
CYBERTAXATION AND THE COMMERCE CLAUSE: ENTITY ISOLATION OR AFFILIATE NEXUS?

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I. INTRODUCTION

Normally in the shadow of the federal income tax, state and local tax policies have been propelled to the foreground by the meteoric rise of the Internet as a tool for conducting business—especially retailing. If current trends continue, “e-tailing” will soon dwarf traditional mail-order selling as well as comprise a much larger slice of the total retail sales pie. In 1995, approximately \$219 billion of retail sales were consummated by mail, phone, or electronic means.¹ Projections vary greatly, but one study estimates that Internet-based sales will grow to \$3.2 trillion by 2003.² This is more than ten times the volume of all remote sales³ just a decade earlier.

This shift from local to remote retailing presents a tremendous challenge for state and local governments, most of which are heavily reliant on sales tax revenues.⁴ The traditional state tax rule is that the dormant

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1. KARL FRIEDEN, CYBERTAXATION: THE TAXATION OF E-COMMERCE 39 (2000).

2. *Id.* at 37.

3. “Remote sales” are sales made by a retailer located out of state who sells to in-state customers. The order is typically placed via mail, phone, fax, or Internet, and the product is delivered by common carrier.

4. See *GAO Reports on Sales Taxes and Challenges of Electronic Commerce Growth*, 2000 ST. TAX TODAY 154-19, at Doc. 2000-20837 (Aug.9, 2000) (sales and use taxes account for 33% of state

Commerce Clause protects sellers with no in-state physical presence from collecting sales or use taxes.⁵ Only physical presence will provide sufficient tax nexus.⁶ The Supreme Court reaffirmed this rule in the pre-dawn hours of the “e-era” in a decision addressing the taxation of mail-order companies.⁷

The consequences of this decision now loom larger than ever anticipated because of the rise of a tax-planning technique known as “entity isolation.” In essence, entity isolation occurs when a taxpayer separately incorporates its nexus-creating assets (or conversely, its remote selling assets), thus protecting its remote selling operations from state tax jurisdiction.⁸ This strategy was initially applied in the mail-order context, after a succession of state court decisions held that the physical presence of a traditional brick-and-mortar department store could not be attributed to its mail-order affiliate for the purpose of determining whether the mail-order affiliate was subject to state tax jurisdiction.⁹ Entity isolation, however, has equal application in the Internet retailing context.¹⁰ State tax

revenues and 11% of local revenues). In addition, traditional “brick-and-mortar” retailers who must collect and pay sales tax are threatened by a playing field tilted in favor of their e-commerce competitors. See generally *Unofficial Transcript of Ways and Means Hearing on Internet Taxation*, 2000 ST. TAX TODAY 101-31, at Doc. 2000-14656 (May 24, 2000) (testimony of “brick-and-mortar” retailers). Internet retailers embrace current law, concerned that collecting and reporting tax would be unduly burdensome when orders can be placed from any one of the more than 6,000 state and local taxing jurisdictions. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.6 (1992). See generally Lee A. Sheppard, *Business Taxpayers Resist Nexus, in Courts and Congress*, 2000 ST. TAX TODAY 89-45, at Doc. 2000-12702 (May 8, 2000); ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *at* <http://www.ecommercecommission.org/report.htm> (Apr. 2000). Internet retailers also justify their existing Commerce Clause protection with infant industry arguments. Thomas H. Steele & Neil I. Pomerantz, *Sales and Use Taxes: Communications Services and Electronic Commerce*, TAX MGMT. 1350 TAX MGMT. MULTISTATE PORTFOLIO at s59 & n.369 (2000). E-commerce supporters, such as Senator Ron Wyden, claim that aggressive taxing authorities would “kill the goose that will lay billions of dollars of golden eggs.” *Id.*

5. *Quill Corp.*, 504 U.S. at 310–11 (1992). As explained *infra* Part II.B, what is traditionally know as “sales tax” is usually bifurcated into two complementary taxes: sales tax and use tax. In general, “sales tax” is paid on in-state purchases while “use tax” is paid on out-of-state purchases. The collection of a sales tax by an in-state seller usually presents no constitutional or administrative difficulty. On the other hand, the state must rely on each individual consumer to self-report the use tax, unless the remote seller has a sufficient nexus with a state for the state to impose a use tax collection obligation on the seller. As a practical matter, this does not occur.

6. *Quill Corp.*, 504 U.S. at 317–18.

7. *See id.*

8. “Nexus-creating assets” are those assets with a physical presence in a state.

9. *See infra* Part III (discussing state court affiliate nexus decisions).

10. *See, e.g.*, L. Jay McIntosh, *Tax Strategies in the Multi-Channel Retail Environment*, CHAIN STORE AGE, May 1, 2000, at 67, 2000 WL 13730694 (practitioner-oriented explanation of entity isolation strategies for clicks and brick retailers).

policymakers have characterized this as the “biggest issue . . . in the next few years.”¹¹

The concept of entity isolation is best described by illustration. Take, for example, the retailer Wal-Mart, which has a physical presence in most—if not all—states. Accordingly, Wal-Mart collects a sales tax from its customers and remits the tax to the states and localities in which its stores are located. Walmart.com, a wholly-owned subsidiary of Wal-Mart, is a web-based retailer selling products that are the same or similar to those that can be found at brick-and-mortar Wal-Mart stores. Walmart.com shoppers, however, pay no sales tax unless they are located in Arkansas, California, Georgia, or Utah—states in which Walmart.com has a physical

11. *Retail Merchants Looking to Enter Internet Market Without Creating Nexus*, 69 U.S.L.W. 2142, 2143 (2000) [hereinafter *Retail Merchants*]. Contrary to popular misconception, recent Congressional action has *not* placed a moratorium on state taxation of Internet sales. Federal legislative activity was sparked by state taxing authorities, who initially reacted to the changing technological landscape by aggressively interpreting “physical presence” to include, for example, the physical presence of an Internet service provider (“ISP”) with which an electronic retailer has a contractual relationship or the presence of a website on an in-state server. *See generally* FRIEDEN, *supra* note 1, at 300–16 (discussing potential physical contacts of Internet businesses). Internet businesses counterpunched by lobbying Congress for passage of the Internet Tax Freedom Act (“ITFA”). Internet Tax Freedom Act, Pub. L. No. 105-277, §§ 1101–1206, 112 Stat. 2681-719 (1998). During a three-year moratorium period, subsequently extended to November 1, 2003, ITFA prohibits taxes on Internet access services and “multiple or discriminatory” taxes on electronic commerce. § 1101(a); § 1101(d) (unless an Internet access services tax was imposed and enforced prior to October 1, 1998); H.R. 1552, 107th Cong. (1st Sess. 2001) (enacted) (extending original moratorium to November 1, 2003). “Discriminatory taxes” were defined to include efforts to tax remote sellers solely on the basis of an in-state customer’s ability to access a site on a remote seller’s out-of-state server or by treating the Internet access service as an in-state agent of the remote seller. *See* ITFA § 1104(2). Thus, the moratorium does not prohibit taxation of Internet transactions. Rather, it preserves the status quo and prevents state taxing authorities from asserting that a physical presence arises from certain Internet-related contacts with the state. Instead, Internet providers are treated as if they are common carriers whose contacts and agency are not considered physical contacts for tax nexus purposes. *See* § 1104(2)(B).

ITFA also created an Advisory Committee on Electronic Commerce (“ACEC”), charged with studying the taxation of Internet transactions and making policy recommendations based on its findings. § 1102. Reflecting the intense controversy surrounding these issues, ACEC was unable to build a two-thirds consensus around any sales/use tax finding or recommendation as required by the terms of its enabling statute. § 1103 (two-thirds consensus required); ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra* note 4, at Appendix G (opinion of legal counsel regarding legal effect of failure to achieve two-thirds consensus). Thus, a “majority proposal” was adopted. *Id.* at 19–20. The majority proposal signaled a clear victory for taxpayer advocates. It would extend the current moratorium for another five years and “clarify,” during the extended moratorium period, that a number of additional types of contacts with a state would not give rise to sales/use tax nexus. Buried in this list of proposed nexus safe harbors is the entity isolation “loophole.” Specifically, the majority proposal would provide that “a seller’s affiliation with another taxpayer that has physical presence in [a] state” would not, in and of itself, “establish a seller’s physical presence in [that] state for purposes of determining whether a seller has sufficient nexus with that state to impose [tax] collection obligations.” ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra* note 4, at 19.

presence.¹² This is because Walmart.com takes the position that it is protected by the dormant Commerce Clause. It has no physical presence in most states, and, it claims, the contacts of its parent company simply do not count.¹³

Can it really be that easy? After all, if Walmart.com were a division of Wal-Mart rather than a separately incorporated affiliate, its tax collection obligation would be clear. Must the Commerce Clause determination of whether the tax collection obligation is unduly burdensome turn on a mere technicality of state corporate law?

Several noted tax policy economists have recognized the threat that entity isolation poses to the future of the sales tax and have criticized judicial authorization of this technique. Michael Mazerov, senior tax analyst at the Center on Budget and Policy Priorities, believes that “these entity isolation strategies really are a threat to the viability of the sales tax in the long term—much more of a threat than companies that are doing business solely online.”¹⁴ John Mikesell, professor of public finance and policy analysis at Indiana University, observes that the trend is to honor the “quaint legal fiction” that affiliated corporations are separate entities.¹⁵ The future of the sales tax is threatened, he argues, by “the ease, under existing legal principles, of shifting purchases of goods from local brick-and-mortar vendors to their electronic affiliates.”¹⁶

12. Wal-Mart has administrative offices and the like in those states. See *Retail Merchants*, *supra* note 11, at 2142–43.

13. Wal-Mart is not the only retailer using this strategy. Target Corp., Kmart Corp., Barnes & Noble Inc., Borders, Inc., and Tower Records also are using entity isolation strategies. *Id.* at 2142. Some retailers have been more circumspect. See, e.g., David Brunori, *Electronic Commerce from the Vendors' Perspective Highlights Georgetown Conference*, 2000 ST. TAX TODAY 100-36, at Doc. 2000-14521 (May 23, 2000) (noting cautionary comments by a Costco, Inc. tax executive). Cf. Letter from Elizabeth Spaulding, Vice-President, Customer Satisfaction, L.L. Bean, to Virginia Customers (July 17, 2000) (advising that L.L. Bean would begin collecting retail sales tax from Virginia mail-order customers as a result of opening an in-state retail store) (on file with author).

14. *Retail Merchants*, *supra* note 11, at 2144. The threat is greater than the “safe harbor” allowed to pure Internet and mail-order companies because, without entity isolation, only companies that limit their business to remote selling can exploit the current physical presence safe-harbor. With entity isolation, all retailers can exploit the remote selling loophole, possibly steering even local shoppers to the Internet to place their final orders, thus avoiding taxation. See Alison Bennett, *Kmart, Barnes & Noble Take Opposing Positions on Tax Collection for Online Orders Placed by Customers Within Retail Stores*, 7 TAX MGMT. MULTISTATE TAX REP. 749 (2000).

15. John L. Mikesell, ‘States of Mind’: *The Commission, Sales Tax Streamlining, and Physical Presence: More Observations on the Internet Battlefield*, 2000 ST. TAX TODAY 108-28, at Doc. 2000-15644 (June 5, 2000).

16. *Id.*

Charles McLure of the Hoover Institution at Stanford University is more emphatic:

[M]ost of the judicial decisions invalidating the inference of nexus by affiliation seem to be absolutely absurd. There is no reason that a group of affiliated companies engaged in closely related activities should be able to avoid nexus for use tax for part of their activities simply by placing them in a distinct corporation¹⁷

Elsewhere, McLure labels entity isolation as a “scam” and states that judicial decisions sanctifying the entity isolation technique do not “pass the ‘idiot test.’”¹⁸

On the other end of the spectrum, many legal commentators have defended entity isolation, concluding that “it is essential that the individual identity and integrity of corporations be respected; the corporate entity concept is integral to the American legal and economic system [T]here appears to be no justification for allowing states to ignore basic jurisprudential concepts in asserting their jurisdiction over foreign corporations.”¹⁹ Jerome and Walter Hellerstein, authors of the definitive treatise on state and local taxation, appear to accept entity isolation as a necessary consequence of American corporate law.²⁰ Some legal academics, however, have criticized entity isolation and suggested statutory remedies.²¹

17. Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 403 (1997).

18. Charles E. McLure, Jr., *Electronic Commerce and the Tax Assignment Problem: Preserving State Sovereignty in a Digital World*, 1998 ST. TAX TODAY 70-21, at Doc. 98-12061 (Apr. 13, 1998).

19. Arthur Rosen, *Jurisdictional Limitations: Attributional Nexus*, 1430 TAX MGMT. MULTISTATE PORTFOLIO at 36 (2000). See also John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, 4 J. MULTISTATE TAX’N 18, 22-24 (1994) (criticizing expansion of affiliate nexus beyond traditional corporate law limits on liability); Arthur R. Rosen & Marc D. Bernstein, *State Taxation of Corporations: The Evolving Danger of Attributional Nexus*, 41 TAX EXECUTIVE 533, 581-83 (1989) (criticizing unitary business nexus theory).

20. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, I STATE TAXATION ¶¶ 6.13, 6.13[1] (3d ed. 1998 & Supp. 2001). The Hellersteins rely in part on a Restatement of Conflicts comment endorsing the traditional *Cannon* doctrine approach to personal jurisdiction. See *id.* (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS: FOREIGN CORPORATIONS—OTHER RELATIONSHIPS § 52, cmt. b, at 180-81 (1971)). *Cannon* is generally considered to stand for the proposition that the presence of an in-state affiliate does not give rise to jurisdiction over an out-of-state affiliate. See *infra* Part IV.A. The continued vitality of the *Cannon* doctrine, however—at least in its stronger forms—is subject to serious question. *Id.*

21. See, e.g., Michael J. McIntyre, *Commentary on McLure and Hellerstein: Taxing Electronic Commerce Fairly and Efficiently*, 52 TAX. L. REV. 625, 636-53 (1997). Cf. RICHARD D. POMP & OLIVER OLDMAN, II STATE AND LOCAL TAXATION: CASES AND MATERIALS 9-51 (3d ed. 2000) (posing question for discussion of whether entity isolation technique is constitutionally protected).

This Article proposes a framework for basing state tax jurisdiction on corporate affiliation.²² Since the arguments set forth herein are predicated on existing Supreme Court jurisprudence, states should feel unconstrained in enforcing sales tax collection obligations against companies currently attempting to avoid taxation through entity isolation techniques.²³

Part II of this Article reviews the federal constitutional limits on state tax jurisdiction. Although no Supreme Court decision has addressed directly the issue of affiliate nexus,²⁴ the Court has addressed “attributorial nexus,” “divisional nexus,” and “unitary business” principles, all of which serve as building blocks for a theory of affiliate nexus. Part III reviews state court decisions addressing affiliate nexus. Notably, since most of the cases have been decided on state law grounds, they do not squarely address the question of whether the theory of affiliate nexus is constitutionally permissible. Part IV explores the non-tax related building blocks for the theory of affiliate nexus. First, this Part reviews parallel non-tax-related due process jurisprudence to determine to what extent corporate formalities are honored when personal jurisdiction is sought over an out-of-state affiliate of an in-state enterprise. There is a surprising divergence of results in this oft-litigated arena. Second, under the general rubric of the “law of corporate groups,” this Part considers whether any possible additional authority exists for allowing substance to override form in the context of

22. Electronic commerce raises numerous other tax issues—both domestic and international. *See generally* ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra* note 4; Walter Hellerstein, *Deconstructing the Debate over State Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 549, 549–657 (2000). Given competing political interests, this author is skeptical of the viability of comprehensive reform proposals, such as superseding state sales and use taxes with a federal tax, or developing a uniform state sales and use tax code that might allow state taxation of remote sellers to pass constitutional muster. As Karl Frieden observes: “[I]t is quite possible that the current deadlock between business and state and local government will drag on, a victim of the complexity of the issues and the lack of consensus for any particular set of tax reforms.” FRIEDEN, *supra* note 1, at 344. *But see* Doug Sheppard, *The Rise of the Streamlined Project and the Fall of the Advisory Commission*, 2000 ST. TAX TODAY 251-25, at Doc. 2001-309 (Dec. 29, 2000) (discussing the creation and goals of the Streamlined Sales Tax Project). Proposals for taxation of mail-order sales have circulated for years without result. *See, e.g.*, Tax Fairness for Main Street Business Act of 1994, S. 1825, 103d Cong. (1994) [hereinafter Tax Fairness Act]. Similarly, numerous scholars have argued that the physical presence test from *Quill Corp. v. North Dakota* should be overruled. *See, e.g.*, *Academic Specialists Reject Advisory Commission Sales Tax Proposals*, 2000 ST. TAX TODAY 80-30, at Doc. 2000-11538 (Apr. 25, 2000) (statement signed by 170 academic tax specialists rejecting, among other things, codification of the *Quill* rule). Nevertheless, the rule remains intact. Accordingly, this Article focuses on a theory of tax jurisdiction that is *consistent with existing jurisprudence* and that taxing authorities can use immediately as a tool to prevent further erosion of the state tax base.

23. Except possibly Connecticut, Ohio, and Pennsylvania taxing authorities—states in which the appellate courts have spoken, however incorrectly. *See infra* Part III.

24. In this context, “affiliate nexus” means to assert state tax jurisdiction over a remote seller by virtue of the in-state physical presence of a corporate affiliate.

affiliated corporations. Part V sets forth a theory of affiliate nexus and addresses possible criticisms. Part VI examines state statutory issues and proposes two types of state legislation. The first would clarify a state's intent to reach remote affiliates of in-state corporations to the maximum extent allowed under the federal Constitution. This type of law should ensure that future courts will not stop short and decide affiliate nexus cases on state law grounds. The second state legislative proposal goes further—making the in-state affiliate responsible for collection of taxes on the sales of the out-of-state affiliate. This would make the in-state affiliate the taxpayer and would circumvent any constitutional objections. Finally, Part VII concludes by commenting on the tax equity implications of affiliate nexus.

II. THE CONSTITUTIONAL LIMITS ON STATE TAXATION OF REMOTE SELLERS

The state taxation of remote sellers invokes both Due Process and Commerce Clause considerations. Until recently, the Court had treated the Due Process and Commerce Clause protections as being conterminous, both requiring the physical presence of a taxpayer within a state for a state tax to be constitutionally imposed.²⁵ However, in *Quill Corp. v. North Dakota*,²⁶ the Court found that the Due Process and Commerce Clauses invoked very different constitutional considerations, and so, the standards diverged. The Court held that the Due Process Clause no longer required a physical presence.²⁷ A mere economic exploitation of a state marketplace generally would be enough to satisfy the due process concerns of “fundamental fairness,” “notice,” and “fair warning.”²⁸ The Commerce Clause nexus, however, was found to be informed “by structural concerns about the effects of state regulation on the national economy.”²⁹ The Court held that these concerns, along with stare decisis considerations, justified retaining the requirement of physical presence for state tax jurisdiction purposes under the Commerce Clause.³⁰

Accordingly, the Due Process Clause is not a significant obstacle to the state taxation of most remote sellers. Only sellers with de minimis, sporadic, or unforeseeable sales in a jurisdiction might qualify for Due

25. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 19.02[3][c][ii] & n.82.

26. 504 U.S. 298 (1992).

27. *Id.* at 308.

28. *See id.* at 308, 312.

29. *Id.* at 312.

30. *See id.* at 317.

Process Clause protection.³¹ The Commerce Clause, however, protects all sellers who have no in-state physical contacts. Thus, the real challenge in developing a constitutionally valid theory of affiliate nexus is to demonstrate that the physical contacts of an in-state affiliate of a remote seller may be considered in determining whether that remote seller has a sufficient Commerce Clause nexus with the state.

There would be little to discuss if the Supreme Court had already addressed affiliate tax nexus. It has not. Nonetheless, legal principles established by existing precedent can be applied to the issue of affiliate nexus. This Part examines applicable Supreme Court precedents, which can be divided into five major categories: (1) cases establishing the general Commerce Clause limits on state taxation, (2) cases applying the Commerce Clause nexus requirement to remote sellers, (3) “attributional nexus” cases, (4) “divisional nexus” cases, and (5) “unitary business” cases.

A. GENERAL COMMERCE CLAUSE LIMITATIONS ON STATE TAXATION OF INTERSTATE COMMERCE

The modern test for determining the validity of a state tax under the dormant Commerce Clause was set forth in *Complete Auto Transit, Inc. v. Brady*:³²

1. *The tax must be “applied to an activity [that has] a substantial nexus³³ with the taxing State;”*³⁴
2. The tax must be “fairly apportioned” to activities carried on by the taxpayer in the state;³⁵

31. Of course, both the Due Process and Commerce Clauses would protect taxpayers if a state sought to impose a tax collection obligation on sales completely unrelated to the state. For example, Wisconsin could not reasonably expect to tax sales by a Florida retailer to a Georgia customer with no plausible Wisconsin connection. Unless otherwise specified, however, the issue addressed in this Article is the taxation of sales to customers located in the state that seeks to impose the tax.

32. 430 U.S. 274 (1977).

33. The significance of the phrase “substantial nexus” in *Complete Auto* has been the subject of controversy. Some commentators believe that “substantial” was not intended to signal a divergence between the Commerce Clause and due process nexus standards. See generally Richard D. Pomp & Michael J. McIntyre, *State Taxation of Mail-Order Sales of Computers After Quill: An Evaluation of MTC Bulletin 95-1*, 1996 ST. TAX TODAY 140–44, at Doc. 96-19908 (July 19, 1996) (noting that the *Complete Auto* and predecessor Courts used the expressions “nexus” and “substantial nexus” almost interchangeably). *Quill* resolved this question by holding that these two standards do diverge. See *infra* text accompanying notes 74–89. Further, *Quill*, for the most part, clarifies what “substantial nexus” means in the context of state sales and use taxes by establishing the bright-line physical presence test. See *id.* In this Article, “nexus” and “substantial nexus” are used interchangeably.

34. *Complete Auto*, 430 U.S. at 279 (emphasis added).

3. The tax must not “discriminate against interstate commerce;”³⁶ and

4. The tax must be “fairly related to the services provided by the State.”³⁷

Before deciding *Complete Auto*, the Court had wrestled with various “free trade” interpretations of the Commerce Clause.³⁸ *Complete Auto*, however, finally “abandoned the abstract notion that interstate commerce ‘itself’ cannot be taxed by the States.”³⁹ *Complete Auto* repudiated the wooden formalism of earlier Commerce Clause analysis because it bore “no relationship to economic realities.”⁴⁰ *Complete Auto* and subsequent Supreme Court decisions have consistently reiterated that modern Commerce Clause jurisprudence is grounded in “pragmatism”⁴¹ and “economic realities,”⁴² and is disdainful of “formalism,”⁴³ “magic words,”⁴⁴ and “labels.”⁴⁵ It is important to keep these admonitions in mind when interpreting the prong of the *Complete Auto* test most relevant to the taxation of remote sellers: substantial nexus.

B. SUBSTANTIAL NEXUS AND REMOTE SELLERS: THE PHYSICAL PRESENCE TEST

In 1944, the Court decided two cases that have since set the tone for sales and use tax collection. *McLeod v. J.E. Dilworth Co.*,⁴⁶ an Arkansas *sales tax* case, concerned Tennessee corporations selling machinery and supplies from their Tennessee location. They had no offices or any other places of business in Arkansas. Instead, traveling salespersons, who resided in Tennessee, solicited orders in person, by mail, or by telephone. Acceptance of orders, shipment of goods, and passage of title, however, all occurred in Tennessee.⁴⁷ The Court held that the Commerce Clause

35. *Id.*

36. *Id.*

37. *Id.*

38. *See, e.g.*, *Freeman v. Hewit*, 329 U.S. 249, 252 (1946) (noting that the Commerce Clause “by its own force created an area of trade free from interference by the States”).

39. *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988).

40. *Complete Auto*, 430 U.S. at 279.

41. *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992).

42. *Complete Auto*, 430 U.S. at 279.

43. *Trinova Corp. v. Michigan Dep’t of Treasury*, 498 U.S. 358, 373 (1991).

44. *Quill Corp.*, 504 U.S. at 310 (quoting *Ry. Express Agency, Inc. v. Virginia*, 358 U.S. 434, 441 (1959)).

45. *Id.* *See generally* HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 4.11[1] (describing Supreme Court’s characterization of its Commerce Clause jurisprudence).

46. 322 U.S. 327 (1944).

47. *Id.* at 328.

prohibited the imposition of an Arkansas *sales* tax: “For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.”⁴⁸

On that same day, the Court decided *General Trading Co. v. State Tax Commission*,⁴⁹ which involved an Iowa *use tax* collection obligation imposed on a company that solicited orders through traveling salespersons sent into Iowa from its Minnesota headquarters. The Minnesota corporation had no offices, permanent employees, or property in Iowa. The orders were accepted in Minnesota, and the goods were shipped to Iowa by common carrier or mail.⁵⁰ The only significant difference between the two cases was that Arkansas imposed a *sales* tax on the vendor, whereas Iowa imposed a *use* tax on the Iowa purchaser that was to be collected by the Minnesota vendor.⁵¹ The difference was deemed crucial, and a unanimous Court sustained the assessment:

The tax is what it professes to be—a non-discriminatory excise laid on all personal property consumed in Iowa. The property is enjoyed by an Iowa resident partly because the opportunity is given by Iowa to enjoy property no matter whence acquired. The exaction is made against the ultimate consumer—the Iowa resident who is paying taxes to sustain his own state government. To make the distributor the tax collector for the State is a familiar and sanctioned device.⁵²

Although these two cases reflect the formalism characteristic of pre-*Complete Auto* Commerce Clause jurisprudence, they established the sales-use tax dichotomy that still exists today. Sales made from within the state are subject to a sales tax while sales made by remote sellers are subject to a use tax. Further, remote sellers may be compelled to collect a use tax from their customers if the remote sellers have sufficient in-state contacts.

As a practical matter, it is virtually impossible for a state to collect a use tax from each individual consumer who makes a purchase from an out-of-state vendor. Accordingly, the power to impose a use tax collection obligation on the seller is crucial to the States.⁵³ With that power, the use

48. *Id.* at 330.

49. 322 U.S. 335 (1944).

50. *Id.* at 337.

51. *See id.* at 336; *McLeod*, 322 U.S. at 328.

52. *General Trading*, 322 U.S. at 338.

53. Most consumers, other than business consumers, do not self-assess use tax on mail-order or Internet purchases. Some states do require self-reporting on state income tax returns, but this reporting requirement is not a very effective enforcement mechanism because of the administrative infeasibility of auditing reported amounts without some sort of reporting obligation on the part of the out-of-state seller. *See, e.g., Alabama DOR Announces Consumer Use Tax Line Item on 2000 Income Tax Return*,

tax becomes the economic and functional equivalent of the sales tax. If, however, a state does not have the power to impose a use tax collection obligation, the sales and use taxes no longer function equivalently. The state loses revenue, and in-state vendors who collect taxes on identical transactions are put at a competitive disadvantage.

As noted, a remote seller can be subject to a use tax collection obligation only if it has a substantial nexus with the state. The Supreme Court first squarely addressed the jurisdiction of a state to impose a use tax collection obligation on a “pure” mail-order company in *National Bellas Hess, Inc. v. Department of Revenue*.⁵⁴ In *Bellas Hess*, Illinois sought to impose a use tax collection obligation on a mail-order company whose only contacts with Illinois were the use of the U.S. mail and common carriers to deliver catalogues and merchandise. The company had no Illinois offices, warehouses, or employees, and no salespersons physically entered the state for the purpose of soliciting orders.⁵⁵ The Court sustained the taxpayer’s challenge, holding that these contacts were not sufficient to allow the state to impose a use tax collection obligation.⁵⁶ *Bellas Hess* had challenged the tax under both the Due Process and Commerce Clauses.⁵⁷ Whether the Court relied on both clauses is somewhat unclear, though it appears that the Court treated these considerations as essentially identical.⁵⁸

One interesting, but seldom (if ever) noted aspect of *National Bellas Hess* is that *Bellas Hess* did concede “its obligation to collect a use tax in Alabama, Kansas, and Mississippi, since it has retail outlets in those States.”⁵⁹ The dissent implied that these retail outlets were “wholly-owned subsidiaries.”⁶⁰ Thus, one plausible reading of the *Bellas Hess* decision is that it may have involved a taxpayer that treated the contacts of its

2001 ST. TAX TODAY 28-1, at Doc. 2001-3779 (Feb. 9, 2001); *North Carolina Final HB 1433 Provides for Payment of Use Tax with Income Tax Returns*, 1999 ST. TAX TODAY 168-32, at Doc. 1999-27796 (Aug. 31, 1999). An intriguing information reporting system in the form of an information sharing arrangement between states has been proposed, but it has doubtful political feasibility, and administration would also be troublesome. See Richard Mason & Lynn Bible, *Use Tax Avoidance: A Self-Help Solution for States*, 2000 ST. TAX TODAY 243-36, at Doc. 2000-32478 (Dec. 18, 2000). Further, as the authors point out, not all states have an income tax, nor are all consumers income tax payers. *Id.*

54. 386 U.S. 753 (1967).

55. *Id.* at 754–55.

56. *Id.* at 758.

57. *Id.* at 756.

58. The *Quill* Court unequivocally treated *Bellas Hess* as both a due process and Commerce Clause decision. *Quill Corp. v. North Dakota*, 504 U.S. 298, 305 (1992).

59. 386 U.S. at 757 n.10.

60. *Id.* at 760. Cf. MOODY’S INDUSTRIAL MANUAL 2710–11 (1962) (summary description of National Bellas Hess corporate structure).

subsidiary corporations as sufficient to give rise to sales-use tax jurisdiction.⁶¹

In *Quill Corp. v. North Dakota*,⁶² the Court reaffirmed the *National Bellas Hess* result on Commerce Clause grounds alone.⁶³ The Court overruled *Bellas Hess*' holding, however, that the Due Process Clause protected remote sellers without a physical presence in a state from taxation.⁶⁴ This decoupling of the Commerce Clause and due process nexus standards cleared the way for Congress to exercise its Commerce Clause powers affirmatively to authorize state taxation of remote sellers without a physical presence in the taxing state.⁶⁵ Because *Quill* sets forth the contemporary substantial nexus standard—the first prong of the *Complete Auto* test—it merits closer examination.⁶⁶

The facts of *Quill* are in all pertinent respects identical to those of *Bellas Hess*. *Quill* was a national mail-order supplier of office products. It had neither retail outlets nor sales representatives in North Dakota.⁶⁷

61. The Court, however, clearly did not reach this issue. If *Bellas Hess* indeed involved a concession on the part of the taxpayer that the contacts of its subsidiaries gave rise to nexus, reliance, or stare decisis arguments against affiliate nexus are somewhat weakened.

62. 504 U.S. 298 (1992).

63. *See id.* at 318.

64. *See id.* at 308.

65. *See id.* at 318. Even prior to *Quill*, legislation had been routinely introduced in Congress that would authorize states to impose a use tax collection obligation on remote sellers. *Id.* at 318 n.11 (citing prior legislative attempts to “overrule” the *Bellas Hess* decision). *See also* Eugene F. Corrigan, *Holding the Bright-Line: Quill Decision Redirects State Use Tax Collection Efforts*, 92 ST. TAX NOTES 190-30 (Sept. 30, 1992) (discussing a near twenty-year history of pre-*Quill* legislative attempts to authorize state taxation of mail-order companies).

66. As a result of *Bellas Hess* and *Quill*, the constitutional question has been decided for the time being. The policy question of whether Congress *should* exercise its Commerce Clause power to allow state taxation of mail-order or electronic retailers, however, remains. The conflicting views expressed in the majority and dissenting opinions in *Bellas Hess* well summarize the persistent policy debate regarding the taxation of remote sellers. The *Bellas Hess* majority noted the burdens that would be placed on interstate commerce if mail-order companies were required to collect a use tax in all states in which they sold products:

The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [Bellas Hess'] 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.”

386 U.S. at 759–60.

Three Justices dissented:

There should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient “nexus” to require Bellas Hess to collect from Illinois customers. . . . Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein. . . . To excuse Bellas Hess from this obligation is to burden and penalize retailers located in Illinois who must collect the sales tax from their customers.

Id. at 761–63.

67. *Quill Corp.*, 504 U.S. at 301.

Quill's mail-order sales to North Dakota customers totaled nearly \$1 million, making Quill North Dakota's sixth largest office products supplier.⁶⁸ North Dakota sought to impose a use tax collection obligation on Quill. The North Dakota Supreme Court upheld the assessment, citing changes in the legal, economic, and technological landscape since the *Bellas Hess* decision.⁶⁹ The court observed that *Bellas Hess* was decided prior to *Complete Auto*, which rejected "formalism" and embraced "economic realities"⁷⁰ in Commerce Clause analysis.⁷¹ In addition, the mail-order industry had grown from "a relatively inconsequential market niche" in 1967 to a "goliath."⁷² Moreover, "advances in computer technology greatly eased the burden of compliance."⁷³

For the first time, the Court separately analyzed the Due Process and Commerce Clause nexus standards and found them to be different.⁷⁴ Due process, it found, "centrally concerns the fundamental fairness of governmental activity."⁷⁵ "Notice" and "fair warning" were the "analytic touchstone" of due process nexus analysis.⁷⁶ "The Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'"⁷⁷

Finding that the Court's due process jurisprudence had "evolved substantially" in the twenty-five years since *Bellas Hess*, the Court had little trouble ruling that due process was satisfied:

[A] mail-order house that is engaged in continuous and widespread solicitation of business within a State . . . has "fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." . . . [I]t matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers

In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents [and] that the magnitude of those contacts is more than sufficient for due process purposes⁷⁸

68. *Id.* at 302.

69. *Id.* at 301.

70. *Complete Auto*, 430 U.S. at 279.

71. *Id.* at 310. *See also supra* Part II.A.

72. *Quill Corp.*, 504 U.S. at 303 (quoting decision below, 470 N.W.2d 203, 208 (1991)).

73. *Id.* (citing decision below, 470 N.W.2d at 215).

74. *See id.* at 305 ("[A]lthough we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.").

75. *Id.* at 312.

76. *Id.*

77. *Id.* at 306 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954)).

78. *Id.* at 308 (quoting *Shaffer v. Heitner*, 433 U.S. 186, 218 (1977) (Stevens, J., concurring in judgment)).

In contrast to the Due Process Clause, the Court found that the Commerce Clause and its nexus requirement “are informed not so much by concerns about fairness for the individual . . . as by structural concerns about the effects of state regulation on the national economy.”⁷⁹ The Court acknowledged that its recent decisions demonstrated a “retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach.”⁸⁰ Nevertheless, it determined that the formalistic approach of the physical presence rule served the legitimate Commerce Clause function of creating a “bright-line”⁸¹ test for remote vendors, avoiding “controversy and confusion,”⁸² encouraging “settled expectations,”⁸³ and fostering interstate commerce in mail-order goods.⁸⁴ Assuming that this test draws a bright constitutional line between sellers who purposefully exploit a local market through physical presence versus those who purposefully exploit that market through other means, the Court insisted that this “artificiality” was “more than offset by the benefits of a clear rule.”⁸⁵

The Court did express some uneasiness about its decision. It hinted that its contemporary Commerce Clause jurisprudence might not support a physical presence test if the case were one of first impression.⁸⁶ Nevertheless, the Court concluded—in the interest of settled expectations and the “principle of *stare decisis*”—that the *Bellas Hess* rule remained “good law.”⁸⁷ The Court found some comfort in the removal of the due process obstacle: “our decision is made easier by the fact that the underlying issue is . . . one that Congress has the ultimate power to resolve.”⁸⁸ Accordingly, the Court concluded that “the better part of both wisdom and valor” is to “withhold[] our hand, *at least for now*.”⁸⁹

79. *Id.* at 312.

80. *Id.* at 314 (quoting the decision below, 470 N.W.2d 203, 214) (1991)).

81. *Id.* at 315.

82. *Id.* (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457–58 (1959)).

83. *Id.* at 316.

84. *Id.*

85. *Id.* at 315.

86. *Id.* at 311.

87. *Id.* at 317.

88. *Id.* at 318.

89. *Id.* at 318–19 (quoting *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 637–38 (1981)) (emphasis added).

C. ATTRIBUTIONAL TAX NEXUS

In the jargon of this specialized field, an “attributorial nexus” is the nexus created when the physical presence or contacts of A are “attributed” to B for the purpose of determining substantial nexus.⁹⁰ This is not a radical concept. For example, corporate nexus is *necessarily* attributorial. A corporation is a legal construct and has no physical attributes.⁹¹ On one end of the spectrum, *Quill* informs us that the physical presence of a common carrier or the U.S. Postal Service is not attributable to a remote corporation for tax nexus purposes.⁹² On the other end of the spectrum, corporate employees and property clearly are physical contacts attributable to a corporation.

The Supreme Court has given some guidance as to other types of relationships that count as attributorial contacts. In *Scripto, Inc. v. Carson*, Florida sought to impose a use tax collection obligation on a remote seller that had no employees, offices, or other places of business in Florida.⁹³ *Scripto* was in the business of selling mechanical writing instruments with advertising printed on them.⁹⁴ It solicited orders from Florida customers through ten “specialty brokers,” each having a non-exclusive written contract and an assigned territory. Orders could be accepted only by the home office, and compensation was by commission only.⁹⁵ *Scripto* challenged the assessment on both Commerce Clause and due process grounds.⁹⁶

The Court held that the taxpayer had sufficient jurisdictional contacts in Florida to give rise to a use tax collection obligation.⁹⁷ That the specialty brokers were “not regular employees of appellant devoting full time to its service” was “a fine distinction . . . without constitutional significance.”⁹⁸ The “formal . . . tagging” of the brokers as independent contractors did not, in the Court’s view, change the economic function of the brokers of “securing a substantial flow of goods into Florida. . . . To

90. See generally Rosen, *supra* note 19.

91. 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7 (perm. ed., rev. vol. 1999) (“The corporation has no physical existence, but exists only in contemplation of law.”).

92. *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

93. 362 U.S. 207, 208–09 (1960).

94. *Id.* at 208.

95. *Id.* at 209.

96. *Id.* at 207.

97. *Id.* at 211.

98. *Id.*

permit such formal ‘contractual shifts’ to make a constitutional difference would open the gates to a stampede of tax avoidance.”⁹⁹

The *Scripto* Court did not engage in a formal inquiry into the law of agency,¹⁰⁰ and the opinion suggests that the Court may not have considered the salespersons to be the company’s legal agents.¹⁰¹ Instead, “[t]he test is simply the nature and extent of the activities of the appellant in Florida,” which included “continuous local solicitation” of orders.¹⁰²

Tyler Pipe Industries v. Washington Department of Revenue involved a similar fact pattern and reached a similar result.¹⁰³ The Court held that a remote seller had a sufficient nexus with the State of Washington—even though the seller had no employees, offices, or other property within the state.¹⁰⁴ The seller used an independent contractor to solicit sales and to maintain “valuable relationships” with customers, “name recognition,” “market share,” and “goodwill” within the state.¹⁰⁵ The showing of a sufficient nexus “could not be defeated by the argument that the taxpayer’s representative was properly characterized as an independent contractor instead of as an agent.”¹⁰⁶ The Court quoted with approval the determination of the Washington Supreme Court: “[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in [the] state for the sales.”¹⁰⁷

In another State of Washington case, a single employee established nexus by “ma[king] possible the realization and continuance of valuable contractual relations between appellant and [its primary customer],”¹⁰⁸ as

99. *Id.*

100. The theory of affiliate nexus presented in this Article does not rely on agency concepts. As a factual matter, however, some in-state affiliates may also be agents of an out-of-state seller/affiliate. In such cases, taxing authorities may rely on traditional agency notions or the extension thereof elucidated in *Scripto*. The theory of affiliate nexus presented in this Article is designed to extend to “mere” affiliates without an agency backdrop. The agency issue does arise, however, in the electronic commerce context, such as in connection with in-store “kiosks” for placing orders with the retailer’s Internet affiliate. It would seem that such transactions are clearly taxable under the authority of *Scripto*: the in-state affiliate is playing the role of the in-state *Scripto* salesman. *But see* Bennett, *supra* note 14 (discussing that Kmart is “confident” that its Internet subsidiary will not be taxable on such sales).

101. The company did not have “any regular employee or agent” in Florida. 362 U.S. at 209 (emphasis added).

102. *Id.* at 211–12.

103. 483 U.S. 232 (1987).

104. *Id.* at 249, 251.

105. *Id.* at 249 (quoting decision below, 715 P.2d 123, 127).

106. *Id.* at 250.

107. *Id.* (analysis of Washington Supreme Court, with which U.S. Supreme Court agreed).

108. *Standard Pressed Steel Co. v. Dep’t of Revenue*, 419 U.S. 560, 562 (1975).

well as resolving post-sale difficulties in the use of the remote seller's product.¹⁰⁹

This line of cases illustrates three major points. First, the physical presence of a corporation is always determined by attribution—attributorial nexus is not a special case. Second, the acts and presence of persons other than employees and legal agents can, at least in some instances, be attributed to corporations for the purpose of determining tax nexus. Third, the Court will look to economic substance and will be wary of the potential for tax avoidance when deciding which in-state persons and what kinds of in-state acts may be attributed to remote sellers for nexus determination purposes. This focus on economic realism is not inconsistent with the formalism of *Quill's* bright-line physical presence test. Although physical presence is a prerequisite for attributorial nexus, once established, the economic substance of the contact and the contact's relationship to the remote seller will determine whether the contact will be attributable to the remote seller. As the next Section demonstrates, the connection between the in-state person and the transaction that the state seeks to tax can be even more remote than has been suggested so far.

D. DIVISIONAL NEXUS¹¹⁰

The above cases addressed situations in which in-state representatives were connected with the development and maintenance of an in-state market for the remote seller's product. But the Court has gone even further in some cases, holding that the physical presence of a separate division of a company or in-state activities unrelated to the taxable transaction can be sufficient to establish a tax nexus.

More than half a century ago, the "Wal-Marts" of an earlier era, Sears and Montgomery Ward, sought Commerce Clause protection from the collection of use tax from the customers of the "Walmart.coms" of that era—their mail-order operations.¹¹¹ Unlike Walmart.com, however, the mail-order operations of Sears and Montgomery Ward were not separately

109. *Id.* at 561. See generally *Gen. Motors Corp. v. Washington*, 377 U.S. 436 (1964) (establishing nexus via activities of in-state personnel, out-of-state personnel performing in-state activities, and activities of corporate division).

110. As used in this section, "divisional nexus" means nexus created by the physical presence of a division of a single corporation. Other authors have used the term "branch" rather than "divisional." See, e.g., McIntyre, *supra* note 21, at 644.

111. *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941).

incorporated.¹¹² The Supreme Court upheld the imposition of an Iowa use tax collection obligation against these retailing giants whose operations included local Iowa stores. Sensing the tax avoidance possibilities, the Court admonished that the taxpayer “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.”¹¹³ Further, the taxpayer “cannot avoid [its tax burden] though its business is departmentalized. Whatever may be the inspiration for these mail orders, however they may be filled, Iowa may rightly assume that they are not unrelated to respondent’s course of business in Iowa.”¹¹⁴

The Court reached the identical conclusion much more recently, citing *Sears* and *Montgomery Ward* with approval.¹¹⁵ In *National Geographic Society v. California Board of Equalization*, the Court addressed the use tax collection obligation of a seller who had in-state contacts unrelated to the taxable transactions.¹¹⁶ National Geographic Society maintained two offices in California that solicited advertising copy for National Geographic Magazine.¹¹⁷ Depending on the time period, the offices were staffed with two to four employees.¹¹⁸ The employees, however, performed no activities related to National Geographic’s operation of a mail-order business for the sale of maps, atlases, globes, and books. Orders for these items were mailed from California directly to National Geographic’s Washington, D.C. headquarters.¹¹⁹

National Geographic contended that its physical contacts did not “count” because they were unrelated to the taxable transactions.¹²⁰ The Court held to the contrary: “such dissociation does not bar the imposition of the use-tax-collection duty.”¹²¹ Indeed, the Court turned to the

112. *Sears*, 312 U.S. at 362; *Montgomery Ward*, 312 U.S. at 374.

113. *See Sears*, 312 U.S. at 366.

114. *Id.* at 364. *Sears* and *Montgomery Ward* pre-date a number of important developments in due process and Commerce Clause jurisprudence, such as *International Shoe Co. v. Washington*, 326 U.S. 310 (1945) (establishing the modern Due Process Clause “minimum contacts” test) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (creating modern Commerce Clause test for state taxation jurisdiction). Nevertheless, these cases have survived, and *Sears* is cited with approval in *Quill*. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 n.4 (1992).

115. *Nat’l Geographic Soc’y v. Cal. Bd. of Equalization*, 430 U.S. 551, 555–59 (1977). Importantly, *National Geographic* was decided after the Court had established the modern Commerce Clause test in *Complete Auto*. *See supra* Part II.A.

116. 430 U.S. at 552–53.

117. *Id.* at 552.

118. *Id.* at 554 n.2.

119. *Id.* at 552.

120. *Id.* at 560.

121. *Id.*

venerable *Sears* and *Montgomery Ward* cases, observing that “the fact Sears’ business was *departmentalized—the mail-order and retail stores operations were separately administered*—did not preclude the finding of sufficient nexus.”¹²²

Thus, *National Geographic*, *Sears*, and *Montgomery Ward* stand for the proposition that the presence of a branch or division of a corporate taxpayer in a state creates a sufficient tax nexus even if the presence is unrelated to the transactions that the state wishes to tax. Unfortunately, however, *National Geographic* does not tell us whether the result would have been the same had the taxpayers separately incorporated their nexus-creating operations.

E. THE UNITARY BUSINESS PRINCIPLE AND COMBINED REPORTING

The relevance of the state income tax combined reporting cases to the theory of affiliate nexus is controversial. These cases are a *non sequitur* to some.¹²³ To others, these cases illustrate, at a minimum, the Court’s willingness to look through corporate formalities to economic realities when deciding state tax commerce clause questions.¹²⁴ Still others have suggested that these cases are all but dispositive because the combined reporting rules can effectively result in the taxation of the income of non-nexus corporations that are members of a unitary multi-corporate group.¹²⁵ This Section begins by explaining the unitary business principle and the corollary concept of combined reporting. The relevance of these principles to affiliate sales and use tax nexus is then considered.

122. *Id.* at 560 (emphasis added).

123. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 19.02[7][c] (unitary business concept inapplicable to sales and use tax nexus).

124. See McIntyre, *supra* note 21, at 643–44 (the Court’s Commerce Clause jurisprudence “has strongly indicated...that it will not permit the androgynous nature of corporations to defeat the goals of the Commerce Clause”). Phillip Blumberg and Kurt Strasser observe: “[T]he issues are closely related, and the cases involve precisely the same choice between enterprise and entity law... In the consideration of this issue, the recognition of enterprise principles in the Unitary Tax Cases will inevitably play a major role...” PHILLIP I. BLUMBERG & KURT A. STRASSER, *THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATE STATUTORY LAW* 426 (1995).

125. *Cf.* HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 19.02[7][c] (discussing and criticizing earlier suggestions by Multistate Tax Commission officials that unitary business principles may be applied to determine whether remote seller has use tax collection nexus).

1. The Unitary Business Principle and Formula Apportionment

Ever since the Court decided *General Trading*¹²⁶ and *Dilworth*,¹²⁷ sales and use taxes have been treated as destination-based transaction taxes. There is no apportionment of tax between the state of origin and the destination state, and credits are allowed to avoid the risk of double taxation. State taxes on net business income, however, are different. Consider a business with manufacturing operations in State A, administrative offices in State B, a distribution center in state C, and customers in States A, B, C, and D. Certainly all four states contribute to the company's net income, but how should that income be allocated or apportioned to each of these states? The theoretical and administrative difficulties in making this determination are readily apparent.

One constitutionally blessed solution is formula apportionment.¹²⁸ Rather than attempt to arbitrarily carve out each separate component of the business and separately account for net income, the Court has allowed states to use the total net income of the business as a starting point.¹²⁹ The state may then use a reasonable apportionment formula to apportion some fraction of that income to the state for income tax purposes.¹³⁰ One well recognized apportionment method is to multiply the company's total net income ("apportionment base") by the average of the ratios of the company's (1) in-state property to total property ("property factor"), (2) in-state payroll to total payroll ("payroll factor"), and (3) in-state sales to total sales ("sales factor").¹³¹

A prerequisite to the formula apportionment of business income is that the business be "unitary." The precise constitutional contours of a "unitary

126. 322 U.S. 335 (1944). See discussion *supra* Part II.B.

127. 322 U.S. 327 (1944). See discussion *supra* Part II.B.

128. See, e.g., *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 119-21 (1920) (early Supreme Court endorsement of formula apportionment of multi-state business income).

129. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436 (1980).

130. See *id.*

131. The formula in the text is set forth in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT §§ 9, 10, 13, 15, 7A U.L.A. 331 (1999). See generally POMP & OLDMAN, *supra* note 21, at 10-7 to 10-56 (explaining various methods). The Supreme Court has given the states wide latitude in adopting various apportionment formulae. See, e.g., *Underwood Typewriter*, 254 U.S. at 120-21 (taxpayer failed to show that formula was "inherently arbitrary"); *Moorman Mfg. v. Bair*, 437 U.S. 267, 273 (1978) (reiterating that the Court "has refused to impose strict constitution restraints on a state's selection of a particular formula"). However, the three-factored formula described in the text has become "something of a benchmark against which other apportionment formulas are judged." *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983).

business” are much disputed and often litigated.¹³² In general terms, the Court has characterized a unitary business as involving “functional integration, centralization of management, and economies of scale.”¹³³ A unitary business can also be characterized by a “sharing or exchange of value” among its parts.¹³⁴ In contrast, a non-unitary business is a “discrete business enterprise” involving “unrelated” business activity.¹³⁵ Although the ultimate characterizations of particular businesses is challenging and controversial, the basic idea is simple: a unitary business is an integrated, interdependent, synergistic whole.¹³⁶ Thus any attempt to divide it into two or more parts and then measure net income would be both artificial and administratively impractical.¹³⁷

The unitary business touchstones of integration, interdependence, and the like are predicated on more than administrative convenience. By including income in the apportionment base that is generated by out-of-state activities, the Commerce Clause requires that there be some connection between that income and a business’s in-state activities. Without such relationship, the state would have no “nexus”¹³⁸ with that out-of-state income and could not include it in the apportionment base.¹³⁹ To be sure, it is the in-state activities of a unitary business (typically in-state property, payroll, and sales) that determine what portion of that

132. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 8.07[2]; POMP & OLDMAN, *supra* note 21, at 10-20 & n.109.

133. *Mobil Oil Corp.*, 445 U.S. at 438.

134. *Container Corp.*, 463 U.S. at 166.

135. *Mobil Oil Corp.*, 445 U.S. at 439.

136. POMP & OLDMAN, *supra* note 21, at 10-20.

137. Pomp and Oldman explain:

[S]ome of the indicia of a unitary business [are]: unity of use and management [citing *Butler Bros. v. McColgan*, 315 U.S. 501 (1942)]; a concrete relationship between the out-of-state and the in-state activities [citing *Container Corp.*, 463 U.S. at 166]; functional integration, centralization of management, economies of scale [citing *Mobil Oil Corp.*, 445 U.S. at 438]; substantial mutual interdependence [citing *F.W. Woolworth Co. v. Taxation & Revenue Dep’t*, 458 U.S. 354, 371 (1982)]; some sharing or exchange of value not capable of precise identification of measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation [citing *Container Corp.*, 463 U.S. at 166].

POMP & OLDMAN, *supra* note 21, at 10-20 to 10-21.

138. The “nexus” here is with the income, not necessarily the taxpayer. See *Complete Auto*, 430 U.S. at 279 (activities subject to tax must have a nexus with the state). Still, there is obviously a strong relationship between nexus with income and nexus with the entities that generated the income. See *infra* notes 156–63 and accompanying text.

139. HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 8.07[1] (noting that “the Court focused on the underlying factors that create[] an organic connection between the corporation’s activities within and without the state and that warrant[] the state’s consideration of the corporation’s out-of-state activities in determining the tax base properly attributable to its in-state activities”).

income is taxable by the state, but it is still the entire income of the business that is being subjected to the state's taxing powers.¹⁴⁰

2. Combined Reporting

What if an otherwise unitary business is multi-corporate, divided into corporate affiliates rather than divisions? May it still be treated as a single unitary business for state income tax apportionment purposes? The Court has answered affirmatively. In *Container Corp. v. Franchise Tax Board*, it held that "respect[ing] formal corporate lines . . . is not constitutionally required."¹⁴¹ Quoting its decision in *Mobil Oil*, the Court noted: "Superficially, intercorporate division might appear to be a[n] . . . attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise."¹⁴²

Including more than one corporate entity in a unitary group is known as combined reporting. One important aspect of combined reporting is that it permits a state to include in the unitary tax base the income of members of the combined group who on a stand-alone basis are not subject to the state's taxing jurisdiction.¹⁴³ For example, if a unitary business is comprised of separately incorporated retail outlets in States A, B, and C, the apportionment bases in States B and C could include income generated by the separately incorporated store in state A, notwithstanding that this store has no physical presence in States B and C, at least on a stand-alone basis. This may seem unremarkable at first blush. Although any income generated by the State A affiliate subsidiary is apportionable to States B and C, the numerators of the property, payroll, and sales factors in State B and C will not include any of the State A store's attributes. In other words, it would seem that no weight will be given to the store in State A in determining the percentage of apportionable income that actually will be apportioned to States B and C.

But this is not always the case. Assume, for example, that the State A affiliate makes mail-order or Internet sales into States B and C. These sales

140. See *id.* See also *Mobil Oil Corp.*, 445 U.S. at 438–40 (1980) (unity of use and management of a business justified the state's inclusion of the income generated by out-of-state activities in the apportionable tax base).

141. 463 U.S. 159, 167–68 (1983).

142. *Id.* at 168 (quoting *Mobil Oil*, 445 U.S. at 440) (alteration in original).

143. See *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 304–07 (1994) (income of more than 220 affiliated corporations apportionable to California even though only two had California operations). See generally POMP & OLDMAN, *supra* note 21, at 10-31 (discussing "pure" versus "hexus" combined returns).

would be included in the numerators of the combined group's sales factors in those states. As a result, the mail-order and Internet sales by the State A store clearly could cause more of the combined group's income to be apportioned to States B and C even though the store in State A has no nexus with States B and C on a stand-alone basis.¹⁴⁴

3. Relevance of Combined Reporting Concepts to Affiliate Nexus

One cannot immediately leap from these observations about the combined reporting and formula apportionment to conclusions about jurisdiction to tax each member of a combined group. The unitary business and apportionment concepts were developed to address the apportionment of income to a state; they do not directly address a state's jurisdiction to tax (although the two are closely related¹⁴⁵). The unitary business principle determines what income is apportionable to a state, but the Court has cautioned that a determination that an affiliate is a member of a combined group may not mean that the state has jurisdiction to tax that affiliate.¹⁴⁶ The Court has not yet been required to address this question directly because state statutes sidestep the issue by treating the nexus members (on a stand-alone basis) of the combined group as the actual taxpayers,

144. Although this result is constitutionally permissible, its implications are the subject of vigorous and complex debate. Complexity arises from several quarters. First, state apportionment formulas often have rules that either "throw-back" sales of non-nexus affiliates to the state of origin, or "throw-out" those sales altogether for the purpose of sales factor computation. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 9.18[1][b]–[c]. Second, some state statutes provide only for nexus combination—non-nexus affiliates are not included in the combined group. See POMP & OLDMAN, *supra* note 21, at 10–31. These first two approaches, though not constitutionally required, tend to skirt the non-nexus affiliate issue altogether. Third, a federal statute, popularly known as P.L. 86-272, offers statutory income tax protection to remote sellers of tangible personal property whose physical presence in a state is limited to the solicitation of orders by sales representatives. 15 U.S.C. § 381 (Supp. 2001). As a result, many of the disputes and much of the commentary on this issue address the purely statutory question of whether P.L. 86-272 prohibits the inclusion of non-nexus sales in the numerator of the sales factor. See, e.g., HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 6.16–6.27. Fourth, taxes measured by unitary group principles are still usually assessed against nexus members of the group. See *infra* note 147 and accompanying text. This again serves to skirt the Commerce Clause jurisdictional issue.

145. See *infra* notes 152–62 and accompanying text.

146. See *Barclays Bank PLC*, 512 U.S. at 311 n.10. In responding to the taxpayers' argument that formula apportionment was, in effect, the assertion of jurisdiction over non-nexus members of the unitary group, the Court noted:

Formulary apportionment of the income of a multijurisdictional (but unitary) business enterprise, if fairly done, taxes only the "income generated within a State." . . . The California presence of the [two] taxpayers [out of more than 220 members of a unitary group] before us is undisputed, and we find nothing in *Quill* to suggest that California may not reference the income of corporations worldwide with whom those taxpayers are closely intertwined in order to approximate the taxpayers' California income.

Id. (citation omitted).

notwithstanding that the net income and attributes of the entire combined group are used to measure the income apportionable to the state.¹⁴⁷

Further, the Court has never specifically addressed the question of whether a state has jurisdiction to tax a non-nexus member (on a stand-alone basis) of a combined group solely because that member has in-state sales that add weight to the combined group's apportionment factor. The Court's typical response when taxpayers complain about the anomalous results produced by formula apportionment is that the taxpayer must demonstrate that the apportionment is "out of all appropriate proportion to the business" being taxed.¹⁴⁸ Indeed, the Court has stated that the Commerce Clause "does not [invalidate] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State."¹⁴⁹ The Court has adhered to the notion that apportionment formulas are simply means to determine what income may be attributable to nexus affiliates.¹⁵⁰ Because the Court allows such imprecision in the effects of apportionment formulas, it is risky to draw jurisdictional conclusions from the results apportionment formulas produce under particular facts.¹⁵¹

Notwithstanding these caveats, the combined reporting cases do nevertheless support to some degree a theory of affiliate sales and use tax nexus. At the very least, these cases demonstrate the Court's willingness to look through formal corporate structures to economic reality in determining whether a state taxing statute passes Commerce Clause muster.

Just as the unitary business concept was born of the policy considerations underlying the apportionment of income (i.e., the practical

147. See Michael J. McIntyre, Paull Mines, & Richard D. Pomp, *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana*, 2001 ST. TAX TODAY 171-11, at Doc. 2001-23001 (Aug. 16, 2001) (explaining tax assessment schemes in Section IV.A.1). Pierre Vogelenzang, *Second-Stage Apportionment of Unitary Income*, TAX NOTES, Oct. 15 1990, at 335; HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 9.18[1][a][ii]. At least one state court has declined to assert income tax jurisdiction over a non-nexus (on a stand-alone basis) affiliate of a unitary group. *MCI Int'l Telecomms. Corp. v. Comptroller of the Treasury*, No. C-96-0028-01, 1999 WL 322702 (Md. Tax. Ct. Apr. 26, 1999), *aff'd*, No. 24-C-002387 AA (D. Md. Mar. 17, 2000).

148. *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931). See also *supra* note 131.

149. *Container Corp.*, 463 U.S. at 169 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272 (1978)) (emphasis in original).

150. *Barclays Bank PLC*, 512 U.S. at 311 n.10. See also *supra* note 146.

151. This caveat pertains only to formula apportionment, but not the antecedent step of determining what income is apportionable by application of the unitary business principle. A further cautionary note in applying state income tax precedents to sales and use tax nexus analysis is that *Quill's* physical presence test has been interpreted by some to be inapplicable to income tax nexus. See POMP & OLDMAN, *supra* note 21, at 10-25 to 10-26 (concisely explaining the controversy and its implications).

and theoretical difficulty in measuring the income earned by business activities in a state that are a mere fragment of a larger integrated enterprise), affiliate nexus is supported by the policy considerations underlying the nexus prong of the *Complete Auto* test as explicated in *Quill*. At bottom, *Quill* addresses the burden placed on interstate commerce by the assertion of taxing jurisdiction over remote sellers.¹⁵² The *Quill* court adopted a physical presence test in furtherance of this policy goal. The *Quill* court did not, however, reject earlier cases, such as *Scripto*, that allowed the attribution of a third party physical presence to remote vendors.¹⁵³ Nor did the Court announce that simply because the physical presence test is “artificial at its edges”¹⁵⁴ that it would be wooden and formalistic in determining what physical contacts count.¹⁵⁵

When faced with the artifice of separately-incorporated remote seller affiliates, it is difficult to contend that the Court would see these entities as standing in the same shoes as remote sellers that are unaffiliated with in-state retailers. The question would then be whether formal corporate structure should control the Court’s decision, or whether the underlying economic reality should. Put differently, was the Commerce Clause really intended to protect entities like Walmart.com? Like combined reporting, the adoption of an affiliate nexus rule under these facts simply would be another instance of the Court recognizing economic realities in interpreting the protections of the dormant Commerce Clause. Thus, it is not the combined reporting cases that compel this result. It is the Court’s recognition of underlying economic realities that does.

The combined reporting cases suggest an even stronger argument in support of affiliate nexus. As noted, whenever a non-nexus (on a stand-alone basis) member of a combined group makes in-state sales, those sales may constitutionally be included in the sales factor of the apportionment formula.¹⁵⁶ This has the practical effect of apportioning some of the income of that affiliate to the state. From here, it is a small step to say that there is jurisdiction to tax such affiliate. If a taxpayer’s income can be fairly apportioned to a state, then it would seem that the taxpayer also would have sufficient nexus. If not, we are left with the artifice of first

152. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992) (the nexus prong of the Complete Auto test is “a means for limiting state burdens on interstate commerce”).

153. See *id.* at 306.

154. *Id.* at 315.

155. See *id.* at 315 n.8 (although floppy disks were physically present, they did not meet physical presence test); *id.* at 315 (nexus determination “may turn on the presence in the taxing State of a small sales force, plant, or office”).

156. See *supra* note 144 and accompanying text.

apportioning combined income among all members of the group, and then attributing such income only to nexus (on a stand-alone basis) members.¹⁵⁷ The economic reality, however, is that the income was earned by the combined group as a whole.

As noted, the Supreme Court has not squarely address this argument, but neither has it foreclosed it.¹⁵⁸ Moreover, the Court's liberal acceptance of various apportionment schemes and results¹⁵⁹ is not a strong counter-argument to this line of reasoning. The de facto taxation of remote sellers under these circumstances is not an anomalous result of imprecise, yet constitutional, apportionment formulae. It is a necessary result of including the sales of these affiliates in the numerator of the sales factor and including their net income in the apportionable tax base. Both of these are theoretically (and intuitively) correct steps in attributing unitary business income to a state.¹⁶⁰

4. Combined Reporting, Attribution and Merger

Some of the confusion surrounding the debate about the relevance of the combined reporting cases to affiliate nexus is the failure to distinguish between the concepts of attribution and merger.¹⁶¹ "Attribution" means that the legal relationship between A and B is such that the acts or jurisdictional contacts of A may be attributed to B. Agency is a typical attributional relationship. "Merger" means that the A's acts or jurisdictional contacts are also treated as the acts or contacts of B because their separate identities are merged. "Piercing the corporate veil" is an example of the "merger" theory in the non-tax substantive law context.¹⁶²

The unitary business cases are theoretically predicated on the concept of merger. Indeed, the Court observed in one of its first unitary business

157. In some cases this might even require the in-state affiliate to "collect" the tax, or some portion of it, from non-nexus (on a stand-alone basis) members. The Court has not seemed troubled by this possibility. See McIntyre, *supra* note 21, at 643 (arguing that it has been no defense to combined reporting scheme that the in-state entities have no "legal authority to require all of the other affiliated companies to cooperate" with the state).

158. See *supra* note 147 and accompanying text.

159. See *supra* note 148 and accompanying text.

160. As noted, in-state sales are considered to be income-producing activities occurring in the state and thus add weight to the state's apportionment factor. When these sales are made by out-of-state affiliates, they still may be constitutionally considered in determining the amount of combined group income apportioned to the state.

161. See Lea Brilmayer & Kathleen Paisley, *Personal Jurisdiction and Substantive Legal Relations: Corporations, Conspiracies, and Agency*, 74 CAL. L. REV. 1, 2 (1986) (three methods are posited which "affect the jurisdictional balance:" attribution, merger, and substitution).

162. *Id.* at 14, 24–28.

cases, which addressed the property taxation of a multi-state railroad: “a railroad must be regarded for many, *indeed for most purposes*, as a unit.”¹⁶³ The modern combined reporting cases follow this same principle. The unitary business, multi-corporate or not, is treated as a single entity. This does not mean that the members of the combined group are merged for corporate law purposes. Nor does it mean that the “corporate veil” has been pierced. It means that they are “merged” for the specific legal purpose of apportioning income for state income tax purposes. Merger for this limited purpose has been constitutionally blessed.¹⁶⁴ Logical and theoretical consistency would strongly suggest that the “merger” approach to state income tax apportionment would also apply to a state’s jurisdiction to tax.¹⁶⁵

The viability of the theory of affiliate nexus hinges largely on whether a merger theory of jurisdiction is limited by the precise contours of substantive corporate law doctrine, particularly veil-piercing doctrine. The adoption of the merger theory in the unitary business cases supports, but does not compel, a more liberal approach. Part IV.A examines parallel developments in the law of personal jurisdiction. First, however, Part III explores the few state courts cases that have addressed affiliate sales and use tax nexus.

III. AFFILIATE NEXUS: THE RECORD TO DATE

Courts have yet to address directly the issue of affiliate nexus in the context of electronic commerce. Several state courts, however, have addressed the taxation of remote mail-order subsidiaries with respect to in-state brick-and-mortar retailers. All of these cases reject the theory of affiliate nexus—at least in result. Nevertheless, a careful examination of these cases reveals that only one addresses the constitutionality of the theory of affiliate nexus head-on. Of the remaining two cases, one was decided on statutory grounds, while the other explored only whether an agency relationship existed between the in-state retailer and its mail-order affiliate.

In *Bloomington’s By Mail, Ltd. v. Commonwealth*,¹⁶⁶ a mail-order subsidiary (“By Mail”) of Federated Department Stores, Inc. (“Federated”)

163. *State Railroad Tax Cases*, 92 U.S. 575, 608 (1875) (emphasis added).

164. *See supra* note 141 and accompanying text.

165. Because of the potential for confusion and misinterpretation when using the term “merger,” “unitary” or “enterprise” principles will be referred to when applying the “merger” concept in the remainder of this Article.

166. 567 A.2d 773 (Pa. Commw. Ct. 1989).

sought a declaratory judgment that it was not subject to a Pennsylvania use tax collection obligation.¹⁶⁷ By Mail conducted a nationwide mail-order business from its offices in Virginia and from its wholly-owned fulfillment center in Connecticut. Mail and phone orders were received at these locations and products were shipped to Pennsylvania customers by common carrier or U.S. mail. Prior to the separate incorporation of By Mail, the Bloomingdale's division ("Bloomingdale's") of Federated conducted similar mail-order operations. On a stand-alone basis, By Mail had no physical presence in Pennsylvania. Further, because customers used various third-party credit cards to make purchases, including the Bloomingdale's credit card, By Mail was never required to enter the state for the purpose of making collection on delinquent accounts.¹⁶⁸

Bloomingdale's, however, operated several retail stores in Pennsylvania. Further, on two separate occasions, employees of the Pennsylvania Department of Revenue were able to return products purchased from By Mail to local Bloomingdale's stores and receive refunds from Bloomingdale's rather than from By Mail. Finally, By Mail and Bloomingdale's sold at least some products that were identical and that bore the Bloomingdale's brand.¹⁶⁹

The Department argued that By Mail's separate corporate existence was "a mere legal formality which cannot control constitutional considerations."¹⁷⁰ Further, according to the Department, nexus was established under *Scripto* because an agency relationship existed between By Mail and Bloomingdale's.¹⁷¹ The Department also contended that a nexus exists "where the affiliated in-state corporation is not directly related to the mail order business from which tax collection is sought," citing *Reader's Digest Association v. Mahin*.¹⁷² In *Reader's Digest*, the Illinois Supreme Court had found a sufficient tax nexus where an out-of-state parent corporation operating as both a magazine publisher and a book and album mail-order company owned an in-state subsidiary that solicited magazine orders on behalf of the parent. The court found a nexus even though the state sought to tax only the mail-order sales.¹⁷³

167. *Id.* at 775–76. See generally Timothy H. Gillis, Note, *Collecting the Use Tax on Mail-Order Sales*, 79 GEO. L.J. 535, 535 (1991) (describing *Bloomingdale's By Mail* decision).

168. *Bloomingdale's By-Mail*, 567 A.2d at 775.

169. *Id.* at 776.

170. *Id.* at 778.

171. *Id.* See also *supra* notes 93–102 and accompanying text.

172. *Id.* at 777 (citing 255 N.E.2d 458 (1970)).

173. *Reader's Digest*, 255 N.E.2d at 460. The magazine sales were tax-exempt. *Id.* at 459.

The court treated the case as turning largely on the question of agency, reading *Reader's Digest* as requiring an agency relationship between the in-state and out-of-state affiliates.¹⁷⁴ It then rejected the Department's agency argument, finding that the two returns of By Mail merchandise to the Bloomingdale's store were insufficient.¹⁷⁵ Furthermore, the court sidestepped the Department's argument that legal formalities should not control the constitutional determination by emphasizing that the Department had cited dictum in *Scripto* to support its position, and *Scripto*, unlike the instant case, involved in-state sales agents.¹⁷⁶

*SFA Folio Collections, Inc. v. Bannon*¹⁷⁷ involved similar facts to those in *By Mail*.¹⁷⁸ SFA Folio Collections, Inc. ("Folio") was the mail-order subsidiary of Saks & Company ("Saks"). Saks also owned Saks-Stamford, an affiliate that operated a retail store in Stamford, Connecticut. The Commissioner of Revenue Services ("Commissioner") assessed sales and use taxes against Folio, and Folio appealed.¹⁷⁹ The Connecticut Supreme Court rejected the Commissioner's argument that Folio had sufficient minimum contacts with Connecticut on a stand-alone basis to give rise to a use tax collection obligation.¹⁸⁰ It then turned to the Commissioner's primary contention that because Folio was part of a larger enterprise of affiliated corporations that include Saks-Stamford, the contacts of Saks-Stamford should "count" for determining whether Folio had nexus with the state.¹⁸¹

Unlike the court in *By Mail*, the court here was squarely faced with the issue of affiliate nexus. The Commissioner relied both on the Supreme Court's combined reporting line of cases and on a general theory of enterprise liability.¹⁸² The court acknowledged the potential relevance of the combined reporting cases but noted that combined reporting is a

174. *Bloomingdale's By-Mail*, 567 A.2d at 778.

175. *Id.* The Court noted that these returns "appear[ed] to be aberrations from normal practice." *Id.* (citing deposition testimony). One wonders whether the Department could have established a better record on this point of store returns.

176. *Id.* As noted above, *Scripto* appears not to have required a strict agency relationship. See *supra* note 100 and accompanying text.

177. 585 A.2d 666 (Conn. 1991).

178. See generally Martin L. McCann, Note, *Use Tax, Mail Order Sales, and the Constitution: Recent Developments in Connecticut*, 12 U. BRIDGEPORT L. REV. 137 (1991) (describing *Bannon* case).

179. *SFA Folio Collections, Inc.*, 585 A.2d at 668.

180. *Id.* at 671.

181. The Commissioner also unsuccessfully sought to have the court disregard the physical presence test established in *National Bellas Hess*, foreshadowing the unsuccessful attempt of the North Dakota taxing authority in *Quill* to do the same. See *id.* at 674-76.

182. See *id.* at 671-73.

statutory creation and that no combined sales and use tax reporting was authorized by Connecticut statute. For this reason, the court held that the combined reporting cases did not apply.¹⁸³

Similarly, the court rejected the theory of enterprise liability as an erroneous statement of Connecticut corporate law. The court held that only facts supporting a true “piercing of the corporate veil,” such as failure to observe the formalities of separate incorporation, would warrant attributing Saks-Stamford’s contacts to Folio (at least absent a use tax “combined reporting” statute).¹⁸⁴ No such showing had been made or even attempted.¹⁸⁵

The court’s reliance on lack of state law authority is subject to criticism. The Connecticut sales tax statute appeared to extend as far as constitutionally allowable.¹⁸⁶ Indeed, the court begins its opinion by implying that its decision will be controlled by constitutional principles.¹⁸⁷ Thus, it is odd for the court to imply that sufficient nexus could exist if a statute were properly drafted to allow the court to look to affiliate contacts to determine nexus. Either a constitutional nexus exists or it does not.¹⁸⁸ The court’s decision maintains its logical consistency only if read as an exercise in the construction of Connecticut statutes—and not a decision regarding the full reach of the state’s taxing authority under the Commerce Clause.¹⁸⁹

183. *See id.* at 672–73.

184. *Id.* at 671–73.

185. *Id.* at 673–74.

186. The court noted that CONN. GEN. STAT. § 12-407(15) (1991) provided:

“Engaged in business in the state” means selling in this state, or any activity in this state in connection with selling in this state, tangible personal property for use, storage or consumption within the state The term *shall include but shall not be limited to* the following acts or methods of transacting business: (a) Maintaining, occupying or using, permanently or temporarily, directly or *indirectly, through a subsidiary* or agent, by whatever named called, of any office, place of distribution, . . . or other place of business

585 A.2d at 668 n.1 (emphasis added).

187. *See SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666, 670 (Conn. 1991).

188. The court probably was saying that without a state statute designating the “taxpayer” as the combined group it cannot consider the contacts of an affiliate, but that it could consider those contacts if state law expressly treated the combined group as a single entity. This is a recurrence of the issue of whether, for jurisdictional purposes, a court may look beyond state substantive law to determine what contacts matter. For cases suggesting that a court may look to affiliate contacts for judicial jurisdictional purposes, *see infra* Part IV.A. For a discussion of whether an express affiliate nexus jurisdictional statute is necessary, *see infra* Part VI.

189. Because *SFA Folio* was pre-*Quill*, it was decided on both due process and Commerce Clause grounds.

In *SFA Folio Collections, Inc. v. Tracy*,¹⁹⁰ Folio again successfully avoided the imposition of a use tax collection obligation, this time in Ohio. The court first held that to impute contacts of one affiliate to another would “run[] counter to federal constitutional law and Ohio corporation law.”¹⁹¹ Thus, unlike *Bannon*, *Tracy* suggests that affiliate nexus is inconsistent with *Quill* regardless of how state law treats the affiliate relationship.¹⁹² The court made this clear when it construed the Ohio tax nexus statute, which provided in pertinent part: “Nexus with this state exists when the seller does any one of the following: ‘(1) Maintains a place of business within this state, whether operated by employees or agents of the seller, by a member of an affiliated group . . . of which the seller is a member.’”¹⁹³ The court found that in order for this statute to be constitutional, it must be interpreted to mean that the in-state affiliate must be involved in operating the mail-order business, or, alternatively, the mail-order affiliate must be facilitating the operation of the retail stores.¹⁹⁴ Under this interpretation, the court found that Folio and Saks were operating two entirely separate businesses despite the affiliate relationship. Therefore, Folio’s mail-order business was found not to be “operated. . . by a member of an affiliated group . . . of which [Folio was] a member.”¹⁹⁵ Followed to its logical conclusion, this holding implies that the Commerce Clause prohibits the Ohio legislature from enacting a statute that allows affiliate relationships to “count” for physical presence determination purposes, regardless of how carefully drafted.¹⁹⁶

The *Tracy* court concluded by rejecting the Tax Commissioner’s unitary business argument.¹⁹⁷ The court’s reasoning is thin, simply stating that the combined reporting cases are about apportionment rather than nexus.¹⁹⁸ As discussed above, this may be a distinction without a difference.¹⁹⁹ If the Supreme Court can look through corporate structure for the purpose of determining the constitutionality of an apportionment

190. 652 N.E.2d 693 (Ohio 1995).

191. *Id.* at 697.

192. *Tracy* is the only one of the three mail-order affiliate cases that was decided post-*Quill*.

193. 652 N.E.2d at 696 (citing OHIO REV. CODE ANN. § 5741.01(H)(1) (repealed)).

194. *See id.* at 697.

195. OHIO REV. CODE ANN. § 5741.01(H)(1) (repealed).

196. Again, this is not to imply that affiliates with agency-like relationships would not create nexus under *Scripto* and similar authority.

197. *SFA Folio*, 652 N.E.2d at 697–98.

198. *See id.* at 698.

199. *See supra* Part II.E.

statute, is it so clear that the court would not do the same for nexus purposes?²⁰⁰

Though not a case involving an in-state retailer with an out-of-state mail-order affiliate, *Franklin Mint Corp. v. Tully*²⁰¹ stands as perhaps the only state case endorsing a pure affiliate tax nexus theory. Franklin Mint was an out-of-state mail-order company that owned an in-state packaging subsidiary (“Sloves”).²⁰² Presumably, the packaging materials were shipped out of state to Franklin’s manufacturing or distribution centers for use in preparing Franklin’s products for shipping. The court found that:

Through Sloves, [Franklin Mint] unquestionably was able to enjoy the advantages of services provided by the State and local governments much like the taxpayer in *National Geographic* . . . The corporate organization adopted by [Franklin Mint] and Sloves cannot obscure the fact that the Sloves plant, New York property, was indeed controlled and owned by [Franklin Mint].²⁰³

Importantly, Sloves was not an in-state sales representative or any other agent. It was merely a supplier. Accordingly, Franklin Mint’s relationship with Sloves could not plausibly have created a nexus had Sloves not been a Franklin Mint subsidiary.²⁰⁴ The dissent in *Franklin Mint* highlighted what it saw as a conflict with New York corporate law, which generally respects the separate juridical identity of corporations.²⁰⁵ Further, the dissent asserted that personal jurisdiction ordinarily cannot be maintained over an out-of-state company solely because an affiliate is located in-state, and, reasoning by analogy, tax jurisdiction should be no different.²⁰⁶

In sum, state courts have been generally hostile to theories of affiliate nexus. Only the *Tracy* court, however, appears to have rejected the theory on Commerce Clause grounds. It correctly observed that the combined reporting cases are about the apportionment prong of the four-part *Complete Auto* test, not the nexus prong. But *Tracy* does not explain why

200. *Id.*

201. 463 N.Y.S.2d 566 (N.Y. App. Div. 1983).

202. *Id.* at 567.

203. *Id.* at 568–69 (citation omitted).

204. Indeed, prior to corporate affiliation with Franklin Mint, the taxing authority considered Sloves to be a third-party entity and did not attempt to assert jurisdiction to tax during those pre-affiliation periods. *See id.* at 568.

205. *See id.* at 569–70.

206. *Id.* at 569–70. This analogous line of reasoning is more fully explored below. *See infra* Part IV.A.

the same legal reasoning and policy considerations should not apply to both.

IV. NON-TAX AUTHORITIES

As we have seen, the case law addressing the issue of affiliate tax nexus is quite thin, and the depth of analysis in those few cases is even less helpful. A common thread among these cases is the assumption that corporate formalities must be respected for the purposes of determining tax jurisdiction. In other words, unless the substantive law of corporations (such as the alter-ego or veil-piercing doctrines) or the law of agency would make the out-of-state affiliate liable for the actions of the in-state affiliate, then it is assumed that the contacts of the in-state affiliate cannot be attributed to the out-of-state affiliate for tax jurisdiction purposes.²⁰⁷ This would seem to be a logical extension of the principle that corporate shareholders are insulated from the substantive liabilities of the corporation.

A natural place to look for confirmation of this premise would be in cases addressing the issue of whether an out-of-state corporation is insulated from personal jurisdiction, notwithstanding the in-state presence of a corporate affiliate.²⁰⁸ Indeed, numerous courts, including the U.S. Supreme Court, have addressed this issue.²⁰⁹ Surprisingly, however, the issue remains unresolved, and the cases conflict markedly.²¹⁰

207. See *supra* Part III.

208. For example, the Hellersteins rely on the Restatement (Second) of Conflicts of Law discussion of personal jurisdiction to support the proposition that a corporation generally will not be subject to state tax jurisdiction based on affiliate contacts. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 6.13. In discounting the theory of affiliate nexus, the Hellerstein treatise quotes heavily from comment b to Section 52 of the Restatement (Second) of Conflicts of Law, suggesting that only “veil piercing” or “alter-ego” facts are sufficient, absent an agency relationship among affiliates. See *id.* However, the text of Section 52 provides: “A state has power to exercise judicial jurisdiction over a foreign corporation . . . in . . . situations where the foreign corporation has such a relationship to the state that it is *reasonable* for the state to exercise such jurisdiction.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS: FOREIGN CORPORATIONS—OTHER RELATIONSHIPS § 52 (1969) (emphasis added). Further, comment b also provides that jurisdiction may be obtained over a subsidiary corporation if it “does an act, or causes effects, in the state at the direction of the parent or in the course of the parent corporation’s business.” *Id.* at § 52 cmt. b (emphasis added). Thus, Section 52 is quite open-ended, imposing only a reasonableness standard, and comment b suggests that a close relationship between parent and subsidiary may be sufficient for jurisdictional purposes even if the subsidiary is neither the agent nor an alter-ego. Being a member of a unitary group might be the sort of “reason” situation contemplated by Section 52, particularly if the unitary business enterprise is considered the “parent corporation’s business” for purposes of comment b.

209. See, e.g., *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333 (1925). See generally Brillmayer & Paisley, *supra* note 161; Daniel G. Brown, Comment, *Jurisdiction over a Corporation on the Basis of the Contacts of an Affiliated Corporation: Do You Have to Pierce the Corporate Veil?*, 61

This Part reviews cases addressing whether personal jurisdiction may be asserted over an out-of-state corporation by virtue of an affiliate's in-state contacts, and then considers to what extent these cases are persuasive authority for resolving the related, but distinct, question of affiliate tax nexus under the Commerce Clause. Next, this Part explores the law of corporate groups generally to determine the extent to which economic realities have prevailed over corporate formalities in other areas of the law. Special attention is paid to Supreme Court decisions that have recognized the economic realities of corporate groups.

A. CORPORATE AFFILIATES AND PERSONAL JURISDICTION UNDER THE DUE PROCESS CLAUSE: REASONING BY ANALOGY

In *International Shoe Co. v. Washington*,²¹¹ the Supreme Court supplanted the prior “doing business” test with a “minimum contacts” test for determining whether an out-of-state corporation could be haled into court.²¹² The Court held that a corporation must have “certain minimum contacts with [the state] such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice.’”²¹³ *International Shoe* involved the presence of individual agents of a foreign corporation in the state of Washington.²¹⁴ The Court did not address, nor has it subsequently addressed, whether the contacts of an affiliated corporation “count” for the purposes of determining personal jurisdiction.²¹⁵

Prior to *International Shoe*, however, the Court did address affiliate jurisdiction against the backdrop of the “doing business” test. In *Cannon Manufacturing Co. v. Cudahy Packing Co.*,²¹⁶ a North Carolina corporation, Cannon Manufacturing Company, attempted to sue a Maine corporation, Cudahy Packing Company, in North Carolina for breach of contract. Cannon initiated the action by serving a wholly-owned subsidiary

U. CIN. L. REV. 595 (1992); Murray E. Knudsen, Comment, *Jurisdiction over a Corporation Based on the Contacts of a Related Corporation: Time for a Rule of Attribution*, 92 DICK. L. REV. 917 (1988); William A. Voxman, Comment, *Jurisdiction over a Parent Corporation in Its Subsidiary's State of Incorporation*, 141 U. PA. L. REV. 327 (1992).

210. *See id.*

211. 326 U.S. 310 (1945).

212. *See generally Developments in the Law: State-Court Jurisdiction*, 73 HARV. L. REV. 909, 919–34 (1960) (analyzing *International Shoe* and describing legal landscape prior to decision).

213. *International Shoe*, 326 U.S. at 316.

214. *Id.* at 313.

215. For a more detailed analysis of the Court's post-*International Shoe* treatment of affiliate jurisdiction, see Brilmayer & Paisley, *supra* note 161.

216. 267 U.S. 333 (1925).

of Cudahy in North Carolina. Cannon defended against Cudahy's motion to dismiss for lack of personal jurisdiction by arguing that Cudahy Packing was doing business in North Carolina through its in-state subsidiary.²¹⁷

The Court acknowledged that Cudahy's subsidiary was (1) physically present in North Carolina, (2) an "instrumentality employed to market Cudahy products within the state," and (3) completely controlled "both commercially and financially" by its parent.²¹⁸ Nevertheless, because the subsidiary was not the "agent" of the parent, and because the formalities of their separate corporate identities had been adhered to, the Court held that Cudahy was not subject to personal jurisdiction in North Carolina.²¹⁹

Cannon has been widely cited as establishing the rule that "mere ownership" of an in-state subsidiary will not subject an out-of-state parent to jurisdiction within the state.²²⁰ The continuing vitality of *Cannon*, however, is doubtful for several reasons. First, the Court seemed to deny that any constitutional questions were presented.²²¹ Instead, the Court suggested that the problem was that no state law or Congressional act authorized jurisdiction. Thus, the Supreme Court may have based its decision on federal common law, a basis for decision that was, of course, repudiated in *Erie Railroad Co. v. Tompkins*.²²² Second, *Cannon* was decided before *International Shoe*, which superceded the "presence" and "doing business" tests applied in *Cannon*. Accordingly, *International Shoe* may have superceded *Cannon* as well.

The case law reflects this uncertainty surrounding the vitality of the *Cannon* doctrine. While some courts have strictly applied the rule in *Cannon*,²²³ others have eroded it significantly while professing to follow it.²²⁴ Still other courts have expressly ruled that *Cannon* is no longer good

217. *See id.* at 334–35.

218. *Id.* at 335.

219. *Id.* at 335, 338.

220. *See supra* note 209.

221. *Cannon Mfg. Co.*, 267 U.S. at 336 ("No question of the constitutional powers of the State, or of the federal Government, is directly presented.").

222. 304 U.S. 64 (1938). Prior to *Erie*, a federal court sitting in diversity jurisdiction would apply the statutory law of the state but was free to determine and/or "create" a federal version of common law. Since *Erie*, federal courts sitting in diversity are required to apply state law, whether statutory or common.

223. *See, e.g.*, *Wehner v. Syntex Agribusiness, Inc.*, 616 F. Supp. 27, 29 (E.D. Mo. 1985) (declining to follow "dangerous innovations" of other district courts); *Clark v. Moran Towing & Transp. Co.*, 738 F. Supp. 1023, 1028 (E.D. La. 1990) (no attribution allowed if separate corporate identities maintained).

224. *See, e.g.*, *Barber v. Pittsburgh Corning Corp.*, 464 A.2d 323, 330–32 (Pa. Super. Ct. 1983) (noting that constitutional analysis is "less stringent" than mandated under *Cannon*); *Sternberg v.*

law.²²⁵ Courts taking this last approach often apply an “enterprise theory” to determine whether an out-of-state corporate affiliate is subject to jurisdiction.²²⁶ In general, the enterprise theory looks to the degree of economic integration among corporate affiliates to determine whether formal corporate legal boundaries may be ignored for the purpose of determining personal jurisdiction.²²⁷ In this sense it is a “merger” theory of jurisdiction.²²⁸ Importantly, a determination that a group of corporate affiliates operates as a single enterprise under the enterprise theory does not require a finding under the substantive corporate law of the state that one corporation is an “alter-ego” of the other or that the facts warrant a “piercing of the corporate veil.”²²⁹

For example, in *Brunswick Corp. v. Suzuki Motor Co.*,²³⁰ Brunswick Corporation brought a patent infringement action against Suzuki Motor Company, U.S. Suzuki Motor Corporation, and a Wisconsin dealer of Suzuki outboard motors. Brunswick claimed that these defendants manufactured and sold outboard motors that infringed Brunswick patents. In addition, Brunswick brought claims against Mitsubishi Electric Corporation and Hitachi, Ltd., Japanese corporations, for contributory infringement resulting from the sale of outboard motor ignition systems to Suzuki that were installed in Suzuki motors.²³¹

The only arguable contact that Mitsubishi and Hitachi had with Wisconsin was the presence in Wisconsin of wholly-owned subsidiaries that marketed Mitsubishi and Hitachi products. Significantly, Brunswick

O’Neil, 550 A.2d 1105, 1119–20 (Del. 1988) (*Cannon* doctrine tempered by subsequent Supreme Court precedent).

225. See, e.g., *Energy Reserves Group, Inc. v. Superior Oil Co.*, 460 F. Supp. 483, 490 (D. Kan. 1978) (rejecting *Cannon* doctrine); *Roorda v. Volkswagenwerk, A. G.*, 481 F. Supp. 868, 879 (D.S.C. 1979) (though no specific Supreme Court case has overruled *Cannon*, it reflects an older, pre-*International Shoe* concept of jurisdiction that is no longer applicable).

226. For a discussion of “enterprise theory” as a basis for jurisdiction over affiliated corporations, see PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS* 3.03, at 43–47 (1983) (discussing *Cannon* doctrine and its progeny).

227. See *id.* at 23–25.

228. Rather than use the language of “merger” and “attribution” suggested *supra* Part II.E.3, the remainder of this Article adopts the nomenclature of “enterprise theory.” “Unitary business” and “affiliate nexus” are both instances of the application of the merger/enterprise theory concepts.

229. See, e.g., *In re Telectronics Pacing Sys., Inc.*, 953 F. Supp. 909, 915 (S.D. Ohio 1997) (noting the “formalistic approach of the alter ego doctrine . . . irrelevant” to jurisdictional inquiry). The *Telectronics* court undertook a thorough analysis of the *Cannon* doctrine and concluded that it was no longer good law. *Id.* at 916–18.

230. 575 F. Supp. 1412 (E.D. Wis. 1983).

231. *Id.* at 1415.

did not claim that any of the products sold by these subsidiaries infringed on Brunswick patents.²³²

Mitsubishi and Hitachi both asserted that they exercised no day-to-day operational or general policy control over their subsidiaries. The subsidiaries had separate corporate charters, by-laws, accounting records, and boards of directors. Because these facts failed to establish that the subsidiaries were agents or alter-egos of the parent corporations, Mitsubishi and Hitachi moved to dismiss for lack of personal jurisdiction.²³³

The court denied the defendant's motion, ruling that *Cannon* "is no longer relevant to the constitutional inquiry into whether an exercise of jurisdiction offends traditional notions of fair play."²³⁴ Further, the court held that "a defendant's relationship with an affiliated corporation in the forum is, *in itself*, a relevant consideration" in determining whether the defendant is subject to personal jurisdiction.²³⁵ Turning to the facts before it, the court held that the "totality" of the parent's contacts satisfied due process, noting that "[t]hrough their affiliated entities they have systematically injected themselves into the Wisconsin market place" and that both companies "possess a continuing sales and marketing relationship" with the state.²³⁶ The court emphasized that "[a]bove all, the Court must not ignore the *economic realities* of the situation. It is naïve to believe that [the defendants] do not exercise control over their local subsidiaries."²³⁷

In a thoroughgoing analysis, Brilmayer and Paisley have identified the following as the major factors considered by courts that have adopted the enterprise theory approach:

- Whether one affiliate is financially dependent on another.
- Whether an affiliate is not an independent decision making body.
- Whether an affiliate's administrative organization is incomplete.
- Whether the related affiliates project an integrated posture to the public.

232. *Id.* at 1415–16.

233. *Id.* at 1416.

234. *Id.* at 1419 (citation omitted).

235. *Id.* at 1421 (emphasis added).

236. *Id.* at 1422.

237. *Id.* (emphasis added).

- Whether the affiliates exchange information, personnel, and group resources.
- Whether the affiliates file consolidated annual tax returns and/or annual reports.²³⁸

Interestingly, these criteria are similar to those applied in the determination of whether a corporate group may be treated as a single combined group for state income tax apportionment purposes under the Commerce Clause.²³⁹

The reasoning in cases that adopt an enterprise theory of personal jurisdiction is sound.²⁴⁰ The *substantive* law principles of limited shareholder liability and separate entity status do not, as a logical matter, control the *jurisdictional* question of whether the relationships among corporate affiliates can establish whether an entity has the minimum contacts with a state necessary to satisfy due process. The determination that a state has jurisdiction over an out-of-state affiliate is not a determination that such affiliate is liable for the debts of an in-state affiliate. It is simply a determination that the affiliation is a contact that counts.

Many commentators have come to this same conclusion,²⁴¹ though some argue that as a matter of policy, rather than constitutional law, state

238. Brillmayer & Paisley, *supra* note 161, at 30 (citations omitted).

239. *See supra* notes 132–42 and accompanying text.

240. The principle of limited shareholder liability for the debts of a corporation does not logically compel the conclusion that the contacts of an in-state affiliate may not be considered in determining whether a plaintiff may hale an out-of-state affiliate into court for the purpose of determining whether the out-of-state affiliate has a legal liability for which it can be held accountable. These are not instances where the out-of-state affiliate is being held liable for debts of its in-state affiliate. This scenario is merely an instance in which a connection with an in-state affiliate can “count” for minimum contacts purposes. The reasons why these contacts should count are often ignored, probably as a result of the fixation on the principle of limited liability. Ownership of stock in a corporation not only limits liability, it gives the shareholder certain rights to govern, control, direct, sell, and extract profits from the corporation. Possessing such valuable rights in an entity that has substantial contacts in a jurisdiction certainly could be a basis for being haled into court in such jurisdiction. Again, jurisdiction is not asserted for the purpose of holding the out-of-state affiliate liable for the controlled corporation’s acts, but rather, for the purpose of adjudicating its own liabilities. This would seem to comport with “traditional notions of fair play and substantial justice.” *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945) (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)). The above argument, however, does not fully apply where jurisdiction is sought over an out-of-state subsidiary or brother/sister corporation by virtue of the in-state presence of a parent or brother/sister entity. In these instances, enterprise theory steps to the foreground. The economic reality is that corporate groups often act as a single business enterprise. It matters little, economically, whether the enterprise is divided into divisions or affiliates.

241. *See, e.g.*, BLUMBERG, *supra* note 226, at 46; Knudsen, *supra* note 209, at 945.

long-arm statutes should extend no further than the substantive corporate law of the state.²⁴² Brilmayer and Paisley go even further, contending that a jurisdictional rule for foreign corporations that varies from a state's substantive rule of limited liability *may* be unconstitutionally discriminatory, at least where no policy grounds exist for making this distinction.²⁴³ Moreover, they argue, the state's interest in creating a forum for local plaintiffs is not a sufficient policy justification.²⁴⁴

Whatever one might think of this view, Brilmayer and Paisley note that it is not applicable to state taxation because "sovereigns characteristically disregard entity boundaries *in domestic situations* to reduce tax avoidance."²⁴⁵ Thus, they conclude that there is no discriminatory effect in using an enterprise theory in the state tax jurisdiction context. Accordingly, they expressly approve of the combined reporting cases, treating them as state tax jurisdictional authority.²⁴⁶

To what extent are these due process principles relevant in the Commerce Clause context? It could be argued that the *Cannon* doctrine has greater vitality in the state tax jurisdiction arena because *Quill's* continued adherence to the "physical presence" test is a relic from the pre-*International Shoe* era, as is *Cannon*. The strength of this view depends upon whether *International Shoe* was a necessary step in the erosion of *Cannon*.²⁴⁷ It may not have been. Indeed, it is just as likely that the changing economic landscape, including the ascendancy of the use of corporate groups, would have eroded *Cannon* even if physical presence had remained the due process standard. Whether the issue is due process "minimum contacts" or Commerce Clause "physical presence," the affiliate nexus issue is whether affiliate "contacts," physical or otherwise, count under the respective tests. Thus, the judicial erosion of the formalistic

242. See, e.g., Brown, *supra* note 209, at 618–19 (proposing that affiliate jurisdiction is constitutionally allowable, but should not be exercised as a matter of policy). But see Voxman, *supra* note 209, at 370 (arguing that *Cannon* is proper expression of due process limits on state jurisdiction).

243. These authors appear to suggest that such a rule would violate the Equal Protection Clause or discriminate against interstate commerce, although there also appears to be a suggestion that such discrimination would offend due process notions of "fair play." See Brilmayer & Paisley, *supra* note 161, at 33–34.

244. *Id.*

245. *Id.* at 34 n.159 (emphasis in original).

246. *Id.* As discussed in Part II.E *supra*, these cases actually address fair apportionment rather than state tax jurisdiction. It is interesting that Brilmayer and Paisley treat this as a distinction without a difference. *Id.* While this author would not go that far, this Article argues that the combined reporting cases are *very* persuasive on the question of state tax jurisdiction.

247. Cf. Richard D. Pomp, *Are the Standards for Tax Jurisdiction and Personal Jurisdiction Identical?*, 92 ST. TAX NOTES 15-35, at Doc. 92-50116 (Jan. 23, 1992) (suggesting that the standards are different).

notion that the substantive law doctrine of limited liability should control for jurisdictional purposes could still occur under either test.

In fact, a number of reasons explain why a theory of affiliate Commerce Clause nexus could find *greater* support than a theory of affiliate due process nexus. First, Commerce Clause analysis tends to focus on real economic effects on interstate commerce, while the Due Process Clause, almost by its very name, invokes formalistic and legalistic considerations.²⁴⁸ Thus, it should not be surprising that due process might require respect for a juridical notion such as the separate identity of corporations, while the Commerce Clause might countenance a more realistic view of the economic realities of a single business enterprise operating as a group of affiliated corporations. Nevertheless, courts have been willing to consider the underlying reality of affiliated groups when making due process personal jurisdiction determinations.

Second, the personal jurisdiction cases generally involve more factually remote circumstances than the Commerce Clause tax nexus cases because plaintiffs need only resort to an enterprise theory of personal jurisdiction where the cause of action against the out-of-state affiliate arose out of state. If the cause of action arose in-state, then due process almost certainly would be satisfied without examining the contacts of affiliated corporations. For example, if Walmart.com sold a defective product to in-state consumers that caused personal injuries, Walmart.com most certainly could be haled into the courts of that state. This situation would not pose a challenging jurisdictional question. Without a theory of affiliate tax nexus, however, this same state would have had no power to impose a use tax collection obligation on Walmart.com in connection with the sale of those same products. For personal jurisdiction purposes, a theory of nexus of affiliate need only be asserted when, for example, the cause of action arose in State A, plaintiff files suit in State B, and the defendant's only contacts with State B are those arising from the presence of a corporate affiliate in State B.²⁴⁹ As discussed above, this approach has been successful where either the *Cannon* doctrine has been relaxed or an enterprise theory has been endorsed. In state tax cases, where the taxable transaction clearly occurs in the state seeking jurisdiction (and thus there are no due process

248. See generally *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992).

249. See, e.g., *Roorda v. Volkswagenwerk, A.G.*, 481 F. Supp. 868, 869 (D.S.C. 1979) (recounting that plaintiff injured in California moved to South Carolina to file suit to avoid California statute of limitations defense; defendant was subject to South Carolina jurisdiction by virtue of affiliate contacts).

barriers to taxation²⁵⁰), it would seem even easier for courts to view the physical contacts of an affiliate as contacts that count.

Third, courts have adopted an enterprise theory in personal jurisdiction cases despite arguably controlling Supreme Court precedent to the contrary. No similar Supreme Court authority addresses whether affiliate contacts count for the purpose of determining Commerce Clause state tax jurisdiction, however, so courts arguably have a freer rein. Indeed, the Court has endorsed an enterprise theory approach to the apportionment of income for state income tax purposes.²⁵¹ Thus, the road to a theory of affiliate nexus for Commerce Clause purposes is much better paved. Finally, even the staunchest opponents of applying different rules for substantive versus jurisdictional purposes agree that tax jurisdiction may be different because *substantive* tax law frequently disregards formal corporate structures in order to thwart tax avoidance schemes and to recognize underlying economic reality.²⁵²

In sum, current trends in the law of personal jurisdiction lend strong support to the proposition that affiliate jurisdiction should not be determined by traditional substantive law limits on liability among affiliated corporations. Neither policy nor jurisprudence supports rigid reliance on the *Cannon* doctrine and the principle of limited shareholder liability for tax nexus purposes.

B. THE LAW OF CORPORATE GROUPS

The erosion of the *Cannon* doctrine and the Supreme Court's combined state income tax reporting decisions are two instances of judicial adoption of the "enterprise law" approach to corporate groups. The enterprise approach eschews the traditional "entity law" approach, which treats each corporation as a separate juridical entity with its own legal rights and duties.

The traditional entity approach can be traced back to ancient Rome.²⁵³ In the early and mid-nineteenth century in the United States and England, the entity approach was "strongly reinforced by acceptance of the doctrine of limited liability,"²⁵⁴ although the concept of limited liability was not the sole philosophical or legal basis for origination of the entity approach. As

250. See *Quill Corp.*, 504 U.S. at 308.

251. See *supra* Part II.E.

252. See, e.g., Brilmayer & Paisley, *supra* note 161, at 34 n.159.

253. BLUMBERG & STRASSER, *supra* note 126, at xxix–xxx.

254. *Id.* at xxix.

Blumberg and Strasser observe: “With the development of limited liability for shareholders, entity law became firmly established as the legal framework that preserved a bright line of demarcation between the corporation conducting the enterprise and the shareholders who owned the enterprise.”²⁵⁵

Importantly, a corporation could not hold shares in another corporation during the era in which the entity concept and the associated doctrine of limited liability were developed. This prohibition was eventually eroded, however, thus blurring the distinction between shareholder and corporation:

[Initially, T]he corporation *was* the enterprise, and the shareholders were comprised entirely of the ultimate investors. Decades passed before it was possible for a corporation to acquire the shares of another corporation without express statutory authority *With this development . . . a corporation no longer always represented the entire enterprise.* The enterprise became increasingly fragmented among the parent and its subsidiary companies Most frequently, the subsidiary was only a part or fragment of the larger business of its parent corporation The bright line of distinction between the simple corporation (the enterprise) and its shareholders was preserved in the distinction between the parent corporation and its investors. But what of the relation between the subsidiary corporations and their shareholder, the parent corporation? The parent and subsidiary corporations collectively constitute the enterprise, and the crucial distinction between the enterprise itself and its investors has disappeared.²⁵⁶

The law has been slow to adapt to the economic reality of corporate groups, and the entity approach is still frequently followed. Nevertheless, the law sometimes has adjusted, such as in the case of personal jurisdiction and combined state income tax reporting.²⁵⁷

Blumberg has chronicled the development of the enterprise approach to corporate groups in a six-volume treatise covering nearly all aspects of American law. He concludes that entity law retains much of its vigor where substantive liability is at stake because the “traditional conceptual view of the separate legal personality of the corporation is strengthened by the principle of limited liability of shareholders, as in the cases involving the attempted imposition upon one affiliate of a corporate group of liability

255. *Id.*

256. BLUMBERG, *supra* note 226, at 3–4 (emphasis added).

257. *See supra* Parts II.E and III.A.

for the torts or contracts of another affiliate of the group.”²⁵⁸ However, “[w]here *substantive liability is not involved*, the traditional view that for almost all purposes each corporation is a separate legal entity with its own legal responsibilities is beginning to collapse when the corporation in question is a constituent part of a corporate group conducting an integrated enterprise.”²⁵⁹

Affiliate nexus does *not* concern the attribution of the substantive liability of one affiliate to another. Rather, it addresses whether the physical presence of an in-state affiliate creates a sufficient nexus for an out-of-state affiliate to be held liable for tax on *its own* activities. Thus, it falls into the category of legal problems that are more readily addressed by application of enterprise theory. Further buttressing the enterprise approach to resolving questions of state tax jurisdiction is that the *substantive* tax law frequently ignores the juridical separateness of corporate entities to prevent tax avoidance.

Blumberg’s generalized observations, however, should not be taken as persuasive authority on the issue of affiliate nexus.²⁶⁰ He cautions that enterprise theory is not a doctrine of universal application.²⁶¹ It is a judicial or legislative response to the particular facts in controversy or the specific problem under consideration. Where applied, it is the result of a determination “that the application of enterprise, rather than entity, concepts better implements the underlying policies and objectives of the law in the area.”²⁶²

Notably, the Supreme Court’s application of enterprise concepts has not been limited to the state tax combined reporting cases. On several other occasions the Court has embraced enterprise principles and rejected the application of traditional corporate doctrines in order to “better implement[] the underlying policies”²⁶³ of the law in controversy.

For example, in *Electric Bond & Share Company v. Securities & Exchange Commission*, several electric utilities sought to avoid

258. BLUMBERG & STRASSER, *supra* note 124, at xxxii.

259. *Id.* at xxxi (emphasis added).

260. One of the possible weaknesses in the taxing authority’s case in *SFA Folio Collections, Inc. v. Bannon* was the apparent naked reliance on the Blumberg treatise, rather than the presentation of a more incremental, case-law based argument. See *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666, 673 (1991). See also *infra* note 313.

261. Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295, 299 (1996).

262. *Id.*

263. *Id.*

regulation under the Commerce Clause by dropping their operating assets into wholly-owned subsidiaries.²⁶⁴ The Court was unimpressed by this regulatory avoidance technique:

That they conduct such transactions through the instrumentality of subsidiaries cannot avail to remove them from the reach of the federal power. It is the substance of what they do, and not the form in which they clothe their transactions, which must afford the test. The constitutional authority confided to Congress could not be maintained if it were deemed to depend upon the mere modal arrangements of those seeking to escape its exercise.²⁶⁵

Thus, the Court refused to allow the form in which a multi-state business chose to conduct its operations to determine the scope of the Commerce Clause.²⁶⁶

In *Copperweld Corp. v. Independence Tube Corp.*,²⁶⁷ the Court repudiated prior decisions in which it had held that a parent and a wholly-owned subsidiary could “conspire” to “restrain trade” in violation of Section 1 of the Sherman Act. The Court began by observing that the central criticism of prior doctrine is that it “gives undue significance to the fact that a subsidiary is separately incorporated and thereby treats as the concerted activity of two entities what is really unilateral behavior flowing from decisions of a single enterprise.”²⁶⁸ After a critical review of its prior decisions, the Court continued:

[T]here can be little doubt that the operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one With or without a formal “agreement,” the subsidiary acts for the benefit of the parent, its sole shareholder.²⁶⁹

The Court recognized that drawing an artificial line between corporate divisions and corporate affiliates would motivate corporations to alter their structures for mere antitrust liability avoidance purposes:

264. 303 U.S. 419, 432–33 (1938).

265. *Id.* at 440.

266. *See id.*

267. 467 U.S. 752 (1984).

268. *Id.* at 766–67.

269. *Id.* at 770–71.

Antitrust liability should not depend on whether a corporate subunit is organized as an unincorporated division or a wholly owned subsidiary If antitrust liability turned on the garb in which a corporate subunit was clothed, parent corporations would be encouraged to convert subsidiaries into unincorporated divisions Such an incentive serves no valid antitrust goals²⁷⁰

Similarly, if state tax jurisdiction “turned on the garb in which a corporate subunit was clothed,”²⁷¹ corporations would be (and currently are) encouraged to convert corporate divisions into separately incorporated affiliates for mere tax avoidance purposes.

Finally, in *First National City Bank v. Banco Para El Comercio Exterior de Cuba*,²⁷² the Court allowed a claim against the Cuban government asserting the right to set off the value of seized assets resulting from a claim asserted by a Cuban government controlled bank, despite the bank’s separate entity status.²⁷³ The Court rejected the application of traditional entity law analysis. It cautioned that “worn epithets” such as “pierc[ing] the corporate veil,” “alter ego,” or “mere instrumentality” should not “substitute for rigorous analysis.”²⁷⁴

The Court’s decision “announce[d] no mechanical formula for determining the circumstances under which the normally separate juridical status of a government instrumentality is to be disregarded.” Instead, the Court relied on “equitable principles to avoid [an] injustice.”²⁷⁵

In summary, enterprise law is not a doctrine of universal application. It does, however, challenge the knee-jerk reaction to entity law that typically occurs when the legal system examines relations between affiliated corporations. It is simply incorrect for litigants, judges, and commentators to assume that traditional entity law doctrine either *does* or *should* control all such controversies. The law is replete with instances in which formal corporate structures are disregarded so that the policies underlying the rule of law in question are best achieved.

270. *Id.* at 772–74. The Court observed that “this [was] precisely what the Seagram company did after this Court’s decision in *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*” in which the Court applied the entity based doctrine. *Id.* at 773 (citation omitted).

271. *Id.* at 773.

272. 462 U.S. 611 (1983).

273. *Id.* at 613.

274. *Id.* at 623.

275. *Id.* at 633–34.

V. A THEORY OF AFFILIATE NEXUS

Thus far, this Article has identified the building blocks for a theory of affiliate state tax nexus. It is now time to cement these blocks together, applying the precedents and legal principles just elucidated to the state tax jurisdictional problem posed by the affiliation of non-nexus corporations (on a stand-alone basis) with nexus corporations, beginning with a presentation of the case for affiliate nexus, and continuing with addressing the standard objections.

A. THE CASE FOR AFFILIATE STATE TAX NEXUS

First, *Complete Auto Transit, Inc. v. Brady* established a four-part test for determining the validity of a state tax under the dormant Commerce Clause.²⁷⁶ It is the test's first prong—substantial nexus—that is most relevant to establishing the validity of the affiliate nexus approach to state tax jurisdiction.

Second, *Quill Corp. v. North Dakota* reconfirmed that a seller must have “physical presence” in a state in order to satisfy the nexus prong of the *Complete Auto* test.²⁷⁷ A seller whose only contacts with the state are by mail or common carrier lacks the “substantial nexus” required by the Commerce Clause.²⁷⁸

Third, *Quill* reaffirmed the Court's holding in *Scripto, Inc. v. Carson* that “physical presence” can result from the contacts of a third-party. In *Scripto*, the Court held that the contacts of an independent contractor soliciting sales on behalf of a remote seller may be attributed to the seller, even though the independent contractor may not have been a legal agent of the seller.²⁷⁹ Thus, the physical presence test does not require the physical presence of corporate property, employees, or even agents. Because agency is a traditional basis for attributing the acts of one corporation to another under state corporate law,²⁸⁰ *Quill's* reaffirmation of *Scripto* suggests that

276. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). See *supra* notes 33–37 and accompanying text.

277. See *supra* notes 62–89 and accompanying text.

278. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

279. See *id.* at 306. See also *supra* Part II.C.

280. Other courts have also held that one corporation may be physically present in a state under “alter-ego” and “piercing the corporate veil” theories. See *supra* note 223. These, too, are well-accepted state corporate law doctrines.

the Court is willing to look beyond traditional corporate law concepts in attributing the physical presence of one entity to another.²⁸¹

Fourth, *Quill* reconfirmed that the seller's physical presence need not be connected with the transaction that the state seeks to tax.²⁸² For example, a mail-order division of an in-state retailer is subject to a use tax collection obligation even if the mail-order division has no physical presence in the state.²⁸³

Fifth, the Court has held in a series of cases that a multi-corporate enterprise that conducts a "unitary business" can be treated as a single entity for the purpose of determining the amount of income apportionable to a state for net income tax purposes.²⁸⁴ Thus, if only one member of a "combined group" has substantial nexus with a state, the net income and in-state contacts of all members of the combined group may be considered when determining the net income apportionable to the taxing state. This calculation includes the net income and sales to in-state customers of non-nexus (on a stand-alone basis) affiliates. The result clearly can allow the apportionment to a state of the net income of a non-nexus entity (on a stand-alone basis) and taxing it. Although the Court has not yet ruled that these non-nexus (on a stand-alone basis) entities are subject to the taxing state's jurisdiction, such a ruling would seem to be the most probable result in light of the Court's combined reporting decisions.²⁸⁵

Sixth, in deciding that a multi-corporate group can be considered a single entity for state tax apportionment purposes, the Court has not relied on traditional principles of state corporate law. To the contrary, it has rejected the application of traditional entity law principles in favor of an enterprise approach for state net income tax apportionment purposes: "Superficially, intercorporate division might appear to be [an] . . . attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of the business enterprise."²⁸⁶ Put differently, affiliate nexus is to divisional

281. See *supra* Part II.C.

282. See *Quill Corp.*, 504 U.S. at 315 (citing *Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551 (1977)).

283. See *supra* Part II.D.

284. See *supra* Part II.E.

285. As discussed *supra* Part II.E, this conclusion is controversial. In any event, it is not necessary to the argument. Affiliate nexus would be supportable as a theory of jurisdiction even if combined reporting had never been "invented".

286. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 168 (1983) (quoting *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 440 (1980)) (alteration in original). See *supra* notes 142-45 and accompanying text.

nexus what combined reporting is to formula apportionment.²⁸⁷ The Supreme Court has endorsed combined reporting. Reasoning by analogy, affiliate nexus is also consistent with existing Commerce Clause jurisprudence.

Seventh, developments in the law of personal jurisdiction support an affiliate nexus approach to state tax jurisdiction. The traditional notion that affiliation with an in-state entity cannot give rise to personal jurisdiction unless there is an agency or alter-ego relationship has been supplanted by an enterprise approach by many courts. In deciding whether affiliation counts for personal jurisdiction purposes, these courts have looked to many of the same factors that are considered in determining whether a multi-corporate group is operating a unity business for state tax apportionment purposes.²⁸⁸

Eighth, in addition to combined reporting and personal jurisdiction cases, courts have adopted the enterprise approach in numerous other circumstances where the policies underlying the specific law that the court is interpreting are better effectuated by enterprise concepts rather than by traditional entity law.²⁸⁹

Ninth, although enterprise law is not a doctrine of universal application, it is more likely to be adopted where the substantive liability of one affiliate is *not* being ascribed to another affiliate in contravention of traditional notions of limited shareholder liability. Jurisdictional cases fall into this class of cases. The theory of affiliate state tax nexus seeks to consider only the contacts of an in-state affiliate for the purpose of determining whether a remote affiliate is subject to the state's taxing jurisdiction with respect to its *own* otherwise taxable activities. It is not a theory that seeks to ascribe the tax liability of one affiliate to another.²⁹⁰

Tenth, courts are more likely to adopt an enterprise approach where it better implements the policies underlying the law in question.²⁹¹ The policies underlying the dormant 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

287. Combined reporting is the logical extension of the formula apportionment rule—which was originally applied to single legal entities conducting unitary businesses—to multi-corporate groups conducting unitary businesses. Similarly, affiliate nexus is the logical extension of the single entity divisional nexus rule to multicorporate groups.

288. See *supra* note 238–41 and accompanying text.

289. See *supra* note 263 and accompanying text.

290. See *supra* note 259 and accompanying text.

291. See *supra* note 262 and accompanying text.

regulation on the national economy.”²⁹² Thus, the “substantial nexus” requirement is not a means for protecting the separate juridical status of a particular taxpayer. Rather, it is “a means for limiting state burdens on interstate commerce.”²⁹³ While conceding that the “bright-line” physical presence test “appears artificial at its edges,”²⁹⁴ the Court has distinguished such formalism from formalism that stands “only as a trap for the unwary draftsman.”²⁹⁵ These Commerce Clause policies support a theory of affiliate nexus. If no member corporation of a multicorporate enterprise is physically present in a state, then the enterprise falls within the “discrete realm of commercial activity that is free from interstate taxation.”²⁹⁶ If a member corporation is physically present, however, then the potential burden that an affiliate nexus rule would place on that single enterprise organized into multiple affiliates would be no greater or less than the burden that the existing divisional nexus rule already places on identical enterprises organized into divisions.²⁹⁷ Accordingly, it is difficult to contend that to tax the multidivisional enterprise and not the multicorporate enterprise does anything more than create a “trap for the unwary draftsman.”²⁹⁸ Indeed, a by-product of creating a “trap for the unwary draftsman” is to create a tax avoidance opportunity for the *wary* one. As the *Scripto* Court warned: “To permit such formal ‘contractual shifts’ to make a constitutional difference would open the gates to a stampede of tax avoidance.”²⁹⁹ This is not the formalism endorsed by *Quill*.

In conclusion, existing Commerce Clause jurisprudence does not bar state taxing authorities, courts, or legislatures from imposing a use tax collection obligation on a remote seller with an in-state affiliate, at least to the extent that the corporate group to which the affiliate belongs constitutes a single business enterprise.³⁰⁰ To the contrary, existing precedent strongly supports the theory of affiliate nexus.

292. *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992) (emphasis added).

293. *Id.* at 313.

294. *Id.* at 315.

295. *Id.* at 314 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

296. *Id.* at 315.

297. *See supra* Part II.D.

298. *Quill Corp.*, 504 U.S. at 314 (quoting *Complete Auto*, 430 U.S. at 279).

299. *Scripto, Inc.*, 362 U.S. 207, 211 (1960). *See also supra* notes 97–100 and accompanying text.

300. It is relatively clear that “mere affiliation” is not enough to result in taxable nexus. This Article does not explore whether the affiliate nexus rule is precisely coterminous with the unitary business concept. Though unitary principles address whether a multi-corporate group is a single, integrated enterprise for income tax apportionment purposes, many of the same factors are relevant to jurisdictional determinations. *See supra* note 238 and accompanying text. *See also supra* note 124. As a practical matter, mail-order and Internet subsidiaries of retailing companies will nearly always be part

B. MEETING THE OBJECTIONS TO AFFILIATE NEXUS

A final response to the major objections to affiliate nexus completes the analysis:

Objection 1: Affiliate nexus ignores Quill's bright-line physical presence test. A full response to this objection would be a rehearsal of most of the preceding discussion. In brief, a corporation can have a physical presence only by attribution, whether it is through the presence of an employee, property, agent, or something else. The question is simply whether the physical presence of an in-state corporate affiliate "counts." *Quill* tells us that *Scripto* is as far as the Court has gone so far, but the Court is silent as to whether it will go further in attributing physical presence. Moreover, the *Scripto* opinion suggests that the independent contractors whose contacts did count may not even have been agents in the traditional corporate law sense. The viability of the theory of affiliate nexus turns on whether affiliation is a contact that counts, and the bright-line *Quill* test does not resolve this issue either way.

*Objection 2: Affiliate nexus conflicts with Quill's reliance on stare decisis and respect for settled expectations.*³⁰¹ It is difficult to maintain that corporate groups that have a physical presence in a state have a *settled* expectation that they are sailing in a safe harbor. *Quill* itself is silent on the issue of whether affiliate contacts count, and the taxpayer in *Quill's* precursor, *Bellas Hess*, may have even conceded that it was subject to tax in states in which its subsidiaries operated retail stores.³⁰² In addition, the combined reporting cases have put taxpayers on notice that the Court might use enterprise principles in delineating the limits of dormant Commerce Clause protection.³⁰³ Though some state courts have declined to adopt an affiliate nexus approach, these decisions are based, at least in part, on an interpretation of state law.³⁰⁴ In any event, these state court decisions cannot be relied upon by taxpayers in other jurisdictions, and the *Quill* Court's concern with stare decisis applies to the Court's own decisions, not those of state courts. As early as 1941, the Court warned that a mail-order business with in-state retail stores "cannot avoid [tax] though its business is

of a unitary business, so there is not much practical need to demonstrate whether the affiliate nexus rule might extend even further. The unitary business concept is based on factors designed to discern the economic and operational reality of a business enterprise, and so it is not very conducive to tax avoidance planning.

301. See *supra* note 87 and accompanying text.

302. See *supra* notes 59–61 and accompanying text.

303. See *supra* Part II.E.

304. See *supra* Part III.

departmentalized.”³⁰⁵ In the wake of the *Montgomery Ward* and *Sears* decisions, only a naïve tax advisor would have suggested to these retailing giants that separate incorporation of their mail-order operations would have protected them from state tax with certainty.³⁰⁶ To claim that expectations are settled today is equally naïve.

Objection 3: The combined reporting cases are irrelevant because they address fair apportionment, not nexus. While it is true that the combined reporting cases address the fair apportionment prong of the *Complete Auto* test, not the nexus prong, this does not mean that these cases are irrelevant.³⁰⁷ Indeed, it would be odd for the Court to adopt an approach to fair apportionment that can have the effect of taxing the income of non-nexus affiliates (on a stand-alone basis) but then later deny the existence of jurisdiction to tax these affiliates despite the physical presence of the combined group. Put differently, having adopted an enterprise approach to one prong of the *Complete Auto* test, it is more likely that the Court would adopt that approach for the other prongs of the test than for it to use enterprise theory “here” and entity theory “there.” The primary significance of the combined reporting cases for affiliate nexus is that they demonstrate that the Court is willing to use an enterprise law approach in deciding dormant Commerce Clause state tax cases. This is highly relevant.

Objection 4: Traditional corporate law (i.e., entity law) principles should control this jurisdictional issue. This argument amounts to little more than table pounding. A major thrust of this Article has been to show that the waters of strong policy arguments can submerge whatever high ground the entity approach might occupy.³⁰⁸ This is particularly true if the attribution of the substantive liability of one affiliate to another is not implicated, as is the case here.³⁰⁹ Developments in the law of personal jurisdiction under the Due Process Clause underscore this point.³¹⁰ It is incumbent upon proponents of “respecting” the formal juridical distinctions among members of a corporate group for state tax jurisdictional purposes to come forward with policy arguments supporting this approach. These arguments have not been forthcoming, and naked reliance on the separate juridical identity of a corporation as if it were inviolable “natural law” will

305. *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 364 (1941). *See supra* notes 111–14 and accompanying text.

306. *Nelson*, 312 U.S. at 365.

307. *See supra* Part II.E.3.

308. *See supra* Part IV.B.

309. *See supra* note 259 and accompanying text.

310. *See supra* Part IV.A.

not do. “Worn epithets” should not “substitute for rigorous analysis.”³¹¹ Even critics of the divergence between domestic corporate law and the enterprise approach to long-arm jurisdiction under the Due Process Clause find no fault with the application of the enterprise approach to state tax jurisdiction.³¹² Here, the enterprise approach is consistent with the pervasive domestic tax law theme of disregarding formal entity boundaries to minimize tax avoidance. And so, to the thoughtful observer, “entity isolation” remains nothing more than a tax avoidance device unworthy of Commerce Clause protection.³¹³

VI. STATE STATUTORY ISSUES

This Article has demonstrated that existing Commerce Clause jurisprudence does not bar states from imposing a use tax collection obligation on remote vendors that have an affiliate with an in-state physical presence. This Part briefly explores whether state legislative action is necessary or advisable for implementing this constitutionally sound approach to nexus.

We have seen that some state courts have declined to consider affiliate contacts when making state tax jurisdiction determinations, largely on state statutory grounds. This undoubtedly has been a source of frustration for taxing authorities. For example, the statutes at issue in both *Bannon* and *Tracy* expressly referenced connections with a “subsidiary”³¹⁴ or a “member of an affiliated group.”³¹⁵ Nevertheless, the courts in both cases found that the statute required a traditional agency relationship between the remote seller and the in-state affiliate.³¹⁶ At least twenty states have sought by statute to impose tax liability on remote sellers who maintain a place of business in the state, either “directly or indirectly,” or through an in-state

311. See *supra* note 274.

312. See *supra* notes 245–48 and accompanying text.

313. As discussed in Part III, litigants have not been successful using enterprise and unitary business arguments in state court affiliate nexus litigation. Future proponents of affiliate nexus may be well advised to be careful not to overstate the implications of the combined reporting cases or to imply that the enterprise approach to corporate groups is one of general application. Reasoning by analogy from the relevant combined reporting and personal jurisdiction cases may be effective, along with emphasizing policy arguments predicated on the underlying goals of dormant Commerce Clause protection. Proponents will also need to demonstrate that an express affiliate nexus statute is not necessary for the court to find that the state’s tax jurisdiction reaches to the limits of the Commerce Clause. See *infra* part VI. Finally, properly conducted discovery may disclose an agency relationship between or among affiliates, making reliance on an affiliate nexus argument unnecessary.

314. SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 668 n.1 (Conn. 1991).

315. SFA Folio Collections, Inc. v. Tracy, 652 N.E. 2d 693, 696 (Ohio 1995).

316. See *supra* notes 183, 197 and accompanying text.

“subsidiary.”³¹⁷ Unfortunately, all of these statutes are susceptible to being interpreted as categorically requiring an agency-like relationship between the remote seller and the in-state affiliate, even though an enterprise interpretation would be no less plausible.

This interpretive problem is further illustrated by the recent debate in California over legislation, vetoed by the Governor, that sought to impose more clearly a use tax collection obligation on in-state affiliates of remote sellers.³¹⁸ Proponents of this legislation argued that it merely would have clarified prior law, i.e., that California taxing authorities already had the authority to impose a use tax obligation on these sellers regardless of the fate of this legislation. Opponents, of course, claimed that it would have been new law. Thus, they clearly hope that collection efforts based on affiliate nexus are foreclosed as a result of the Governor’s veto.³¹⁹

Is legislation that specifically addresses affiliate nexus required? Not in theory. For example, a statute could simply provide that all persons making sales subject to use tax are responsible for collecting the tax to the full extent permissible under the Commerce Clause. Properly read, this would permit a taxing authority to consider contacts of affiliates of a seller when determining whether the seller has sufficient nexus under *Quill*. In view of state court decisions such as *Tracy* and *Bannon*, however, courts still may be inclined to hold that affiliate contacts cannot count unless a seller is defined by statute to mean a corporate group operating a unitary business or enterprise.³²⁰ For this reason, it is still advisable for states

317. BLUMBERG & STRASSER, *supra* note 124, at 419 & n.2.

318. A.B. 2412, 1999–2000 Leg., Reg. Sess. (Cal. 2000).

319. See, e.g., ‘Functional Test’ Discussion Highlights California Policy Conference, 2000 ST. TAX TODAY 223-3, at Doc. 2000-29415 (Nov. 17, 2000). There is a certain irony in state court holdings and gubernatorial vetoes limiting the power of state taxing authorities to impose taxes on out-of-state retailers to something less than is constitutionally allowable. A primary role of the Commerce Clause is to prevent states from discriminating against interstate commerce. Here, however, we find courts and governors exercising more restraint than is constitutionally required, thus discriminating against *in-state* businesses.

320. Such a statute should not be necessary. Some confusion on this point may arise because statutory authority is sometimes held to be necessary for a state to require a corporate income taxpayer to file a combined return. See HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 8.11[2] (discussing conflict among the courts of various states regarding the power of state taxing authorities to require combined reporting absent express statutory authorization). Even if, however, express statutory combined reporting authority were required, there is a difference between imposing a tax and asserting tax jurisdiction. Traditionally, a taxpayer must have clear and unambiguous notice that a tax is being assessed. See, e.g., *Arizona Tax Comm’n v. Dairy & Consumers Coop. Ass’n*, 215 P.2d 235, 242 (Ariz. 1950) (taxing statutes must be clear and unambiguous). Thus, statutes imposing a tax are strictly construed against the taxing authority. Cf. HELLERSTEIN & HELLERSTEIN, *supra* note 20, ¶ 8.11 (asserting that combined reporting does not seek to tax income, rather it measures income). On the other hand, jurisdictional determinations usually turn on the due process notions of notice, fundamental

wishing to extend their taxing jurisdiction as far as constitutionally allowable to provide so expressly. That is, a state statute could explicitly provide that the physical presence of an affiliate is a contact sufficient to give rise to a use tax collection obligation.

There is an obvious limitation to the approach of legislatively clarifying that a state's use tax collection obligation extends as far as constitutionally allowable, or that affiliate contacts count: courts may still reject the theory of affiliate nexus on Commerce Clause grounds. Although this Article demonstrates that affiliate nexus passes constitutional muster, courts may continue to display the reticence of the courts that have addressed mail-order affiliate nexus. Accordingly, an alternative approach is for state legislatures simply to impose the use tax collection obligation on the nexus affiliate.³²¹ Thus, for example, Wal-Mart would be responsible for collecting and remitting a use tax on the sales of Walmart.com. In practical effect, the law would then make Wal-Mart responsible for directing its affiliate, Walmart.com, to collect the tax. Wal-Mart would have a physical presence in the state, and so any *Quill* issues would evaporate.

The only remaining constitutional issue is whether directing an affiliate (the in-state retailer) to collect and pay tax that arises from transactions conducted by another member of the affiliate group somehow violates the Due Process or the Commerce Clauses. For example, directing this author to pay taxes measured by the income of his students would probably violate due process. The relationship between the taxable activity and the taxpayer is too remote—there is not a sufficient nexus (in a non-jurisdictional sense) between the two for due process to be satisfied.

However, this has never been a serious problem in the context of affiliated corporations. For example, federal income tax law generally

fairness, and foreseeability. For example, although state long-arm statutes frequently spell out the details of various contacts and relationships that are necessary and sufficient for a state to impose judicial jurisdiction, state courts generally treat these statutes as superfluous, interpreting them to be coterminous with the federal constitutional due process standard. *See, e.g., Brunswick Corp. v. Suzuki Motor Co.*, 575 F. Supp. 1412, 1416–17 (E.D. Wis. 1983) (Wisconsin long-arm statute interpreted as a codification of the due process “minimum contacts” standard). Thus, it would be incorrect to treat the “failure” of a state to expressly spell out all of the grounds for assertion of tax jurisdiction, such as the presence of a corporate affiliate, as a reason to deny such jurisdiction if the Commerce Clause and Due Process Clause requirements are satisfied.

321. This solution has been proposed by Michael J. McIntyre. *See McIntyre, supra* note 21, at 651–53. This approach comes close to simply labeling the “combined group” as the taxpayer and making the nexus affiliate (on a stand-alone basis) liable for the tax. This essentially is what occurs in the corporate income tax context. *See supra* Part II.E.

requires affiliated corporations to file consolidated returns, and each affiliate is treated as being severally liable for the tax debt of the group.³²²

Similarly, with respect to state income tax combined reporting, the Supreme Court has had no trouble holding that combined returns may be required even where only two subsidiaries of a more than 220-corporation multinational banking enterprise were physically present in the state.³²³ It mattered not that the two entities present in the state did not have the legal authority to require all of the other affiliates to cooperate with the state taxing authorities or to provide the financial and accounting records necessary to complete the combined returns.³²⁴

In summary, express statutory language providing that the contacts of affiliates should count to the extent allowable by the Commerce Clause would assist taxing authorities in enforcing the use tax collection obligation of remote sellers with in-state affiliates, although it is not theoretically necessary. Alternatively, states could adopt legislation that makes the in-state affiliate responsible for payment of the tax. This would more clearly avoid any constitutional impediments. Again, however, the constitutional question should not turn on “draftsmanship and phraseology.”³²⁵

VII. CONCLUSION

Affiliate nexus is an essential tool for preventing further erosion of tax equity among retailers. For some retailers to be subject to sales taxes, and others not, distorts the economic playing field. This disparity is especially troublesome if different tax treatment results from formalistic manipulation of the corporate structure. Still, sales tax equity can be fully achieved only if *Quill's* anachronistic physical presence test is either judicially or legislatively overruled. As long as *Quill* remains good law, pure Internet and mail-order companies will be constitutionally protected from state sales and use taxes, notwithstanding that there is no meaningful economic difference between exploiting a market electronically, by mail, or by a physical presence.³²⁶

322. 26 C.F.R. § 1.5202-6.

323. *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 304–07 (1994).

324. *See id.* at 307, 311–14.

325. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 281 (1977).

326. The theory of affiliate nexus would not give states jurisdiction over tax retailers that do not have an in-state affiliate. For a discussion of economic neutrality among various types of retailers, see McLure, *supra* note 17, at 321–51, 393–414 (including a comprehensive discussion of the impact of technology on retailing and the anachronistic structure of the sales tax).

In fairness, one can appreciate the administrative burden on smaller electronic retailers of tax reporting to a multiplicity of state and local taxing jurisdictions. Advances in sales tax reporting software, however, among other reasons, reduce this to something less than a dormant Commerce Clause concern.³²⁷ Judicious exercise of Congress' affirmative Commerce Clause powers could result in legislation that balances tax equity, administrative concerns, and state revenue needs.

It is said that life is what happens while you are busy making plans. The same can be said of tax policy. Despite the flurry of activity on both the federal and state level, it is doubtful that a meaningful legislative response to the sales and use tax issues raised by electronic commerce will be crafted anytime soon.³²⁸ The competing interests are so diverse that a consensus is unlikely to emerge, and Congress is understandably reticent about interjecting itself into state tax policy.³²⁹ In the meantime—which may be a long time indeed—it is up to state taxing authorities and the courts to prevent a further relapse into formalism in Commerce Clause jurisprudence. As between entity isolation and affiliate nexus, the latter is the correct policy and jurisprudential choice.

327. See, e.g., *California's Andal, CBPP's Mazerov Go Head-to-Head on E-Commerce*, 1999 ST. TAX TODAY 233-22, at Doc. 1999-38291 (Dec. 6, 1999) (discussing tax compliance software solution to e-commerce tax reporting).

328. See *supra* note 22.

329. Cf. Kendall L. Houghton & Walter Hellerstein, *State Taxation of Electronic Commerce: Perspectives on Proposals for Change and Their Constitutionality*, 2000 BYU L. REV. 9 (2000) (raising Commerce Clause and Eleventh Amendment concerns with federal intervention in state cybertax issues).