brief as standing for the proposition that Commerce Clause nexus does not require physical presence outside of the sales and use tax arena. It is notable that physical presence was, in fact, found to exist in those cases. See Couchot v. State Lottery Comm'n, 659 N.E.2d 1225 (Ohio), cert. denied, 519 U.S. 810, 117 S.Ct. 55, 136 L.Ed.2d 18 (1996) and Borden Chemicals and Plastics, L.P. v. Zehnder, 726 N.E.2d 74 (Ill. App. Ct.), app. denied, 731 N.E.2d 762 (Ill. 2000). Thus, consideration of the "physical presence" implications of Complete Auto Transit was not necessary.

D. The Modern Trend Looks To "Physical Presence."

Contrary to the Division's suggestion, the trend in the courts has not been to follow the decision in Geoffrey. Putting aside the Division's derisive characterization of Judge Pizzuto's analysis of the case law as "rote" and "mechanical,"

almost all of the post-Quill cases that have squarely considered the question have confirmed that a state's attempt to tax without physical presence unduly burdens interstate commerce in violation of the Commerce Clause. Thus, Judge Pizzuto was correct when he observed, "the question of the necessity of physical presence for Commerce Clause nexus has been addressed in other state court decisions after Quill and Geoffrey. None of them find nexus absent physical presence." (Da137). See Rylander v. Bandag Licensing Corp., 18 S.W.3d 296, 300 (Tex. App. 2000) ("when the corporation conducts its activities solely through interstate commerce and lacks any physical presence in the state, no sufficient nexus exists to permit the state to assess tax."); J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. App. 1999) (income received by Delaware banking corporation from credit card activity in Tennessee not subject to Tennessee franchise and excise tax; physical presence required); Cf. Bridges v. Autozone Properties, Inc., 2004 WL 26487, *2 n.2, __ So. 2d __ (La. App. 1 Cir, 1/5/2004) (in context of due process objection to corporate income and franchise tax claim, stating "Quill court noted that physical presence is still required under a Commerce Clause analysis"); Acme Royalty Co. v. Director of Revenue, 96 S.W.3d 72 (Mo. 2002) (interpreting state law, corporate income tax statute did not

apply to income earned by foreign corporations from licenses of marks used by related operating corporations in Missouri).

E. New Jersey Case Law Supports A "Physical Presence" Element.

Judge Pizzuto also noted that "settled precedent" in New Jersey has consistently held that physical presence is necessary for a finding of "substantial nexus" under Commerce Clause analysis. (Da143). For example, in Avco Financial Services Consumer Discount Co. One, Inc. v. Director, Div. of Taxation, 100 N.J. 27 (1985), the Supreme Court of New Jersey examined the imposition of New Jersey's corporation income tax on a Pennsylvania corporation that conducted business activities in the State of New Jersey.[6] Citing the decision in Bellas Hess, the Court held that the "question turns on how the taxpayer has come into the state to work the market." Id. at 38. The Court found that the taxpayer in that case engaged in a "vigorous, systematic and persistent effort, aided by a substantial physical presence" (emphasis added) to collect overdue accounts, occupied the New Jersey offices of its affiliate to conduct business, and regularly used the New Jersey courts to pursue its rights. Id. at 40. Based upon the record in that case, the

[6] The corporation income tax, which was repealed in 2002, was a direct tax on income that foreign corporations derive from New Jersey sources that otherwise would escape taxation under the CBT because of the interstate nature of the entity's business.

Court concluded that the taxpayer was subject to taxation on that portion of its income that could be allocated to its activities in the State of New Jersey. Id. at 41. However, the linchpin of taxability was the taxpayer's physical presence and the result would likely have been different in the absence thereof.

The position advocated by the Division constitutes a change in the law that would disrupt "settled expectations" and create further confusion in an area of the law that the United States Supreme Court has described as "a quagmire." Quill, 504 U.S. at 316, 112 S.Ct. at 1915, 119 L.Ed.2d 91 (citing Northwestern States Portland Cement, 358 U.S. at 457-458, 79 S.Ct. at 362, 3 L.Ed.2d 421). Accordingly, this Court should continue to observe the rule voiced in Avco Financial - that the Commerce Clause prohibits the taxation of a nonresident who does not have a physical presence in the State of New Jersey.

The Division states that consideration of whether a tax passes muster under the Commerce Clause depends upon the nature of the tax, as opposed to whether the taxpayer conducts activities in the taxing state. Such a distinction threatens to further complicate the "tangled underbrush" in this area of the law that the United States Supreme Court criticized more than 40 years ago. Northwestern States Portland Cement, 358 U.S. at 457, 79 S.Ct. at 362, 3 L.Ed.2d 421. The Court in Quill

criticized the "formal distinction between taxes on the 'privilege of doing business' and all taxes [as] serv[ing] no purpose within our Commerce Clause jurisprudence, but . . . 'only as a trap for the unwary draftsman.'" Quill, 504 U.S. at 314, 112 S.Ct. at 1914, 119 L.Ed.2d 91 (citing Complete Auto, 430 U.S. at 279, 97 S.Ct. at 1079).

F. The Decision In Quill Should Apply Here.

The Division's distinction between the vendor in Quill and Lanco in the case at bar is drawn from whole cloth. Lanco's only contact with New Jersey is its agreement with Lane Bryant, Inc., an independent New Jersey corporation. The fact that this "related" corporation is a retail merchant in the State of New Jersey (and, presumably, pays taxes in connection with those retail activities) is irrelevant to the question of whether Lanco has a physical presence in New Jersey. Indeed, the activities and burdens on state resources cited by the Division in its brief are in fact the activities of Lane Bryant, Inc., not Lanco. (Db 4-5). For example, it is Lane Bryant, Inc. that "operates numerous retail outlets" in New Jersey and Lane Bryant, Inc. that uses Lanco's marks to generate sales at Lane Bryant, Inc. stores in New Jersey. The "increasing traffic, . . . police and fire protection, and imposing demands on the State's labor pool" are burdens associated with Lane Bryant's

retail operations, not a contract that Lane Bryant has with a non-resident.[7] The fact that Lanco's marks may enhance Lane Bryant's ability to market its goods in New Jersey is irrelevant to the analysis of whether the State may permissibly tax Lanco, a nonresident with no physical presence in the State. Moreover, the fact that Delaware chooses not to tax Lanco for this type of income is immaterial.

Under the Division's analysis, Lane Bryant's sale in New Jersey of a shirt manufactured in and purchased by it in, for example, Arkansas, would subject the Arkansas manufacturer to income tax in New Jersey simply because the product "enhanced" Lane Bryant's ability to market in New Jersey. Alternatively, Lane Bryant's purchase of accounting services from a firm in Denver would subject the nonresident accountants to New Jersey income taxation because the advice improved Lane Bryant's profitability in New Jersey. Whether that fictional manufacturer or accounting firm were subject to a similar tax scheme in their home states is irrelevant to the question of whether New Jersey may tax a nonresident solely for the privilege of engaging in interstate commerce, something that the

[7] The Division acknowledges that New Jersey law now captures all of the taxable income associated with this "enhanced" retail activity, without deduction for royalty payments that Lane Bryant pays to Lanco. (Db8). Thus, the Division's concerns about profits that "rain upon Lanco" appear to be unfounded. If anything, the Division is attempting to tax the same income twice.

Commerce Clause plainly prohibits. Quill, 504 U.S. at 312, 112 S.Ct. at 1913, 119 L.Ed.2d 91.

The record suggests that Lanco's activities in New Jersey are even more attenuated than those of the vendor in the Quill case. In Quill, the non-resident vendor regularly solicited North Dakota residents through mailings and telephone calls directed into that State. 504 U.S. at 302, 112 S.Ct. at 1907, 119 L.Ed.2d 91. The vendor in Quill, although located in other states, was the sixth largest shipper of office supplies into the State of North Dakota. Id. at 302, 112 S.Ct. at 1907-1908, 119 L.Ed.2d 91. Despite those contacts, the Supreme Court concluded that Quill was not subject to taxation by the State of North Dakota. The Court specifically rejected the contention that Quill's licensing of intangibles used within North Dakota could satisfy the substantial nexus requirement of the Commerce Clause. Id. at 315 n.8, 112 S.Ct. at 1914 n.8, 119 L.Ed.2d 91.

Lanco's contacts are far less significant. Based upon a fair reading of the record, Lanco's only contact with New Jersey is its contract - executed in Delaware - with a separate corporation (Lane Bryant, Inc.) that conducts retail operations in, among other states, New Jersey. (Da98-108). That agreement permits Lane Bryant, Inc. to use Lanco's marks in, *inter alia*, the State of New Jersey. (Da98). Although Lanco requires that Lane Bryant observe certain standards of quality in connection

with Lane Bryant's use of the marks, it is Lane Bryant, not Lanco, that uses the marks in New Jersey. Indeed, the agreement requires Lane Bryant to pay Lanco in Delaware, (Da101, 106) and requires that any dispute between them be resolved in a Delaware forum using Delaware law. (Da107). If Quill's ongoing business dealings with North Dakota residents, including long term software license agreements with North Dakota residents, were insufficient to pass Constitutional muster, Lanco's agreement with Lane Bryant similarly fails the test

G. Delaware's Tax Structure Is Irrelevant.

In a transparent attempt to divert this Court from the Constitutional issues, the Division complains that Lanco is "dodging" New Jersey State taxation and that Delaware law excludes the subject income from its corporate taxes. (Db 44). However, it is not the prerogative of the State of New Jersey to evaluate whether a nonresident is being "properly" taxed by another state. The fact that the Delaware legislature may exempt certain categories of income from taxation has nothing to do with the question of whether New Jersey is flexing its taxing authority within Constitutional boundaries. In addition, nowhere do Quill, or the cases that gave rise to it, engage in an analysis of the tax scheme in the nonresident's home state in order to determine whether the taxing state is unreasonably

burdening interstate commerce. The Constitutional question is whether the tax unreasonably burdens interstate commerce. The test developed by the United States Supreme Court, and followed by the Supreme Court of New Jersey, requires physical presence. Judge Pizzuto was correct to apply it here.

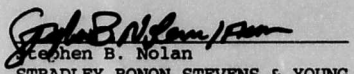
The Commerce Clause requires that Lanco have substantial nexus with the state of New Jersey in order to be subject to the CBT. Simply put, it does not.

IV. CONCLUSION

The actions of the Division in Lanco and its recent actions, including those discussed above incident to the BTRA, evidence a clear intent to tax even the most remote taxpayer's income. As indicated above, the BTRA now provides that a taxpayer's exercise of its franchise in this State is subject to taxation if the taxpayer's business activity in the State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States. However, neither this statement nor the promulgation of regulations or other policy by the Division alter the fact that the Commerce Clause of the United States Constitution, as interpreted, requires that a taxpayer have a physical presence in order to be subject to taxation. For this reason, the well-

reasoned decision by Judge Pizzuto with regard to the Commerce Clause should be affirmed.

Respectfully submitted,



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A-3285-03T1

LANCO, INC., a Delaware corporation,	SUPERIOR COURT OF NEW JERSEY APPELLATE DIVISION DOCKET NO. A-3285-03T1
Plaintiff-Respondent,	Civil Action
v.	On Appeal from a Final Judgment Of the Tax Court of New Jersey
DIRECTOR, DIVISION OF TAXATION,	Sat Below: Hon. Peter D. Pizzuto, J.T.C.
Defendant-Appellant.	

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BRIEF OF AMICUS CURIAE MULTISTATE TAX COMMISSION

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INTEREST OF *AMICUS CURIAE*

The Multistate Tax Commission ("MTC") files this brief pursuant to R. 1:13-9, N.J. Court Rules, 1969, as *amicus curiae* in support of the Director, Division of Taxation of the State of New Jersey. The MTC is the administrative agency created by the Multistate Tax Compact ("Compact"). Twenty-one States have legislatively established full membership in the Compact. In addition, five States, including New Jersey, are sovereignty members and nineteen States are associate members.[1]

The purposes of the Compact are to (1) facilitate proper determination of state and local tax liability of multistate taxpayers; (2) promote uniformity or compatibility in significant components of tax systems; (3) facilitate taxpayer convenience and compliance; and (4) avoid duplicative taxation. *Id.*

In furtherance of the identified goals of the Compact, the MTC seeks a correct and uniform understanding of the constitutional nexus standard for the imposition of state income taxes. A correct nexus standard ensures that interstate commerce pays its fair share of state taxes. *See Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995). A uniform nexus standard facilitates taxpayer convenience and compliance because taxpayers will more readily understand constitutional limits on state income taxes. The MTC takes issue with the nexus standard employed by the Tax Court below. The Tax Court failed to follow longstanding U.S. Supreme Court precedent permitting States to impose income tax on taxpayers not physically present in the State and failed to

[1] **Compact Members** (legislative enactment of the Compact): Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. **Sovereignty Members** (Executive decision to join the Commission): Florida, Kentucky, Louisiana, New Jersey, and Wyoming. **Associate Members** (participation in Commission programs): Arizona, Connecticut, Georgia, Illinois, Maryland, Massachusetts, Mississippi, New Hampshire, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, West Virginia, and Wisconsin.

recognize the explicit limitation on the mail order safe harbor the Court set in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The appropriate standard is that reiterated by the U.S. Supreme Court in numerous corporate income tax cases: "nexus is established if the corporation 'avails itself of the "substantial privilege of carrying on business" within the State.'" *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 220 (1980).

ARGUMENT

THE PHYSICAL PRESENCE REQUIREMENT FOR COMMERCE CLAUSE "SUBSTANTIAL NEXUS" FOR SALES AND USE TAXES UNDER *QUILL CORP.* v. *NORTH DAKOTA* DOES NOT EXTEND TO INCOME TAXES.

1. The Issue before the Court is Whether New Jersey May Constitutionally Impose a Fairly Apportioned Income Tax on Lanco on Profits it Earns in New Jersey from Licensing the Right to Put its Trademarks on New Jersey Retail Stores.

The constitutional question turns on whether requiring Lanco to pay tax in New Jersey is either "fundamentally unfair" in violation of the Due Process Clause of the Fourteenth Amendment or "unduly burdensome on interstate commerce" in violation of the Commerce Clause. Your amicus submits that these are reasonable tests to require state taxes to meet and are precisely the tests imposed by the United States Supreme Court's modern due process and commerce clause jurisprudence. The New Jersey tax on Lanco passes these tests.

The facts are not at issue. Lanco licenses its affiliate "Lane Bryant, Inc." to place Lanco's revered and valuable trademarked name "Lane Bryant" on stores to attract customers. The value of that trademark in New Jersey derives from the goodwill that exists within the hearts and minds of New Jersey customers, developed through their long and happy experiences in New Jersey Lane Bryant stores. The marketplace confirms that value of Lanco's property in New Jersey because these New Jersey retail stores are

willing to pay millions of dollars in royalty fees to obtain the right to display the name "Lane Bryant" there. That royalty is fittingly measured by a percentage (5.5%) of the retail sales made in those New Jersey Lane Bryant stores.

State corporate income taxes from their inception have been both source based—imposed on the portion of income non-residents earn in a State—and residence based—imposed on the total income of a State's residents. *Shaffer v. Carter*, 252 U.S. 37 (1920). Source-based taxing is the only way to impose an income tax successfully on modern business. If tax were based on residency alone, the use of artificial and mobile corporate entities could ensure that a corporation's "residence" was located in a jurisdiction that imposes little or no tax. Only source-based taxation has the promise of imposing tax where income is earned.

To determine where income is earned, States have long used the factors of property, payroll and sales. The Supreme Court has affirmed that basing tax on these factors meet due process requirements that state tax be fairly related to benefits provided and commerce clause requirements that income of multistate businesses be fairly apportioned. *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942) ("We read the statute [California's three factor apportionment formula] as calling for a method of allocation which is 'fairly calculated' to assign to California that portion of the net income 'reasonably attributable' to the business done there"). Forty years later, the Court noted that "not only has the three-factor formula met our approval, but it has become . . . something of a benchmark against which other apportionment formulas are judged." *Container Corp v. Franchise Tax Board*, 463 U.S. 159, 170, 183 (1983) ("The three-factor formula used by California has gained wide approval precisely because payroll,

property, and sales appear in combination to reflect a very large share of the activities by which value is generated.") Lanco clearly earned considerable income in New Jersey from the sale of the right to use its valuable property in the State by allowing the name "Lane Bryant" to be put on big signs—in lights no less—at stores there.

Lanco asserts that New Jersey cannot tax the profits it earns in New Jersey because it has no physical presence there. Looked at initially from a common-sense policy perspective, this makes no sense. Why should physical presence be required when Lanco is earning these profits from selling something in New Jersey that has no physical presence? Lanco is selling the right to use its trademarked name "Lane Bryant," an intangible that has no corporeality. Indeed, Lanco, itself, which exists solely to own and license these "Lane Bryant" trademarks, barely has any physical presence anywhere.

The legal basis for Lanco's assertion, adopted by the Tax Court below, is that the bright line, physical-presence nexus standard for imposing a use tax collection obligation on mail order sellers reluctantly retained by the Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), should be extended to state corporate income taxes.

Long-standing Supreme Court precedent authorizes States to impose income tax on taxpayers with no physical presence in the State on income earned from the use of intangibles there. The language and the reasoning of the Court in *Quill* provide no basis to overrule those decisions or to extend the physical presence requirement to income taxes. To evaluate what effect *Quill* has on the nexus standard for income tax, it is helpful to understand the source and development of the income tax nexus standard and then analyze the language and the reasoning of the *Quill* decision.

2. Early State Income Tax Nexus Decisions Did Not Require Physical Presence

The Supreme Court in *Wisconsin v. J.C. Penney*, 311 U.S. 435, 444-445 (1940), set out at length the underlying conceptual basis for nexus to impose income tax.

> Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. 'Taxable event', 'jurisdiction to tax', 'business situs', 'extraterritoriality', are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. (Emphasis added.)

Most States have enacted as the statutory standard for the application of corporate income and franchise taxes some variation of this "fiscal relation" labeled "doing business in the state" or "deriving income from an in-state source". *See, e.g.*, N.J. Rev. Stat. §54:10A-2.[2]

Of specific relevance here are the Supreme Court's repeated authorizations of States to tax intangibles of non-residents who have no physical presence in the State. As early as 1869, the Court authorized state property tax on nonresidents on their intangibles employed in a State. In *National Bank v. Commonwealth of Kentucky*, 76 U.S. 353 (1869), the Court approved a tax on the shares of stock in a Kentucky bank owned by nonresident shareholders with no presence in the State. In *City of New Orleans v. Stemple*, 175 U.S.

[2] "Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for each year, as hereinafter provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of deriving receipts from sources within this State, or for the privilege of engaging in contacts within this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act."

309 (1899), the Court approved a local property tax on notes and mortgages belonging to a person whose only contact with the State was the presence of that property in the State.

After States began imposing income taxes, it was inevitable that such taxes would be applied to income earned from intangibles. The Court affirmed the authority of the States to impose income tax on taxpayers without physical presence in such cases. In *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937), the Supreme Court upheld New York's authority to assess income tax on a non-resident with no physical presence in New York. The Court phrased the issues as follows: "The question here presented relates to the constitutional validity of a tax imposed by the State of New York upon the profits realized by a nonresident upon the sale of a right appurtenant to membership in the New York Stock Exchange." *Id.* at 369. The relator, Whitney, had "contended that the assessment of the tax under the provisions of the state act contravenes the Fourteenth Amendment of the Federal Constitution as an extraterritorial tax." *Id.* at 370. The Court emphasized Whitney's assertion that he and his partners were neither residents of New York nor came to New York to transact business:

> The relator, in challenging the jurisdiction of the State of New York to lay the tax, stresses the points that the relator and his copartners have always been domiciled in Massachusetts; that they have never had an office or abode in New York and have never carried on business there; that while they advertise themselves in Boston as members of the New York Stock Exchange and accept orders from customers at their Boston office for execution on the New York Stock Exchange, none of that business is conducted by the relator or his copartners on the floor of that Exchange; that they do not buy and sell securities on the Exchange for their firm account; that orders requiring execution on the Exchange are telegraphed to members of the Exchange who have business offices in New York and who execute their orders on the Exchange in their own names, acting as correspondents, lending money on the security of the stock purchased and other collateral delivered to them.

Id. at 371. Unquestionably, the Court was dealing with a New York income tax imposed on someone lacking the kind of physical presence within that State for which Lanco argues. The Court concluded that the source of the income, the seat on the NYSE, had a business situs in New York, and "that in laying the tax upon the profits derived by the relator from the sale of the right appurtenant to his membership the State did not exceed the bounds of its jurisdiction." *Id.* at 374.

Seven years later, the Supreme Court upheld another state tax imposed on non-residents with no physical presence within the State. *International Harvester Co. v. Wisconsin Dept. of Taxation*, 322 U.S. 435 (1944). The tax was for the privilege of receiving dividends measured by the Wisconsin portion of distributed earnings. Although there was some contention concerning on whom the incidence of the tax fell, the Court made clear that it was imposed on the stockholders. "For present purposes we assume that . . . the tax is thus, in point of substance, laid upon and paid by the stockholders." *Id.* at 440. The Court found no problem with Wisconsin's laying this tax on persons who had no physical presence within the State.

> Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.

Id. at 441-442. Its affirmation of the lack of need for physical presence was unequivocal. "And the fact that the stockholder-taxpayers never enter Wisconsin and are not represented in the Wisconsin legislature cannot deprive it of its jurisdiction to tax. It has

never been thought that residence within a State or country is a sine qua non of the power to tax." *Id.* at 443. Finally, the Court concluded "that appellants' stockholders can have no constitutional objection to the withholding by Wisconsin of a tax measured by their dividends distributed from Wisconsin earnings." *Id.* at 445. While it is not clear whether the Court viewed the stockholders' intangibles—the shares of stock in the International Harvester Corporation—as having a business situs in Wisconsin, it is clear that the Court premised its decision on the reality that those intangibles were used in Wisconsin to earn income for the stockholders. The fact that the entity in which the shareholders had an ownership interest—the corporation—had a physical presence in Wisconsin had the same relevance there as the fact here that Lanco and Lane Bryant, Inc., are commonly owned and Lane Bryant has a physical presence in New Jersey. While it does not provide the owner a physical presence, it does establish where the owner's intangible earns income.

These cases provide early and direct support for the authority of States to impose tax on non-residents earning income from the use of their intangibles in a State.

3. The Modern Due Process Nexus Standard Does Not Require Physical Presence

The modern "minimum contacts" due process nexus standard was announced just a year after *International Harvester* in the seminal case of *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). The Court ruled that a State has jurisdiction where a company has "certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *Id.* at 316. Subsequent cases applying the "minimum contacts" test have focused on whether an out-of-state business "purposefully avails" itself of the benefits of the economic market in the forum State. If so, it is subject to that State's jurisdiction even if it has no physical

presence in the State. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). Clearly, physical presence is not required under the modern due process nexus doctrine.

Recognizing this evolution of due process nexus by the late 1980s, North Dakota sought a declaratory judgment that the Quill Corporation, a mail-order seller that annually sent close to $1 million worth of products to North Dakota customers, had sufficient nexus with North Dakota to be subject to the obligation to collect use tax. The State argued that the Supreme Court's decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), was no longer good law.[3] The North Dakota Supreme Court agreed that subsequent development of the Court's due process jurisprudence undermined the authority of *Bellas Hess*, and it upheld the collection obligation. *State v. Quill Corp.*, 470 N.W.2d 203 (N.D. 1991).

The U.S. Supreme Court affirmed the North Dakota court in part and reversed in part. It affirmed that North Dakota's analysis of modern due process jurisprudence was correct, and that as a matter of due process, there was sufficient nexus for North Dakota to impose on Quill the obligation to collect use tax. "[T]here is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State." 504 U.S. at 308.

The Court then identified for the first time, however, a separate commerce clause nexus standard.

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[3] In *Bellas Hess*, the Court had ruled that a Missouri mail order seller whose only contact with Illinois was to send catalogues and products there by U.S. mail and common carrier did not have sufficient nexus for Illinois to impose a use tax collection obligation on the company. The decision was based on both due process and commerce clause grounds, described by the Court as "closely related" and "similar." *Id.*, at 756.

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. . . . In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.

Id. at 312. The Court ruled that the Commerce Clause "'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Id.* at 313. Noting the burden imposed by North Dakota and the "similar obligations [that] might be imposed by the Nation's 6,000 plus taxing jurisdictions," *id.* fn. 6, the Court opted to continue the bright-line physical presence test from *Bellas Hess*, recognizing the settled expectations of the industry on this rule.

Here, then, is where the physical presence requirement surfaces. But just as the due process nexus standard has evolved into the modern doctrine based on economic presence, modern dormant commerce clause jurisprudence has eclipsed earlier, more rigid doctrine. The context of this development of dormant commerce clause jurisprudence informs the scope of *Quill*'s newly-minted, commerce clause "substantial nexus" standard.

4. Commerce Clause Limitations on State Taxation Require Even-handed Treatment of Intrastate and Interstate Commerce.

The Commerce Clause, unlike the Due Process Clause, is not a restriction on state power. Rather it is one of Congress's enumerated powers under Art. 1, §8: "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Remarkably, Congress did not use that affirmative grant of power to regulate

state taxation of interstate commerce until 1959 when it enacted Pub. Law 86-272, 73 Stat. 555 (1959), codified in part at 15 U.S.C. §381*ff*. But long before that, the Supreme Court had filled the vacuum under its "dormant commerce clause" doctrine by limiting state taxation of interstate commerce even though Congress had not acted at all.

In its first decision invalidating a state tax expressly on commerce clause grounds, the Court turned the clause empowering Congress on its head to bar the States from taxing anything that Congress could regulate, even though Congress had not actually regulated it. The Court held "whenever the subjects over which a power to regulate commerce is asserted are in their nature national . . . they may justly be said to be of such a nature as to require exclusive legislation by Congress." *Case of the State Freight Tax*, 82 U.S. 232, 279 (1872). Congress had not acted, but it could, and therefore the States could not. The Court initially treated interstate commerce as a free-trade zone. "No state has the right to lay a tax on interstate commerce in any form." *Leloup v. Port of Mobile*, 127 U.S.640 (1888).

The Court soon realized that barring state taxation of all aspects of interstate commerce ended up precluding considerably more state taxes than seemed justified. The Court proceeded over the next 70 years to create a series of formal and sometimes artificial distinctions between "direct" and "indirect" taxation of interstate commerce, between taxing transactions that were still in "the stream of commerce" or had "come to rest," between taxes imposed on a "local activity" or on goods destined for "delivery to out of state customers."[4] As more and more commerce became interstate in nature, the unfairness of excluding interstate commerce from state taxation became palpable.

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[4] *Hope Natural Gas Co. v. Hall*, 274 U.S. 284 (1927); *American Mfg. Co. v. St.* Louis, 250 U.S. 459 (1919); *Adams Express Co. v. Ohio*, 165 U.S. 194 (1897); *Coe v. Errol*, 116 U.S. 517 (1886).

Finally, in 1938, the Court began to articulate its modern dormant commerce clause jurisprudence with its decision in *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938). It was crafting a theory that in the absence of congressional regulation, the Commerce Clause did not bar States from taxing interstate commerce, but rather required only a level playing field between interstate and intrastate commerce. The Court recognized "the double demand that interstate business shall pay its way, and that at the same time, it shall not be burdened with cumulative exactions which are not similarly laid on local business." *Western Live* Stock, 303 U.S. at 258. Gone was treating interstate commerce as a tax free zone.

After some backsliding toward the free-trade-zone concept of the dormant commerce clause during the 1940s and 1950s, *see Freeman v. Hewitt*, 329 U.S. 249 (1946), and *Spector Motor Services Inc. v. O'Connor*, 340 U.S. 602 (1951), the Court continued its modern commerce clause analysis in *Northwestern States Portland Cement*, 358 U.S. 450 (1959). It held that "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same." *Id.* at 452. The Court accepted that interstate commerce should not be disadvantaged as compared to local commerce, but it should not be advantaged, either.

Ultimately, with *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), the Court completely abandoned formalistic distinctions of "direct" and "indirect" taxes and enunciated its authoritative and oft-quoted four-pronged test of the validity of state taxes imposed on multistate business activity. The state tax is permitted "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned,

does not discriminate against interstate commerce, and is fairly related to services provided by the State. *Id.* at 279.

Following *Complete Auto*, the Court proceeded in a series of cases to confirm the utility of its modern dormant commerce clause doctrine by cogently identifying how States can disadvantage interstate commerce. The States gave the Court ample fodder to test its dormant commerce clause analysis by enacting a number of state taxes that managed in a variety of clever ways to discriminate against multistate businesses. *See Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (exemption from gross receipts tax on wholesale sales granted to local manufactures who pay a manufacturing tax discriminates against interstate commerce because exemption is not available to out of state manufacturers who may be subject to a manufacturing tax in their State); *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984) (tax exemption for locally produced wine discriminates against interstate commerce); *Tyler Pipe Indus. Inc. v. Washington DOR*, 483 U.S. 232 (1987) (business and occupations tax exemption granted on in-state wholesale sales to local manufacturers paying tax on manufacturing discriminates against out-of-state manufacturers selling into Washington); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (gasoline tax credit granted for ethanol manufactured in Ohio or a State granting a reciprocal credit); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (tax on sale of milk to local retailers, largely borne by out-of-state dairies, discriminatory because the proceeds of the tax are distributed to Massachusetts dairies).

As the Court limned the limits on state cleverness in each of these decisions, it became reassuringly clear that the modern dormant commerce clause doctrine worked. It treated interstate commerce on a level playing field with intrastate commerce. Interstate

commerce was no longer a protected "free trade" area that did not pay its fair share of tax, but it was protected from shouldering a greater burden of state tax than local commerce.

5. The Language and Reasoning in *Quill* Limit its Applicability to Sales and Use Tax

Against this backdrop, the Court decided *Quill*. The separate commerce clause "substantial nexus" standard it announced was based on the archetypal commerce clause consideration that state regulation and taxation must not unduly burden interstate commerce. Protecting interstate commerce from undue burden has long been considered a primary concern of dormant commerce clause jurisprudence, generally appearing in state regulation cases where the Court has balanced the burden placed on interstate commerce with the nature of the local interests and whether a less burdensome alternative is available. *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662 (1981); *Southern Pacific Co. v. Arizona*, 325 U.S. 761 (1945). Taxation of multistate businesses can also impose an undue compliance burden as the Court noted in *Bellas Hess* and *Quill*, citing the "welter of complicated obligations" facing a mail order seller having to collect tax for some 6000 separate jurisdictions with "many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements" *Quill* at 313, fn. 6.[5]

What, then, does the Court's decision and reasoning in *Quill* tell us concerning any purported extension of a physical presence requirement to income taxes?

A. The Court Used Specific Language in *Quill* Excluding Application of the Physical Presence Requirement to Other Taxes.

[5] Some commentators have noted the illogic of using "undue burden" as a *nexus* requirement. Nexus, after all, is all about the degree of contact with a state. Undue compliance burden can exist even for taxpayers with a great deal of contact with a number of states. *See* Robert D. Plattner, "*Quill*: 10 Years After", State Tax Notes, Vol. 25, No. 24, p. 1017, Sept. 30, 2002. The burdens inquiry is entirely appropriate, but conceptually the analysis properly should focus on whether the multiplicity of jurisdictions with whose diverse and conflicting taxes a multistate business must comply unduly burdens interstate commerce in a manner that puts it at a discriminatory disadvantage with local commerce.

First and foremost, one must look to the actual language of the *Quill* decision. The Court was clear that the physical-presence safe harbor applies *only* in the area of use tax collection. The Court did not say that it had not dealt with the issue of requiring physical presence for other taxes. To the contrary, it acknowledged that when it had affirmatively reviewed "other types of taxes it had not articulated the same physical presence requirement." *Quill*, 504 U.S. at 314. Thus, we need not look anywhere else for authority that the physical presence requirement for substantial nexus is limited to the mail order, use tax situation. Indeed, the Court reiterated that the physical presence requirement had not been extended to other taxes even after *Bellas Hess*. "In sum, although in our cases subsequent to Bellas Hess and concerning other types of taxes we have not adopted a similar bright-line . . . ." *Quill*, 504 U.S. at 317. The Court's unequivocal statements in *Quill* certainly sets a strong presumption that the physical presence requirement for "substantial nexus" under the Commerce Clause applies only to use tax collection obligations of mail-order sellers and does not extend to other taxes.

B. The Two Bases for the *Quill* Decision—*Stare Decisis* and Undue Burden—Reinforce its Limitation to the Use Tax Collection Obligation.

The Court's underlying reasons for its decision in *Quill* further supports limiting the physical presence requirement to use tax collection for mail order sellers. The Court gave two principal reasons for retaining the bright-line physical presence requirement from *Bellas Hess*. First, the Court relied on *stare decisis* to preserve "settled expectations" in the mail order industry.[6] Secondly, the Court relied upon the very basis it

[6] 504 U.S. at 316 ("a bright-line rule in the area of sales and use taxes also encourages settled expectations . . . it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in Bellas Hess"), and 317

gave for articulating a separate commerce clause nexus standard—limiting undue burdens on interstate commerce—and noted the undue burden that could result from requiring remote sellers to comply with the disparate use taxes of potentially 6,000 sales and use tax jurisdictions requiring monthly tax returns.

(1) *Stare Decisis* Points the Other Way Since the Court Has Long Found Income Tax Nexus Without Physical Presence.

The Court indicated great concern with *stare decisis*. Three concurring Justices based their decision entirely on *stare decisis* (perhaps based on their discomfort with the doctrinal atavism of the lead opinion). In the 25 years after *Bellas Hess*, the mail order industry had relied on this bright-line rule and had not collected use tax from its customers. Even though the Court acknowledged that current Commerce Clause jurisprudence might lead it to a different conclusion if it were writing on a clean slate, it felt constrained by industry's settled expectation. *Quill*, 504 U.S. at 311("contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today . . . .")

When one shifts to income taxes, however, considerations of *stare decisis* lead to the opposite conclusion—no physical presence is required. Clear U.S. Supreme Court precedent has long supported the imposition of state income taxes on non-residents without the kind of physical presence in the taxing State for which Lanco argues. See, *Whitney v. Graves*; *International Harvester* discussed in Part 2, above.

Whitney v. Graves and *International Harvester* found nexus over income of a person not physically present in a State based on Fourteenth Amendment due process

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("the *Bellas Hess* rule has engendered substantial reliance and . . . therefore counsels adherence to settled precedent.").

challenges. Commerce clause "substantial nexus" was not discussed because there was no separate commerce clause "substantial nexus" until *Quill*. Prior to *Quill*, there was only one kind of nexus.[7] No physical presence requirement was articulated as being applicable in those income tax cases. Indeed, these decisions are obvious examples of cases the Supreme Court may well have had in mind when stating 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 . . . ." 504 U.S. at 314. No Supreme Court decision has applied the *Quill* physical presence requirement to a state income tax.[8] No taxpayer could reasonably have expected constitutional protection from paying an income tax in States where her intangible property—be it a seat on the stock exchange, a share of stock, or a trademark—earns income for her.

Furthermore, any taxpayer who consulted the scholarly commentary on the *Quill* decision would find little assurance that the same physical presence requirement applied to use taxes of mail-order sellers would be extended to income tax. *See, e.g.*, John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 41 WILLIAM AND MARY L. REV. 319 (2003); Jerome R. Hellerstein and Walter Hellerstein, STATE TAXATION, ¶ 6.02[2] (3rd ed.1998); Jerome R. Hellerstein, *Geoffrey and the Physical Presence Nexus Requirement of Quill*, STATE TAX NOTES, February 13, 1995;

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[7] Indeed, the physical presence requirement in *Bellas Hess*, affirmed in *Quill*, derives from due process nexus concepts. *See* Pomp & McIntyre, *State Taxation of Mail-Order Sales of Computers after Quill: An Evaluation of MTC Bulletin 95-1*, 11 STATE TAX NOTES 177, 180-181 (July 15, 1996). Although the Court in *Quill* recognized that it had abandoned a physical presence requirement for due process nexus, it retained the requirement for commerce clause nexus for use tax collection obligations. The lack of any physical presence requirement in *New York ex rel. Whitney v. Graves* and *International Harvester* thus implicates both due process and commerce clause nexus with regard to state income taxes.

[8] Since the Court has denied review in both *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993), and *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.2d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000), it is up to the state courts in the first instance to determine whether the physical presence requirement applies to income taxes.

Michael T. Fatale, *Geoffrey Sidesteps Quill: Constitutional Nexus, Intangible Property and The State Taxation Of Income*, 23 HOFSTRA L. REV. 407 (1994). Any reliance on *Quill* to defeat nexus for imposing an income tax would be risky at best.

Consequently, *stare decisis*, so strongly the basis for the Court's retaining the bright-line test in *Quill*, points the other way in the income tax area. Settled precedent supports nexus to impose income tax on nonresidents without physical presence in the taxing State. Such precedent removed any basis for "settled expectations" that physical presence in a State is a prerequisite to States' imposing income tax.

(2) State Income Taxes Impose No Undue Compliance Burden on Multistate Taxpayers.

The Court identified the second basis for its decision in *Quill* in articulating the distinction between due process and commerce clause nexus standards as follows:

> The two standards are animated by different constitutional concerns and policies.
>
> Due process centrally concerns the fundamental fairness of governmental activity. . . . In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. . . . Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce [citation omitted] and bars state regulations that *unduly burden* interstate commerce.
>
> * * * The first and fourth prongs [of *Complete Auto Transit, Inc. v. Brady*], which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not *unduly burden* interstate commerce. Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for *limiting state burdens* on interstate commerce.

504 U.S. at 312, 313 (emphasis added, footnote omitted). Emphatically, ***undue burden*** is the essence of commerce clause "substantial nexus." The burden the Court described was a *compliance* burden with diverse and complicated state and local taxes.

> North Dakota's use tax illustrates well how a State tax might unduly burden interstate commerce . . . [when] similar obligations might be imposed by the Nation's 6,000 plus taxing jurisdictions . . . [such] that the "many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations."

504 U.S. at 313, fn 6, quoting *Bellas Hess*, 386 U.S. at 759-760.

The burden at issue was not the burden of paying tax. Due process determines whether it is fair for a state to impose a tax burden—"whether the state has given anything for which it can ask a return." *Wisconsin v. J.C. Penney*, 311 U.S. at 445. The Court in *Quill* answered that question with a resounding yes: "the use tax is related to the benefits Quill receives from access to the State." 504 U.S. at 308. Laying a tax obligation on someone who purposefully avails himself of a state's market fully conforms to the fairness standard of due process. It also conforms to the cardinal principle of modern commerce clause jurisprudence that interstate commerce should pay its fair share of taxes.

As Robert Plattner perceptively observed in *Quill Ten Years After*, 25 State Tax Notes at 1019, there is a whiff of the discredited free-trade aspect of earlier dormant commerce clause doctrine in *Bellas Hess* that was carried over in *Quill*. See the Court's comment that the bright-line test provides "the demarcation of a discrete realm of commercial activity that is free from interstate taxation." 504 U.S. at 315. The Court was clearly struggling in *Quill* with this doctrinal throwback in noting that "contemporary Commerce Clause jurisprudence might not dictate the same result," and that "[l]ike other

bright line tests, the Bellas Hess rule appears artificial at its edges." *Id.*, at 311, 315. The Court was hardly suggesting that the exclusively interstate character of mail order transactions *ipso facto* entitles the industry to a safe harbor from state taxes. Rather, the Court continued the safe harbor because of the undue burden of compliance with the diverse state and local sales and use taxes. Once the sales and use taxes are simplified and made more uniform, as the States are doing with the Streamlined Sales Tax Project, then the undue burden will have been removed and the safe harbor will no longer be appropriate.

The Tax Court below misconstrued this distinction in tax burdens in stating, without discussion or analysis, that "it does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant to justify a different rule for each concerning physical presence as an element of commerce clause nexus." The constitutional rule, of course, must be the same for all taxes. But that rule turns on whether imposing a tax obligation on interstate commerce would create an undue compliance burden. The Tax Court failed to recognize that the compliance burdens differ for sales and use taxes as compared to income taxes.

No undue compliance burden now exists with respect to state income taxes. The Supreme Court explicitly so held in *Barclay's Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298 (1994), just one year after *Quill*. Barclay's had argued that the burden for a large, multinational bank to prepare the records necessary to file California income tax on a worldwide combined reporting basis was unduly burdensome and therefore discriminated against interstate and foreign commerce. Barclay's complained in particular of the extra complexity caused from translating language, accountancy principles, and exchange rates

in applying apportionment factors to its foreign operations. "Barclays urges that imposing this 'prohibitive administrative burden' . . . on foreign-owned enterprises gives a competitive advantage to their U.S.-owned counterparts and constitutes 'economic protectionism' of the kind this Court has often condemned." *Id.* at 313. The Court agreed that this could be a problem. "Compliance burdens, if disproportionately imposed on out-of-jurisdiction enterprises, may indeed be inconsonant with the Commerce Clause. *Id.* The Court found, however, that California's simplified reporting procedures for foreign operations removed any undue burden and, as a result, there was no discrimination against foreign commerce. "In sum, Barclays has not demonstrated that California's tax system in fact operates to impose inordinate compliance burdens on foreign enterprises. Barclays' claim of unconstitutional discrimination against foreign commerce therefore fails." *Id.* at 314. Since the Court found no undue compliance burden even with the added complexity of including foreign operations under California's world wide combined reporting system, necessarily there is no undue burden under the substantially simpler, separate entity reporting system used in New Jersey.

There are significant differences in the compliance burdens for sales and use taxes and income taxes that support the *Barclay's* holding. The most salient distinction is the number of jurisdictions. Only some 46 States (including the District of Columbia) impose a state income tax—a far cry from the 6,000 plus jurisdictions cited in *Quill.*

The second significant distinction is the extent of uniformity among the States in their income tax laws. This uniformity was the salutary consequence of the 1959 Supreme Court decision in *Northwestern States Portland Cement* and federal and state legislative reactions to that decision. *Northwestern States* recognized for the first time

that States had the sovereignty to impose an income tax on a nondomiciliary business engaged exclusively in interstate commerce. Within just over six months, Congress reacted by enacting Pub. Law 86-272, Title I of which bars States from imposing a net income tax on income from the sale of tangible personal property where an out-of-state company's contacts with the taxing State are limited to the prescribed safe harbor.

Title II of Pub. Law 86-272 mandated a congressional study of state income taxes as applied to interstate commerce. In discharge of this mandate, Congress formed the Willis Committee (so named for the chair of what actually was a Special Subcommittee of the House Judiciary Committee). The Committee conducted extensive hearings as a part of its exhaustive review of state taxes as applied to interstate commerce. Consistent with the controversy that greeted *Northwestern States* surrounding the application of state income taxes to interstate commerce, the Willis Committee observed:

> While each of the State laws contains its own inner logic, the aggregate of these laws—comprising the system confronting the interstate taxpayer—defies reason. Indeed, so varied are the provisions concerning jurisdiction, division of income, and tax base, that it is rare to find a statement which is true of all income tax States. [H.R. REP. No. 952, 89th Cong., 1st Sess., Pt. VI, at 1143 (1965)]

The Willis Committee made extensive recommendations for federal legislation to preempt and regulate the application of state taxes to interstate commerce, including state income taxes. *Id.* at 1139*ff*. The recommendations for state income taxes sought, among other things, more uniformity in the rules for the division of income among the States and in the starting point used to compute the state income tax, the tax base. These and other recommendations attempted to address numerous problems that flowed from a substantial lack of uniformity that resulted in complexity, uncertainty, compliance burden, administrative challenge, and overtaxation and undertaxation.

The enactment of Pub. Law 86-272 and the recommendations of the Willis Committee galvanized the States into resolving a practical problem—state income taxes were not then well framed to be applied to interstate business. State income taxes required reform, especially in the development of substantial uniformity, in order for States realistically to exercise their sovereignty to impose income tax on interstate commerce. The States could not ignore the immediate need for reform of state income taxes because Congress stood ready to enact the reform itself through federal legislation that would preempt and regulate these and other state taxes.

The need for the States to solve their own problems prompted States to enact the Uniform Division of Income for Tax Purposes Act (UDITPA), to adopt the Multistate Tax Compact, and to form the Multistate Tax Commission. Consequently, uniformity is now a significant part of the state income taxes. "Of the forty-six states (including the District of Columbia) with corporate income taxes, twenty-three have adopted UDITPA, and most other states have similar statutory schemes." Jerome R. Hellerstein & Walter Hellerstein, STATE TAXATION, ¶ 9.01 (3rd ed. 1998).[9] Congressional action was forestalled. These enactments greatly simplified the burden for multistate corporations in filing income tax in numerous States. As a result, the Supreme Court has never struck down the imposition of a fairly apportioned state income tax on a multistate business doing business within several States as unduly burdensome because of compliance difficulties.

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[9] While it is true that States no longer maintain uniform apportionment formulas, the Supreme Court has ruled that the Commerce Clause does not require total uniformity. *Moorman Mfg. Co. v. Bair*, 437 U.S 267 (1978) (use of a single factor for sales in apportioning income does not result in impermissible double taxation notwithstanding that other states use a three factor apportionment formula). In any event, such relatively minor differences that exist do not cause great *compliance* difficulty. Double weighting the sales factor, for instance, requires only the simple arithmetic calculation of an eighth grader.

Not only have the Multistate Tax Compact and UDITPA created significant apportionment uniformity among the States, but the starting point to figure the income tax—the tax base—is also generally uniform. Most States piggyback their state income tax on federal income tax calculations, further simplifying multistate compliance. Few of the definitional problems, the extensive varying exemptions and deductions, and the myriad of rates with frequent changes that are all characteristic of sales and use taxes apply to state income taxes. Furthermore, state income taxes require only one annual return, not monthly returns as sales and use taxes generally do. Finally, the calculations of the property, payroll and sales factors necessary for apportionment under UDITPA for one State furthers the calculations needed to determine other States' apportionment.

Ultimately, with regard to Lanco, whose entire income derives from royalties paid by Lane Bryant based on Lane Bryant's receipts at each of its locations, figuring the tax base and apportioning the tax is straightforward and simply done. Affiliate Lane Bryant already employs tax accountants to file income tax returns in each State.[10]

In sum, no credible reason can be found to extend a physical-presence nexus requirement to state income taxes. This conclusion is based on long-standing Supreme Court precedent allowing States to impose income tax on persons who earn income from doing business within their jurisdiction but who are not physically present there. It is

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[10] We note the failure of Lanco to meet its burden to establish the existence of any undue burden on interstate commerce that would flow from its obligation to pay the New Jersey income tax. *See Norton Co.* v. *Dept. of Revenue*, 340 U.S. 534, 537 (1951) (burden to establish exemption from state tax based upon constitutional principles rests on the taxpayer); *General Motors Corp.* v. *Washington*, 377 U.S. 436, 441-42 (1964) (to same effect); *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 175-76 (1983) (to same effect); *Silent Hoist & Crane Co. v. Director, Div. of Taxation*, 100 N.J. 1, 10, 494 A.2d 775, 779, (1985) ("the [U.S. Supreme] Court appeared resolved to take itself out of the business of being a tax commission and made it clear that the taxpayer has the 'distinct burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed...'".) Significantly, the only reasons for any additional burden on Lanco to file separate income tax returns in each State is because Lane Bryant chose to create the complication itself as a tax planning attempt to avoid paying tax on all of its income earned in each of these States. Any burden on the taxpayers here is entirely self-induced.

based on the language of *Quill* itself limiting the physical presence requirement to mail-order sellers' use tax collection obligation. It is based on the reasons articulated by the Court in *Quill* for continuing the physical presence nexus requirement for mail order sellers—*stare decisis* and undue burden—reasons that are clearly not applicable to the income tax area. And finally, it is based on the only sensible response to the modern economy where value is increasingly generated from intangibles that have no physical presence. Excluding from tax all income earned from intangibles within the state will inevitably destroy the state income tax (such intangibles can always be put in an overseas holding company with no presence in any State and excluded even from water's edge combined reporting). Recognizing the authority of States to impose a fairly apportioned income tax based on economic presence affirms how and where intangibles earn income, proving once again the utility, and the fairness, of the Court's modern due process and commerce clause jurisprudence.

CONCLUSION

For the reasons elaborated above, your amicus respectfully requests that the Judgment of the Tax Court of January 9, 2004 be reversed.

Respectfully submitted,

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