I. About 45 States and the District of Columbia have sales taxes and use taxes and these taxes range between one percent and 11%.

A. These sales taxes are generally imposed with respect to a business retail sale of tangible personal property which occurs in a State.

1. Sales taxes imposed on, for example, renting a hotel room and automobile parking are often significantly higher rates.

B. Each State which has a sales tax with respect to the purchase of tangible personal property also has a use tax.

1. The use tax is imposed for the purpose of taxing a purchase made in another State when the tangible personal property is brought back into the taxing State for the purpose of:

   a. Using;

   b. Consuming; or,

   c. Storing the tangible personal property.

   d. Normally, the use tax rate is the same as the sales tax rate, but, generally, a credit is allowable for any sales tax paid, upon such purchase, to the other State.

   e. The purpose of the use tax is to make certain that an in-state purchaser, who does not pay the sales tax to the purchaser’s home State, will pay a use tax to the purchaser’s home State.

      (1) The thought is that - - - someone should pay a tax on the purchase of tangible personal property.

2. Generally, sales and use taxes are not imposed on services, except to the extent that the services are incorporated in the sales price of the tangible personal property.

   a. It takes some services, for example, to build a dishwasher, but when the dishwasher is sold, without breaking out the cost of the services, then the entire sales price is subject to the sales tax.

   b. So plumbers, electricians, automobile repair businesses list separately the costs for services and those costs for materials, and only charge you sales taxes on the latter.

   c. Sprayers of poisons on your lawn do not break out the services and you pay the sales tax on both the poisons and the spraying services, just like a purchase of a dishwasher.

II. Some basic questions are:

A. How far will state law reach?
1. When may a State impose a requirement on an out-of-state business to collect the taxing State’s taxes? Consider basic constitutional laws with respect to State:
   
   a. Death taxes;
   b. Traditional inheritance tax.
   c. Traditional pick up tax.
   d. Property taxes; and,
   e. Income taxes.

2. For sales and use taxes, the issue is generally not whether or not the taxing State may impose the sales/use tax on an out-of-state seller of goods.
   
   a. Nor is the issue whether or not the taxing State may require an out-of-state seller to collect the taxing State’s sales tax.
   
   b. The issue is whether or not the taxing State may require an out-of-state seller to collect the taxing State’s use tax.
   
   c. The question is frequently raised as to whether or not the seller, who is, for example, in the State of Indiana, can be required to collect the use tax of your State, for your State, and be required to add your State’s use tax on to the bill which you are required to pay to the seller, who is in the State of Indiana.

B. The use tax probably creates more tax cheaters and evaders than any other Federal or State tax.

1. Most States have seriously attempted to collect use taxes by having the out-of-state business collect the use tax when a resident of one State purchases tangible personal property from a seller in another State.

2. Not many individuals pay the use tax to their home State either because they do not understand its application or because the individuals just do not want to pay it.

   a. But, clearly, if use taxes are not paid to the taxing State either by the individual when the goods are purchased from and paid for to an out-of-state seller or when the individual later files the individual’s in-State income tax return, then the sales/use taxes wind up being imposed only on in-State purchases/sales and individuals who purchase goods in their home State pay more for the goods than individuals who purchase goods from out-of-state sellers.

   b. Some estimates of losses of revenues and taxes are as follows.

      (1) During the year 1999, sales in the amount of $18.15 billion occurred on the internet, which sales would normally have occurred in stores.

      (2) During the year 2002, $76 billion of sales were lost to stores.

      (3) The estimated amount of loss of sales/use taxes for the 2003 for some states are as follows.

        (a) Illinois $844.8 million
        (b) Michigan $757.5 million
c. With respect to the loss of sales/use taxes by all 50 states, one estimate is over $20 billion.

3. Local stores have been and will continue to demand that States repeal the sales/use taxes which, as the stores see, is an unfair underwriting by the States of the companies who make sales through the internet.
   a. The irony of all this is that many States have reduced (or not dramatically increased) property taxes and have relied to a great extend for revenues from sales/use taxes and income taxes.

4. The out-of-state seller does not have much more of a an administrative burden in collecting another State’s use tax than an in-state seller has, and in both cases, the taxing State will compensate the sellers for collecting the sales tax or use tax, as the case may be.
   a. And both the in-state seller and the out-of-state seller may be liable to pay to the taxing State the amount of sales tax or use tax whether or not the in-state or out-of-state seller actually collects the sales tax or use tax, as the case may be.

III. There are many statutory exemptions from the sales and use taxes, and the two most important ones are as follows.

A. The manufacturing or business type exemptions are there for many purposes.
   1. The primary reason is to eliminate sales/use tax when manufacturers (including, farmers, etc.) purchase tangible personal property which is to be incorporated in the product being manufactured or which is to be incorporated in the machines which manufacture the product which is being manufactured. This helps to cut the cost of the product which will ultimately be sold to the public. There will be no sales/use tax imposed on a previously paid sales tax.
   2. The interstate commerce exemption, such as, the Federal interstate commerce exemption may be thought of as follows.
      a. If an individual, who lives outside of the State of Indiana, purchases a coat (by cash or credit card) in his or her home State and if the purchaser’s home State imposes a sales tax, then the purchaser would be obligated to pay the sales tax to the purchaser’s home State.
      b. And, if, alternatively, the purchaser comes to the State of Indiana and purchases a coat (by cash or credit card), then the individual must pay the Indiana sales tax - - - the same as Indiana residents would have to do.

         (1) Selecting the coat and paying for the coat in the State of Indiana and having the store send the coat to the purchaser’s home State (outside of the State of Indiana) is not going to eliminate the purchaser’s obligation to pay Indiana sales tax - - - despite what the store clerk states.
(2) But whether or not the purchaser pays Indiana sales tax, the purchaser might still owe a use tax to the purchaser’s home State when the purchaser takes the coat back to the purchaser’s home State.

(3) However, if the purchaser does not leave the purchaser’s home State and, instead, calls, by telephone, the Indiana store and orders the coat (and pays for the coat by sending a check or by using a credit card), then nobody may impose a tax on that transaction without the Federal government allowing the imposition.

(a) The question is: where did the purchase/sale take place? And, the answer is: it did not take place in the purchaser’s home State and it did not take place in the State of Indiana, and therefore, the sale/purchase must have taken place somewhere in between the purchaser’s home State and the State of Indiana, and that place or corridor is called the “interstate commerce corridor”.

(b) To repeat: if a purchase/sale takes place in the interstate commerce corridor, then nobody, but nobody, may impose a tax with respect to the purchase/sale transaction without the consent of the Federal government.

(c) However, when the coat is delivered to the purchaser in the purchaser’s home State, then the purchaser might owe a use tax to the purchaser’s home State.

IV. There are two clauses of the U.S. Constitution which frequently come into issue with respect to what one State may require a seller in another State to do with respect to the collection of sales/uses taxes by out-of-state sellers: the Commerce Clause; and, the Due Process Clause.

A. The Commerce Clause, which is at Article I, Section 8, Clause 3 of the U.S. Constitution, states that Congress shall have the power to regulate commerce with foreign nations and among the several States and with the Indian tribes.

1. The Due Process Clause, which is in the Fourteenth Amendment of the U.S. Constitution, states that no State shall deprive any person of life, liberty, or property, without due process of law.

2. After many years of attempts, Congress has passed very little legislation to interpret the meaning of these two clauses with respect to State taxation powers - - - probably:

   a. Due to the individual philosophies of our representatives; and,

   b. Because of enormous political contributions of interstate sellers of tangible personal property.

(1) However, the courts have made considerable contributions to interpret these two clauses and the U.S. Supreme Court has contributed the most.

V. Some of the important cases are as follows.
A. The National Bellas Hess Case. The most famous case in this area is the U.S. Supreme Court case of National Bellas Hess, Incorporated v. Department Of Revenue Of The State Of Illinois, 87 S.Ct. 1389 (05/08/67). This case involved the State of Illinois which attempted to require National Bellas Hess, a Missouri business, to collect Illinois use tax from residents of the State of Illinois who purchased goods from National Bellas Hess. The National Bellas Hess case was decided by the U.S. Supreme Court almost 35 years ago and I have paraphrased and edited the court’s opinion and dissent and you might want to read what is presented below for additional background. The general facts of the case were as follows: National Bellas Hess was a Missouri business which sold goods outside of the State of Missouri. All of the contacts which National Bellas Hess made with the purchasers in the State of Illinois were made through the United States mail or common carrier. Twice a year, catalogues were mailed to National Bellas Hess’ active or recent customers throughout the nation, including those customers in the State of Illinois. This latter mailing was supplemented by advertising flyers which were occasionally mailed to past and potential customers. The catalogue contained about 4,000 items of merchandise. The company's mailing list included over 5,000,000 names. The flyers were sent to an even larger list than the catalogue list and were occasionally mailed in bulk addressed to “occupant”. All orders for merchandise were mailed by the customers to National Bellas Hess in the State of Missouri and the orders were accepted at National Bellas Hess’ Missouri plant. Then, the ordered goods were sent to the customers either by mail or by common carrier. National Bellas Hess did not maintain, in the State of Illinois, any office, distribution house, sales house, warehouse or any other place of business other than in Missouri. Nor did National Bellas Hess have, in the State of Illinois, any agent, salesman, canvasser, jobber, retailer, wholesaler, manufacturer representatives, solicitor or other type of representative or independent contractor or broker who was paid a salary or commission to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise which National Bellas Hess sold. National Bellas Hess did not own any real or tangible personal property in the State of Illinois nor did National Bellas Hess have a telephone listing in the State of Illinois nor did National Bellas Hess deliver any of the goods ordered to the Illinois purchasers with National Bellas Hess’ trucks. National Bellas Hess did not advertise its merchandise for sale in newspapers, on billboards, or by radio or television in the State of Illinois. During 1961, National Bellas Hess’ net sales were in the neighborhood of $60,000,000, and its accounts receivable amounted to about $15,500,000. National Bellas Hess’ sales in Illinois amounted to $2,174,744 for the approximately 15 months for which the Illinois use taxes were assessed. A substantial part of National Bellas Hess’ sales was on credit. The catalogues featured NBH Budget Aid Credit which required no money down but required the purchaser to make monthly payments which include a service fee or interest charge and which also incorporated an agreement, unless expressly rejected by the purchaser, for budget aid family insurance. National Bellas Hess also offered charge account services, which were payable monthly, including a service charge if the account were not fully paid within 30 days. The form to be filled in for credit purchases contained the usual type of information, including, the place of employment, name of bank, marital status, and home ownership or rental. Merchandise could also be bought c.o.d. or by sending a check or money order with the order for goods. After stating that the purpose of the Commerce Clause is to ensure that a national economy is free from unjustifiable local entanglements, the U.S. Supreme Court observed that Congress alone, through the provisions of the U.S. Constitution, has the power of regulation and control of interstate commerce. Based on these facts, a majority of the U.S. Supreme Court held that the State of Illinois did not have the power to require National Bellas Hess, a Missouri company, to collect Illinois use taxes from State of Illinois purchasers. Clearly, in the National Bellas Hess case, the U.S. Supreme Court was looking for more of a presence in the State of Illinois than National Bellas Hess had. Specifically, the U.S. Supreme Court wanted National Bellas Hess to have more “physical presence” in the State of Illinois before the U.S. Supreme Court would uphold the State of Illinois’ ability to require National Bellas Hess to collect Illinois’ use taxes. For example, had National Bellas Hess had a distribution center in Illinois, then, without question, the State of Illinois would have the constitutional authority to require National
Bellas Hess to collect the State of Illinois use taxes. However, the dissenting opinion states, in general, that there should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market was a sufficient nexus to require National Bellas Hess to collect the Illinois use tax from Illinois customers and to remit the use tax to the State of Illinois. This is especially true when considering National Bellas Hess’ use of the credit resources of residents of the State of Illinois because that mechanism is upon the State's banking and credit institutions. National Bellas Hess is not simply using the facilities of interstate commerce to serve customers in the State of Illinois. National Bellas Hess is regularly and continuously engaged in exploitation of the consumer market of the State of Illinois by soliciting residents of the State of Illinois who live and work there and have homes and banking connections there, and who, absent the solicitation of National Bellas Hess, might buy locally and pay the sales tax to support their State.

National Bellas Hess could not carry on its business in the State of Illinois, and particularly its substantial credit business, without utilizing the Illinois banking and credit facilities. Because this case was tried on affidavits, we are not informed as to the details of National Bellas Hess' credit operations in the State of Illinois. We do not know whether or not National Bellas Hess utilized credit information or collection agencies or similar institutions. National Bellas Hess states that it has brought no suits in the State of Illinois. Accepting this as true, it would nevertheless be unreasonable to assume that National Bellas Hess did not either sell or assign its accounts or otherwise take measures to collect its delinquent accounts or that collection did not include local activities by National Bellas Hess or its assignees or representatives. National Bellas Hess enjoyed the benefits of, and profits from, the facilities nurtured by the State of Illinois as fully as if National Bellas Hess were a retail store or maintained salesmen therein. Indeed, if National Bellas Hess did either, then the benefit that National Bellas Hess received from the State of Illinois would be no more than National Bellas Hess then had, specifically, the ability to make sales of its merchandise, to utilize credit facilities, and to realize a profit, and, at the same time, National Bellas Hess would be required to pay additional taxes. As the facts stood in this case, National Bellas Hess conducted its substantial, regular, and systematic business in the State of Illinois and the State of Illinois demanded only that National Bellas Hess collect from National Bellas Hess’ customer and users the Illinois use tax and to remit to the State of Illinois the use tax which was merely equal to the sales tax which resident merchants must collect and remit. To excuse National Bellas Hess from this obligation is to burden and penalize retailers located in the State of Illinois who must collect the sales tax from National Bellas Hess’ customers. While this advantage to out-of-state sellers is tolerable and a necessary constitutional consequence where the sales are occasional, minor and sporadic and not the result of a calculated, systematic exploitation of the market, it certainly should not be extended to instances where the out-of-state company is engaged in exploiting the local market on a regular, systematic, large-scale basis. In such cases, the difference between the nature of the business conducted by the mail order house and by the local enterprise is not entitled to constitutional significance. This case, as most cases in this area, dealt with both the commerce clause and the due process clause, the issues of which are very similar, and the distinctions are between them are rapidly disappearing.

1. The Complete Auto Transit Case. 25 years ago, after much more litigation, the U.S. Supreme Court formulated some tests to determine whether or not another State’s tax statute was an unconstitutional impingement on interstate commerce in the case of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). In this case, the U.S. Supreme Court stated four tests, which if met, would allow a State tax statute to be constitutional with respect to the Commerce Clause. Specifically, the State tax statute must (to be constitutional):
   a. Be applied to an activity with substantial connection (nexus) with the State;
   b. Provide a tax which is fairly apportioned;
c. Not discriminate against interstate commerce; and,
d. Be fairly related to the services which are provided by the State.

This was an extraordinary decision, because up to the issuance of the opinion and decision in this case, it was thought that sales through the interstate corridor were virtually untouchable.

2. What is nexus? Clearly, the National Bellas Hess court determined that the important fact for finding nexus was a significant physical presence in the taxing State by the out-of-state seller.

a. The term “nexus”, in the sales/use tax arena, means the presence, whether physical or economic, in a taxing State, by an out of State seller, which presence allows the taxing State to constitutionally impose a requirement that the out of State seller collect use taxes for the taxing State with respect to sales which the out of State seller makes to individuals in the taxing State.

b. While the concept of “nexus” was around long before the Complete Auto Transit case, it seems as though more States began pushing the envelope, as to the meaning of the term “nexus”, after the Complete Auto Transit case was decided. In fact, the National Bellas Hess opinion listed the following types of contacts which, if sufficient in number or quality, would added up to a nexus which would allow the taxing State to constitutionally tax an out-of-state seller. Notice that all of these can be viewed as physical presence in a State, and the first three of these can easily be seen as substantial physical presence in a State.

(1) Maintaining an office, distribution house, sales house, warehouse or other place of business in the taxing State.
(2) Having an agent, salesman, canvasser, solicitor, or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise which the out-of-state seller sold in the taxing State.
(3) Owning real or tangible personal property (more than a computer disk) in the taxing State.
(4) Having a telephone listing in the taxing State.
(5) Advertising the out-of-state seller’s merchandise for sale in newspapers, on billboards, by radio, or by television in the taxing State.

c. What is physical presence?

(1) Does it take a foot print on the soil of the taxing State in order to have presence in the taxing State - - - for tax purposes?
(2) Consider the following types of facts.
(a) The number of the out-of-state seller’s customers in the taxing State.

(b) The percent of the out-of-state seller’s customers in the taxing State as compared to the out-of-state seller’s total customers.

(c) The number of purchases made by the customers in the taxing State from the out-of-state seller.

(d) The percent of the out-of-state seller’s sales in the taxing State as compared to the out-of-state seller’s total sales.

(e) The dollar amount of purchases made by the customers in the taxing State from the out-of-state seller.

(f) The percent of the dollar amount of the out-of-state seller’s sales in the taxing State as compared to the dollar amount of the out-of-state seller’s total sales.

(g) The type and quality of services provided by the taxing State to the out-of-state seller, for example, banking services, waste disposal services, fire department services, and police department services.

3. The Quill Case. Almost ten years ago, an important case came out of the State of North Dakota, the Quill case, and I have paraphrased and edited both the North Dakota Supreme Court’s marvelous opinion and decision (at 470 N.W.2d 203 (1991)) and the U.S. Supreme Court’s opinion and decision (at 504 U.S. 298 (1992)).

a. Quill was (and still is) a Delaware corporation with offices and warehouses in the States of Illinois, California, and Georgia. At the time when this case was heard, Quill sold office supplies, stationery, and equipment, offering over 9,500 different products ranging from paper clips to computers. Its annual sales were in excess of $200,000,000. Quill solicited business through its numerous catalogs and flyers, advertisements in nationally distributed "card packs," advertisements in national periodicals and trade journals, and telephone solicitation of current customers. Of the more than 200,000 orders Quill received monthly, approximately one-half were by telephone. The remaining half were received by mail, fax, telex, and by direct computer contact. Quill's annual sales to nearly 3,500 active North Dakota customers were just under $1,000,000. By sales volume, Quill was the sixth largest seller of office supplies in North Dakota. Quill each year mailed over 60 different catalogs and flyers to its North Dakota customers. This amounted to more than 230,000 separate pieces of mail, weighing over 24 tons, sent into North Dakota annually by Quill. It was estimated that 44% of all such direct mail solicitations are disposed of unopened and unread. Estimates prior to the Quill case indicated that such "junk" mail was a nearly 4 million-ton colossus that accounts for 39% of all U.S. postal volume, with about 41 pounds of junk mail being generated for each adult American. Quill made sales on approval in the State of North Dakota, and thus, the State of North Dakota argued that Quill had retained title to the goods until the merchandise was accepted or rejected by the buyer, and therefore, Quill owned property within the State which received fire and police protection, as well as other benefits. Quill's catalog makes the following offer to customers: "Use any product
from Quill in your office FREE for 30 days. During that time, try it, inspect it, use it ... just to be sure you're satisfied with the product. You have no reason to pay us and can return it during that period for any reason ... no questions asked ... and we'll give you a full credit against your invoice." In addition, customers could, at any time within 90 days of purchase, return any item for a full refund if not completely satisfied.

b. As in other cases, the State of North Dakota attempted to make Quill collect North Dakota use taxes with respect to purchases from Quill which were made by individuals who resided in the State of North Dakota. But where was the physical presence of Quill in the State North Dakota? The North Dakota Supreme Court answered this by pointing out two things.

(1) First, that the National Bellas Hess test was out-of-date with today’s commercial transactions and that the Commerce Clause no longer mandated the sort of physical-presence nexus which was suggested in National Bellas Hess.

(2) Second, considering all of those catalogues, advertisements, and computer disks (which Quill let customers use to order products, etc.) and considering that fact that Quill used North Dakota’s banking services for credit card purchases and used the waste collection services to dispose of all of those catalogues, etc. and considering that Quill might have used the police services if a computer disk were stolen and might have used the fire department services if a building, with Quill computer disks in it, caught fire, the appropriate nexus required by the Interstate Commerce Clause was met.

c. The North Dakota Supreme Court concluded that an out-of-state seller’s "economic presence" in the taxing State is the most important fact to determine a State’s legal ability to impose an obligation on the out-of-state seller to collect the use tax of the taxing State. The North Dakota Supreme Court believed that under an “economic presence” test, the most important factors are the services and benefits which are provided by the taxing State to the out-of-state seller, and therefore, based on these facts, the economic presence of Quill in the State of North Dakota generated "a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax." The North Dakota Supreme Court concluded as follows.

(1) We conclude that Quill's asserted lack of physical presence is not fatal to the State's attempt to require Quill to collect and remit use tax on its sales into North Dakota. Applying Bellas Hess in light of subsequent case law, and within the context of contemporary society and commercial practice, we conclude that the concept of nexus encompasses more than mere physical presence within the State, and that the determination of nexus should take into consideration all connections between the out-of-state seller and the (taxing) State, all benefits and opportunities provided by the (taxing) State, and should stress economic realities rather than artificial benchmarks.

d. However, the U.S. Supreme Court stuck to a “physical presence” test and
somewhat bating Congress to enact any test which Congress believes is best, stating, roughly, as follows.

(1) In sum, although in our cases subsequent to National Bellas Hess and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that National Bellas Hess established in the area of sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the National Bellas Hess rule remains good law. For these reasons, we disagree with the North Dakota Supreme Court's conclusion that the time has come to renounce the bright-line test of National Bellas Hess. This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. Indeed, in recent years Congress has considered legislation that would "overrule" the National Bellas Hess rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in National Bellas Hess that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes. Indeed, even if we were convinced that National Bellas Hess was inconsistent with our Commerce Clause jurisprudence, "this very fact [might] giv[e] us pause and counse[l] withholding our hand, at least for now. Congress has the power to protect interstate commerce from intolerable or even undesirable burdens." In this situation, it may be that "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government."

4. The Orvis And VIP Cases. About five years ago, along came the following two cases from the State of Vermont: In the Matter of Orvis Company, Inc., v. Tax Appeals Tribunal of New York, Commissioner of New York State Department of Taxation and Finance; and, In the Matter of Vermont Information Processing, Inc. (VIP) v. Tax Appeals Tribunal of New York, Commissioner of New York State.

a. The Orvis Case. In the Orvis Company, Inc. case, Orvis sold, at both retail and wholesale, camping, fishing and hunting equipment, casual and outdoor clothing and food and various gift items. Orvis' retail sales were almost entirely through mail-order catalog purchases shipped from Vermont by common carrier or the United States mail. Orvis also sold merchandise at wholesale to New York retail establishments. Orvis employees visited New York retailers to whom Orvis sold merchandise during the three-year audit period. Relying upon Quill Corp. v. North Dakota, 504 U.S. 298, the Appellate Division held that in the absence of a substantial physical presence by Orvis personnel in New York, the imposition of the duty to collect use taxes from its New York mail-order purchasers contravened the Commerce Clause. The Court concluded that Orvis' "sporadic activities in New York" failed to meet the substantial physical presence standard and, therefore, the assessment of the tax was invalid.
b. The VIP Case. In the Vermont Information Processing, Inc. case, VIP markets computer software and hardware to beverage distributors in New York and elsewhere throughout the United States. In most instances, VIP's customers' orders were filled through shipments by common carrier or United States mail. An audit of VIP's invoices and sales records, however, showed visits by its employees to New York customers to resolve problems and give additional instructions in connection with the use of VIP software programs, and occasionally for installing software. The Appellate Division again concluded that those activities were insufficient to constitute the requisite substantial physical presence of VIP in this State and annulled the determination assessing the tax.

c. With respect to these cases, the highest court in the State of New York stated that it did not read the Quill decision to make a substantial physical presence of an out-of-state vendor in New York a prerequisite to imposing the duty upon the vendor to collect the use tax.


B. A very recent case is America Online Inc. v. Johnson (Tenn. Ct. No M2001-00927-COA-R3-CV, 07/30/02. AOL, a Delaware corporation with headquarters in Virginia, provides various Internet and online services, including electronic mail and Internet access. For purposes of AOL's motion for summary judgment, the commissioner agrees that AOL does not own or lease any real property in Tennessee. AOL does not have regular employees in the state, and sells its services through the mail or by magazine inserts. The promotional materials include printed brochures and a floppy disk containing the software necessary to access AOL's data center in Virginia. By using the disk the customer can sign up online and become an AOL member by agreeing to the terms and conditions of the offer. With the software in place and the agreement consummated, a member can access AOL's services by dialing a telephone number supplied by a third-party network service provider (NSP), which routes the call to its general data network and on to AOL's data center in Virginia. During the relevant period, AOL used two types of public data networks provided by NSPs. The x.25 data networks were provided by public companies, such as Spring and Tymnet, that provided the same services to other customers. In 1994 AOL began using AOLnet, which had its own network of NSPs. Each NSP in AOLnet, one of which was ANSCO+RE Systems Inc., a subsidiary of AOL, operated a public data network used by other customers in addition to AOL members. In this system, however, the service was provided to AOL members through dedicated modems and other component parts leased by AOL and located in Tennessee. The ownership of AOLnet itself is in dispute. Some of AOL's members in Tennessee were designated as "remote staff." They were unpaid persons, working from their homes, and trained by AOL to moderate real-time conferences. They were subject to call at any time to help enforce AOL's rules, such as the rules against vulgarity or harassment. They did not, however, solicit business in Tennessee. Holding. Because the undisputed facts do not show that the taxes the commissioner seeks to impose on AOL would violate the commerce clause of the U.S. Constitution for lack of "nexus," the chancery court's summary judgment for AOL is reversed.

1. One of the four requirements established by the U.S. Supreme Court in Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1977), for a state to impose a tax on interstate
commerce without violating the commerce clause is that the activity being taxed have a "substantial nexus" with the taxing state.

2. The fact that AOL does not have offices or employees in the state or that it does not own or rent real property there is not conclusive of the issue of nexus. A substantial nexus may be established by activities carried on within the state by affiliates and independent contractors.

3. The only situation the court knows of in which a substantial nexus does not exist is where the only contact with the state is by the Internet, mail, and common carriers. On the other hand, where activities are "being conducted in the taxing state that substantially contribute to the taxpayer's ability to maintain operations in the taxing state," a substantial nexus does exist.

4. Considering the record as a whole, the court finds the question of whether AOL's nexus with Tennessee satisfies the Complete Auto Transit test is still open. A substantial number of businesses operating in this state help make the AOL service available to Tennessee customers.

   a. The NSPs provides services, some through their own equipment, and some by using equipment leased by AOL and located in the state.

   b. One of the NSPs is an AOL subsidiary.

   c. The record so far developed cannot support a finding that the activities conducted on AOL's behalf were inconsequential or of slight significance. AOL's connection with Tennessee amounts to more than the Internet, mail, and common carrier.

   d. Further, at some point the number of floppy disks mailed by AOL into the state could become a factor to be added to the balance.

   e. The matter is remanded to the trial court for further proceedings.

C. Another recent case which involves interstate commerce is Schering-Plough Healthcare Products Sales Corp. v. Pennsylvania, Pa Commonw, Ct. No.1015 F.R. 1998 (08/25/02). This case involved the power of the State of Pennsylvania to impose an income tax on the income which was earned by (Sales Corp) a California corporation, with headquarters in New Jersey, and which corporation solicited orders for healthcare products in Pennsylvania. Sales was wholly owned by (Healthcare), a Delaware corporation which was based in Tennessee, and which corporation develops, manufacturers, and sells health care products. Sales Corp solicited orders for Healthcare's products in Pennsylvania and elsewhere and also conducts other activities which are considered to be ancillary to that solicitation activity, such as promoting products and offering advice on the retail display of the products. Sales Corp carried out no other activities in Pennsylvania and these activities were carried out by Sales Corp’s salespersons and by independent contractors. Each order was sent to Healthcare’s Tennessee facilities for approval and all orders were filled by Healthcare from inventory which was located outside of Pennsylvania. The inventory was sent to the Pennsylvania customers by common carriers. Sales Corp did not: take title to the sent inventory; have an office
or other place of business in Pennsylvania; lease or own any property in Pennsylvania; have any authority to accept orders for the products; or, handle credit claims or collect accounts receivable. Sales Corp received commission directly from Healthcare for Sales Corp solicitation activities, specifically, Sales Corp was paid a fixed percentage of the net final sales which were consummated by Healthcare. Public Law 86-272 (15 U.S.C. § 381-2) provides as follows.

1. Sec. 101. (a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
   (1) The solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and,
   (2) The solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of net income tax by any State, or political subdivision thereof, with respect to:
   (1) any corporation which is incorporated under the laws of such State; or
   (2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consists solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section:
   (1) The term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and,
   (2) The term "representative" does not include an independent contractor.