TAXATION OF
COMPUTER SOFTWARE
AND SERVICES

SALES TAX SCHOOL II
THEORY AND PRACTICE FOR THE EXPERIENCED
SALES AND USE TAX PROFESSIONAL

Learning Objectives
At the end of this section, the learner will be able to:

- Provide examples of/or definitions for the following:
  - Prewritten or canned software
  - Custom software
  - Data processing services
  - Cloud Computing (software as a service, infrastructure as a service and platform as a service)
  - Information Services
  - Digital Automated Services
  - Technology licensing contract
  - Intellectual property

- Discuss the difference between basic operational software and application software.
- Determine factors to consider when analyzing the taxability of prewritten or custom software.
- Evaluate the taxability of software sales based on delivery mechanism and the reasoning behind it.
- Determine how tax applies to the following:
  - Mandatory and optional maintenance contracts for hardware and software
  - Training services
  - Software installation or implementation services
  - Consulting services

- List types of exemptions that apply to purchases of computer software
- Discuss the general sourcing rules for software accessed from multiple jurisdictions when:
  - Software is loaded on and accessed by users at the purchaser’s server
  - Software is loaded on and accessed by users at the vendor’s server
- Define phrase “True Object of the Contract”.
- Analyze the tax ramifications of complex contracts that bundle services, goods, and intellectual property.
- Analyze the impact of software modifications to prewritten software vs. custom software.
- Determine how tax applies to contracts involving goods, services, and/or intellectual property.
I. INTRODUCTION

A. Existing statutes and regulations are often inadequate for addressing the taxability of new products and services.

The rapid pace of invention and introduction of new products and services have dramatically increased the time lag between the point that taxability issues are first recognized and the point at which the state legislatures adopt new statutes to resolve or otherwise address the taxability issues.

Lacking appropriate and timely statutes, state taxing agencies are left in the unenviable position of applying existing tax statutes and regulations that probably were never intended to address the new and complex issues arising from new computer products and related technology services.

B. There is a lack of uniformity in state definitions of computer services and in how these services are taxed.

1. It is important to critically review the definitions and terms used in each state’s statutes.

For example, the term “custom software” has various definitions, some of which are inconsistent from state to state.
2. It is important to evaluate and frequently revisit each state’s position on the taxability of various computer software products and services since this area seems to be constantly evolving.

Some state taxing authorities (alternatively, “agencies”) have changed their policy on the taxability of certain computer software products even though the underlying statutes and regulations have not changed.

For example, consider how various states are treating software license sales when transmitted via the Internet and/or remote telecommunications or provided via remote access.

C. New technologies have blurred the lines between telecommunications, information services, data processing services, access to application software and other services. Contracts often include, in a single contract, the sale of statutory and/or traditional tangible personal property, services and a license to use intellectual property. Accordingly, multiple statutes and regulations may apply to a single contract.

The onslaught of new computer services and products has increased the complexity of determining the true object of the contract as well as how and where to tax the transaction.

D. In the past few years, many states have added to or revised their statutes, regulations or administrative policies to specifically address the taxability of computer software and related services. Additionally, a number of states have adopted the definitions related to software that are included in the Streamlined Sales Tax Agreement.


E. A company’s perspective regarding the taxability of software licenses, software updates, and related services may depend upon whether the company is the purchaser or the seller. Generally, the seller will be motivated to collect the tax unless the transaction is unquestionably exempt. The purchaser should be motivated to determine whether an exemption may apply, and if need be, request changes in the contract language to enable all or part of the contract to be eligible for exemption. The onus is on the purchaser to research the various states’ statutes and regulations and then plan, negotiate, and document the transaction so that it qualifies for any exemptions claimed.
II. PRE-WRITTEN OR CANNED SOFTWARE SALES

A. Definitions of Canned Software: What's Included? What's Excluded?

Each state has its own definition of prewritten, also known as “canned” software.

1. Idaho Rule 27 (Rule 35.01.02.027) contains several common definitions for “canned” or prewritten software:
   
   a. Prewritten software which is offered for sale, lease, or use to customers on an off-the-shelf basis with little or no modification at the time of the transaction beyond specifying the parameters needed to make the program run.
   
   b. Includes program modules which are prewritten and later used as needed for integral parts of a complete program.
   
   c. Includes subsequent sales of a "custom" program.

2. Verify terminology & definitions
   
   a. Understand the legal distinction in the tax code between prewritten (canned) versus custom software

   The definitions and taxable status of canned (prewritten) and custom software differ from state to state. Some states' tax statutes may not have the same definition for terms that are used in your company's contracts. It is advisable to check your contracts for commonly used industry terminology that may have different definitions in a particular state's tax code or regulations. If the state defines the same term differently from
how your company intended that term to be interpreted in the context of the contract, then recommend that the term be explicitly defined in the contract.

b. Understand how the state views the sale of prewritten software

Generally, most states deem prewritten or canned software to be tangible personal property. Under certain circumstances, however, a sale involving software may be considered the sale of a service or the licensing of intangible intellectual property.

B. Types of Prewritten Software

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1. Basic Operational Software

Basic operational programs are generally inseparable from the sale of the computer hardware and are not itemized nor sold for a separate price. In general, basic operational software will have the same tax status as that of the sale of the computer hardware.

**Why know the difference between operational software and application software?** The difference between basic operational software and application software tends to be more meaningful for business personal property tax, but a working knowledge of the difference between the two types of software can serve the sales tax practitioner as follows:

- By reinforcing the sales tax practitioner’s grasp of what can and cannot, in the way of software, be practically or arbitrarily distanced from traditional tangible personal property: Computer hardware is typically sold along with
basic operational software which has been loaded onto the hardware; without basic operational software the hardware cannot be activated (turned “on”). By way of example, basic operational software generally would not be purchased for a “first time” download to computer hardware, because without basic operational software, the computer hardware can’t run.

- By preparing the sales tax practitioner for unique sales tax rules, such as Ohio’s imposition of sales and use tax on “computer services” for which the definition distinguishes between services involving “systems software” and “application software”. Rule 5703-9-46(A)(2) Ohio Admin. Code

- By preparing the sales tax practitioner for more abstract analyses such as California’s “Technology Transfer Agreement” statutes.

California Revenue and Taxation Code Section 995.2 provides a good definition of basic operational software: “a computer program which is fundamental and necessary to the functioning of a computer”.

Similarly, Arizona Revised Statutes Section 42-19003.01. D. defines “operating software” as, “the collection of software that directs the computer's low-level operations, controlling and scheduling the execution of application programs and managing the low-level operation of storage, input, output and communication resources.”

Ohio Regulation 5703-9-46(A) (4) provides the following definition of “Systems software”:

"Systems software" includes all programming that controls the basic operations of the computer, such as arithmetic, logic, compilation or similar functions, whether it is an integral part of the computer hardware or is contained on magnetic disks or other storage media. "Systems software," solely for purposes of Chapter 5739 and 5741 of the Revised Code because of division (Y)(2)(e) of section 5739.01 of the Revised Code, does not include application software programs that are intended to perform business functions or control or monitor processes.
2. Application Software

Application software is designed to perform a specific function or task. Common examples of application software include spreadsheets, word processing, payroll, and Enterprise Resource Planning (ERP) programs. Because a jurisdiction’s statutes and regulations tend not to define terms unless specifically required for the administration of the jurisdiction’s tax, definitions of “application software” are often defined in terms of what systems or operations software is not; however, some jurisdictions have provided definitions for application software, such as:

The Code of Virginia, Section 58.1-1101. A.8., provides the following definition of “application software”: “Computer application software, … is defined as computer instructions, in any form, which are designed to be read by a computer and to enable it to perform specific operations with data or information stored by the computer”; and,

Nebraska 20-001.01B (1) defines application software as “software which is not necessary for computer hardware to function”
C. Factors Affecting Taxability of Prewritten (Canned) Software

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1. Canned software purchased for resale
   a. Incorporated into another product for resale
      (1) Loading software onto personal computers, servers or other end-user commodities.
      (2) Incorporating software into another software package for sale.
      (3) Incorporating software into an intermediate product, such as a microprocessor.
   b. Reselling the canned package on a standalone basis
   c. Canned software resold as intellectual property

Most states allow canned software to be purchased for resale.

Multiple copies of software can be purchased for resale purposes.

Alternatively, the buyer can secure rights to a master copy of the program that can then be incorporated into products for resale. In the latter situation, the buyer contracts for the right to reproduce the software for the purpose of reselling it to third parties, and will generally pay a royalty or license fees to the seller based on the number of times the software is copied and resold. The master copy of the software can be received on physical media or through means of remote telecommunications.
2. Canned software purchased for internal use

Even though a jurisdiction may tax prewritten software, it is important to verify whether a manufacturing, research and development, economic incentive or other exemption may apply to the purchase of software for internal use.

a. Software purchase qualifies for a manufacturing exemption

Numerous states have enacted various types of sales or use tax exemptions to encourage manufacturers to locate within their state. Be sure to check out the applicability of such exemptions for purchases of computer hardware, software, and related services.

For example, consider the State of Texas; prewritten software is generally taxable in Texas. However, the manufacturing exemption provided in T.A.C. Rule 3.300, Manufacturing, Fabricating, and Processing, has been interpreted to apply if the software is necessary, essential, and used in the actual manufacturing process. Examples include software that is incorporated into equipment that is necessary, essential, and used in the actual manufacturing process or that is necessary for monitoring a pollution control process.

b. Software purchase qualifies for an R & D exemption

Numerous states exempt purchases of tangible personal property that is consumed in qualifying research and development efforts, which could include (prewritten) software, to the extent specifically included in the statute or regulation or to the extent such states deem prewritten software to be statutory tangible personal property. For example, Pennsylvania’s research exemption applies to computer software used directly in research. Regulation Sec. 60.19(d)(2)

c. Economic incentive and other exemptions

Some states provide economic incentives for targeted industries to keep or promote certain behaviors by those industries in their states. It is important to be sure your company has complied with all of the requirements necessary to qualify for the exemption.

Georgia provides an exemption for computer equipment, including software, which is purchased or leased exclusively for use in Georgia at a “high-technology” company as defined. Code of Georgia, Section. 48-8-3(68)

Missouri provides an example of an economic incentive designed for a specific industry and for a specific behavior. It would appear that the
exemption was designed for a specific company! Section 144.030(2) (29) exempts computers, computer software and computer security systems for use by architectural or engineering firms headquartered in Missouri. (Underscoring added).

New Jersey exempts prewritten software delivered electronically when used directly and exclusively in the conduct of the purchaser’s business, trade or occupation. However, please note that this exemption does not apply to software received on tangible media or software that has been delivered by a load and leave method N.J. Admin. Code 18:24-25.5

3. Method and mode of delivery for canned software

a. Canned software delivered on tangible media

Canned software transferred for consideration on tangible media is generally taxable because most states impose the tax on the sale or purchase of tangible personal property within their state. The most common forms of media used to transfer software are floppy disk, CD-ROMs, and magnetic tape; in an asset acquisition it is not uncommon to take delivery of software on one of the other acquired assets, the server.

b. Canned software delivered via electronic transmission or downloaded via the Internet

While some states view the downloading of prewritten software programs from the Internet a non-taxable delivery via "remote telecommunications", other states may specifically define software downloaded from the Internet or over telephone lines as the purchase of a taxable service or tangible personal property.
(1) **States that do not tax the electronic transmission of programs**

Some states’ statutes or regulations do not provide for the taxation of electronic transmissions of prewritten software. Such states have taken the position that an electronic transmission of a computer program does not constitute the receipt of tangible personal property. When using electronic transmissions to sell or receive software in one of these states, it is imperative to comply strictly with the statutory or regulatory requirements, if any, needed to secure or prove the exemption.

As an example, California Regulation 1502 (f)(1)(D) states that:

“The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller’s place of business, to or through the purchaser’s computer and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction.”

The regulation further clarifies that receiving copies of program manuals does not invalidate the exempt status of the electronically transferred software. The seller is considered the consumer of manuals provided without charge in this type of transaction. Separate charges for manuals are considered taxable, however.

(2) **States that tax the electronic transmission of software programs**

States will usually tax electronically transmitted software under one of the following theories:

- The receipt of electronically transmitted software constitutes the receipt of tangible personal property, or,
- The receipt of electronic transmissions constitutes the receipt of a taxable service in the receiving state.

In addition to reviewing the statutes and regulations that address computer services and/or software, also consider reviewing taxable services rules for telecommunications, computer services, information services, etc. to determine if the transaction could be taxable under those provisions of law.
c. Canned software transferred via the "load & leave" method

The “load and leave” method of delivery requires the seller of the software to physically load the software onto the customer’s computer from the seller’s tangible medium, such as a disk or memory stick. After the software has been loaded, the vendor then leaves the customer’s premises with the tangible medium. The customer does not receive a backup copy on tangible medium.

(1) States that do not tax software delivered by the load and leave method

California Regulation 1502 (f)(1)(D) states:
"The sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or the installation of the program is a part of the sale of the computer."

While states such as Arkansas, Georgia, and Nevada have followed California’s lead in specifically exempting load and leave software as a service transaction, the more recent trend has been to specifically tax “load and leave” software.

(2) States that tax software delivered via load and leave method

In recent years, many states have revised or added statutes to clarify that their tax is imposed on canned software delivered via the load and leave method.

Massachusetts revoked its exemption for software delivered via “load” and “leave” in 2006 and now taxes prewritten software regardless of the form in which delivered. Massachusetts Reg 830 CMR64H.1.3(3)(a), Technical Information Release No. 05-15 (2-10-2006)

In Minnesota, a sale and a purchase includes the transfer for a consideration of prewritten computer software whether delivered electronically, by load and leave, or otherwise. Minn Stat. Section 297A.61, Subdivision 3(f).

In Missouri, the term “sale at retail” has been broadened to embrace a “load and leave” transaction, because the customer receives the right to use the software. This change in policy applies any time software is sold and delivered via tangible media, regardless if the purchaser installs the software and returns the tangible media to the seller or if the seller installs the software and
leaves with the tangible media Effective November 21, 2003 per letter ruling LR1724, Missouri Tax Policy Notice 01/09/2004 No. TPN16.

Examples of other states that impose tax on prewritten software delivered via load and leave method include Florida, Indiana, Iowa, Kansas, Kentucky, Michigan, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, Wisconsin, West Virginia and Wyoming.

d. Blanket contract to license multiple copies of a canned program using "keys" to access the program

Companies often purchase site licenses that provide the right to use the software for a given number of users. Vendors frequently use "keys" to control the number of users that can access the software. This ensures the customer pays for each copy of the program being used. The key is generally a code the vendor issues to the user to “unlock” access to the program, but sometimes the key may be contained in a physical article of tangible personal property, that the customer must insert to the hardware to facilitate unlocking the software.

Accordingly, when a payment for a "key" represents payment for the right to use the software, and if the key is not an article of tangible personal property, then it is important to keep track of how the original software was received in those states where electronic transmission is exempt. Renewal of licenses purchased in the past can be taxable or nontaxable depending on how the original software was received.

When physical keys are received, the entire software transaction is likely taxable. For instance, California Annotation 120.0524 concludes that the installation by the vendor of a physical key, called “a dongle”, renders the entire software purchase taxable even though the vendor used the exempt “load and leave” method for the software delivery. If the physical key is needed to operate the software, then California deems the entire amount taxable.

However, for an original software purchase which was subject to an exemption for certain qualified uses e.g. a manufacturing or R&D exemption, then subsequent payments for such "keys" or additional licenses would likewise be exempt provided that the use of the software still qualified for the exemption.
4. Multi-state use of canned software

When prewritten software is delivered to a central location, where it is installed on the purchaser’s server; (sometimes called “on-premises” software) to be accessed by users from multiple states, will this impact the taxability of the software in the jurisdiction in which the software was delivered and/or the jurisdictions from which the users will access the software?

What if the contract designates multiple site-licenses to be used in multiple states, including support, even though the software is electronically delivered onto the purchaser’s server in a state that allows exemptions for electronically transmitted software?

What about "floating" licenses in which a user may move the "use" of the software license to various corporate locations?

Should the tax on software be apportioned between the various sites that are licensed to use the program or is the tax due 100% to the state of delivery even though the software is used at multiple locations around the world?

There are few specific answers in state statutes to questions involving multi-state use of a software product delivered to a single location, and while a few states such as Colorado and Massachusetts have begun to incorporate language into their statutes or regulations to clarify taxation of software having multiple points of use, care should be taken to confirm the jurisdiction will permit the multiple point of use exemption on software delivered onto a server in its jurisdiction as such exemptions usually apply to “Software as a Service” but don’t always apply to traditional, on-premises software.
States typically approach the sourcing of software which resides on a customer’s server when there are multiple points of use in one of two ways:

a. Tax should be allocated based on the number of licenses in each jurisdiction.

For example, explained in Washington Regulation WAC458-20-15502(4)(c), Washington addresses the use of software in Washington when the software resides on a server in another state as follows:

“Use of a site license partly in this state and partly outside this state. The part of the site license used by the person in this state is subject to use tax, provided Washington state sales tax was not previously paid. For example, a person purchases and takes delivery of a site license in California. Pursuant to the multiple site license agreement, this person is licensed to use one thousand copies of prewritten computer software, of which four hundred copies will be used in Washington. Use tax is due on the four hundred copies of prewritten computer software used in this state. If the prewritten software purchased by the licensee is delivered in Washington, then the entire charge for the site license is subject to retail sales tax if purchased from a seller responsible for collecting Washington's sales tax. However, a purchaser may issue a multiple points of use exemption certificate under certain circumstances to minimize Washington tax.” As stated in WAC458-20-15502(11) (a), Multiple points of use (MPU) exemptions, “The retail sales tax does not apply to the sale of prewritten computer software or remote access prewritten software if the buyer correctly provides the seller with an exemption certificate claiming multiple points of use.”

Similarly, 830CMR64H.1.3(15) (a)11, examples 1 and 2, describe the rules for software loaded on a server in Massachusetts or a different state and accessed by users both within and without Massachusetts:

“Example 1: Prewritten software is installed on a server located in another state but concurrently available for use by purchaser's employees in Massachusetts as well as other states. The purchaser gives the seller a properly completed MPU form. Part of the sales price of the software will be apportioned to Massachusetts for sales/use tax purposes.

Example 2: Prewritten software is installed on a server located in Massachusetts but concurrently available for use by purchaser's employees in other states as well as Massachusetts. The purchaser gives the seller a properly completed MPU form. Part of the sales price will be apportioned to those other states for sales/use tax purposes.”

Please note, not every state has a multiple point of use exemption certificate, and not every state may allow for allocation of tax when the purchased software resides on the customer’s in-state server.

b. Tax is due on the entire purchase price of the software on the state of delivery despite the fact that the licenses are for users in multiple states or countries. In such jurisdictions, although tax is due to the state of delivery of the software,
the delivery-state may allow some amount of credit for tax paid to the state where the users are located.

In Texas Policy Letter Ruling 200609749L, the Comptroller ruled that if the sales and delivery of software was made in another state, but some of the customer’s users will access the software from within Texas, the vendor is not required to collect Texas tax but the customer will be required to self-asses use tax to the extent the software is used in Texas. The letter ruling also explains that a software license for use in Texas is subject to Texas sales and use tax if the software is downloaded or otherwise placed on a computer in Texas, referencing Texas Administrative Code Rule 3.308 (b)(2). The letter ruling notes that for software delivered onto a server in Texas, the State will allow a credit against Texas use tax due on the software purchase for another state’s legally imposed sales or use taxes paid on the same property, to the extent use occurs outside of Texas. *Texas Policy Letter Ruling 200609749L, September 19, 2006.*

Potential tax minimization ideas may include:

a. Requiring the vendor to deliver the software to your location in a state that does not impose a sales or use tax, load the software in a server in that state, then ensuring the purchase order specifies how many licenses will be used at each specific location. Tax may then be accrued in states requiring use tax on the use of software based on the number of licenses used in that state.

b. Receiving electronic delivery of the software in a state that does not tax electronically delivered software, and then making a copy of the software for use in the state in which the server is located. Maintain the original copy of the software in the delivery state. Use tax will likely be due to the extent there are users in the server-location state and on the cost of the duplicated copy. Again, ensure that the locations of multiple licenses be specified in the purchase order and sales agreement.

Always check state statutes and regulatory guidance prior to executing any tax minimization plan.
III. CUSTOM SOFTWARE

A. Examples of Definitions: What's Included? What's Excluded? What is it anyway?

Check each state's definition of custom software, paying particular attention to those transactions specifically included or excluded from the definition. Some states view custom programming as the sale of tangible personal property; others view custom programming as a services contract.

In Texas, for example, the creation of a customer software program is deemed exempt if the creator transfers exclusive rights of ownership to the program to the customer; see for example, Decision, Hearing No. 102,940, Texas Comptroller of Public Accounts, November 30, 2011. Conversely, In Decision, Hearing No. 44,668, November 19, 2004, the Texas Comptroller ruled that a software program which had been custom-developed for a customer was a taxable sale because the contract indicated the taxpayer was granted only a non-exclusive license to the use the software and that the programmer retained all rights, title, and interest in the software.

Idaho’s Rule 27 provides excellent definitions for custom software. While you do not need to remember the state, you will need to comprehend these definitions.

1. Definitions - Idaho - What's Included?

Idaho provides a good working definition for the term "custom program” as follows:

"Custom software is specified, designed, and created by a vendor at the specific request of a client to meet a particular need."
"Custom software includes software which is created when a user purchases the services of a person to create software which is specialized to meet the customer's particular needs."

"The term includes those charges that are represented by separately stated and identified charges for modification to existing canned software which are made to the special order of the customer, even though the sales, lease, or license of the existing program remains taxable."

"If the custom programming charges are not separately stated from the sale or lease of the equipment, they will be considered taxable as part of the sale."

"Custom software includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program."

2. Definitions - Idaho - What's Excluded?

Excluded from Idaho's definition of custom software are the following:

"Loading parameters to initialize program settings & arranging preprogrammed modules to form a complete program."

"The sale of the (custom) program by the customer for whom the custom software was prepared will be a sale of canned software."

B. Factors affecting taxability

1. Purchased for resale

   Even if the software program does not qualify as exempt custom software, it may still qualify as an exempt sale for resale.

2. Purchased for internal use

   Even though a state may tax custom software, it is important to verify whether a manufacturing, research and development, economic incentive or other exemption may apply: for example, manufacturing and research and development exemptions, as discussed in the section on prewritten software, typically could also apply to the purchase of custom software.

3. Mode of delivery

   The issues regarding specific modes of delivery, i.e., electronic transmission and multi-state use of software discussed above in Section II, Canned Software, are generally applicable to custom software.
4. Multi-state use of custom software

Identifying the state or states which have jurisdiction to tax custom programs can be complex because a custom software program may be developed in one state, delivered to another, but intended to be loaded onto a network server and used at multiple domestic and international sites.

As discussed in Section II, Canned Software, when purchasing custom programming services that will be delivered to a state which taxes custom software and will be used in multiple states, be sure to verify whether the state of delivery will allow the sales price to be allocated among the states from which the users will access the custom software.

C. Subsequent Sale of a "Custom" Program

1. Definitions

   Many states **include** the subsequent sale of a custom program in their definition of canned or prewritten programs. Conversely, the subsequent sale of a custom program may be explicitly **excluded** from the definition of exempt custom programming. Either way, the result is the same: most states impose tax on subsequent sales of custom programs.

2. Situations in which the subsequent sale of a custom program generally occurs:

   a. Vendor who wrote the custom program retained the right to sell it to other customers

   b. Customer who bought the custom program decides to sell or market it
c. Software is developed in-house for use, then a subsequent sale is made

d. Sale of a business, including computer systems with installed custom software

3. Taxability

Since the subsequent sale of custom program is considered the sale of existing statutory tangible personal property in many states, consider the sale taxable unless a specific exemption applies. Common exemptions include those for occasional sales, statutory mergers, or contributions to commencing partnerships or corporations.

4. Court cases


In **Touche Ross & Co. vs. State Board of Equalization**, the California Court of Appeals ruled that once a computer program has been created and is in possession of the original customer, a subsequent sale can no longer be characterized as a tax-exempt service transaction.

b. In **Navistar International Transportation Corporation vs. State Board of Equalization**, the California Supreme Court ruled that custom computer programs developed in-house for internal use and later transferred to a third party as part of the sale of the taxpayer’s business were taxable. **Navistar International Transportation Corporation vs. State Board of Equalization, California Supreme Court, No. S032195, 8 Cal. 4th 868, 884 P.2d 108, 35 Cal. Rptr. 2d 651, November 28, 1994.**
IV. SERVICES COMMONLY SOLD IN CONJUNCTION WITH THE SALE OF COMPUTER HARDWARE AND/OR COMPUTER SOFTWARE

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When considering whether services commonly sold with or performed to computer hardware and computer software are taxable, one must determine exactly how the various states impose tax on services:

- Is the service directly taxed as an enumerated service?
- If the service is not directly taxed as an enumerated service, is the service nonetheless deemed taxable because it is included within the definition of “gross receipts”, “sale” or “sales price”?
- Is the service a non-taxable service which requires separate statement to retain non-taxable treatment?

If non-taxable services are considered sold as part of the sale of goods, such services will generally be taxed if the goods are taxable. However, before delving into the taxability of a particular service purchased with goods, one may want to consider whether the purchased commodity may qualify for an exemption which extends to the service, for example:

- Resale exemption
- Manufacturing exemption
- Research and development exemption
- Special enterprise zone exemption.
A. Training services

1. Exempt training services

The majority of states exempt training, instructional seminars and classes if the charges are optional and separately stated from the purchase price of the computer and/or software.

If books and other materials are provided for no additional fee other than the price of the seminar, then the vendor is usually considered the consumer of the books and materials used in performing the exempt service, while books and materials sold for a separate stated price are generally considered to be a taxable sale at retail.

2. Taxable training services

a. Taxable as an enumerated service:

Ohio imposes tax on the charges to train “computer programmers and operators” in the operation and use of computer equipment and its system software, under the provisions of its “Computer Services” statute. Ohio Revised Code Section 5739.01(Y) (1) (b); Rule 5703-9-46(A)(2)(d) Ohio Admin. Code

Connecticut interprets charges for computer and software training classes to be subject to tax under the provisions of its computer and data processing statute, subject to the special 1% rate for computer and data processing services. However, if the training is specific to the skills required for an employee’s day-to-day job performance the Computer training and software training are taxable under the provisions of Connecticut’s business management consulting service...
statute, at the full state tax rate. Policy Statement 2006(8), Connecticut Department of Revenue Services, March 23, 2007; modified and superseded in part by Special Notice 2015(5), Connecticut Department of Revenue Services, July 17, 2015

b. Taxable when sold by the retailer of the software

Nebraska imposes tax on the gross receipts of the total sales price charged by the retailer on a sale or lease of tangible personal property, specifically including software training when provided by the software retailer, and including training provided by the retailer under a separate agreement. Charges for providing computer software training are taxable if the software retailer provides training in Nebraska or if the person receiving the training is located in Nebraska. Revised Statutes of Nebraska Sec. 77-2701.16(3) and (4), R.S. Sec, 77-2701.16(1); Reg. 1-088.02; Information Guide 6-511-2011, Nebraska Department of Revenue, January 22, 2014; Farmers Cooperative V. Department of Revenue, District Court, 3rd District (Nebraska), No. CI 13-2325, March 4, 2014.

c. States in which training is taxable when sold in conjunction with a taxable sale of tangible personal property:

Some states tax training services when sold in conjunction with the sale or license of tangible personal property, which would include the sale of computer hardware or licensing of computer software, for example, Florida. Florida Statutes, 212.02(16), Technical Assistance Advisement, No. 06A-025, Florida Department of Revenue, August 23, 2006; Technical Assistance Advisement, No. 10A-035, Florida Department of Revenue, August 23, 2010. For such states, it may be possible to sell non-taxable training services under a separate contract for which the sale of the services is not mandatory in connection with the contract for purchase of taxable tangible personal property.
B. Installation services and consulting services

1. Installation

“Installation” and “implementation” are somewhat similar terms which people sometimes employ interchangeably when discussing software. However, the terms “Installation” and “implementation” can represent different types of actions in the context of a software project. “Installing” software is often as simple as loading the software onto a server and may even be performed in a manner of minutes. Conversely, a software “implementation” may involve activities which go beyond “installation” and may meet the definition of taxable enumerated services in some states. Implementation may also be considered professional consulting services as discussed in the consulting services section.

State statutes, rules and/or regulations will generally provide specific guidelines regarding the taxability of installation services sold in conjunction with the sale of computers or any other tangible personal property. In many states the taxability of software installation charges usually depends on whether a sale of software is deemed the sale of statutory tangible personal property, the sale of intangible property or the provision of a service.

a. Some states differ on the taxability of installation labor according to whether the tangible personal property to be installed is new or used.

States may deem services rendered on used items as "exempt" installation or repair labor, while treating services rendered to new items as taxable "fabrication" or assembly labor. For purposes of this course, this point would generally apply in the context of computer hardware.

In California Annotation 315.0124, the State Board of Equalization ruled that charges for labor to replace a motherboard and add new memory to a used
Taxation of Computer Software & Services

computer were exempt labor, provided the motherboard or additional memory merely upgraded the computer, rather than refitting the computer for a use different from which it was originally produced.

In California Annotation 315.0122, however, the State Board of Equalization ruled that installation of utility boards in a new computer is taxable because it is a step in producing a final product (i.e., fabrication labor) and were thus taxable regardless of whether the installation was made by the seller of the computer, the seller of the boards, or someone else hired by the purchasers.

b. Some states tax installation labor regardless of whether it has been separately stated.

Some examples of states which tax installation labor when sold with software are: Florida, Kansas, Michigan, Minnesota, Mississippi, New Jersey, New Mexico, New York, Ohio, Pennsylvania, South Dakota, Texas, Tennessee, Washington, West Virginia, Wisconsin and Wyoming.

In states which tax installation labor sold in conjunction with the sale of tangible personal property, the services may acquire any exemption which may apply to the sale of the tangible personal property sold. For example, if a purchase of software is subject to a machinery and equipment exemption, the installation charges may also acquire the same exempt treatment accorded to the software purchase.

c. Some states exempt installation labor provided it is separately stated in the sales contract and/or sales invoice.

In most states which exempt installation labor, installation services must be separately stated to secure the exemption. For example, Georgia’s statute states that “no deduction is allowed for installation charges unless they are separately stated on the invoice, billing or similar document given to the purchaser.” GA Code Ann. § 48-8-2(34) (B)(iv)

Similarly, New York Code Section 1115(o) states, “Services otherwise taxable …. shall be exempt from tax under this article where performed on computer software of any nature; provided, however, that where such services are provided to a customer in conjunction with the sale of tangible personal property any charge for such services shall be exempt only when such charge is reasonable and separately stated on an invoice or other statement of the price given to the purchaser.”

c. States which exempt installation labor regardless of whether separately stated.

In California, installation services are exempt even if they are not separately stated in the invoice to the customer. California Revenue & Taxation Code Section
6012(c)(3) provides that taxable gross receipts do not include “the price received for labor or services used in installing or applying the property sold”.

In Annotation 315.0123, the State Board of Equalization ruled that a seller is not required to itemize the price installation labor on the sales invoice in order for the exclusion exemption to apply. The California Court of Appeals settled the same finding in *Dell, Inc. v. The Superior Court of the City and County of San Francisco*, Court of Appeal of California, First District, No. A118657, 159 Cal. App. 4th 911, 71 Cal. Rptr. 3d 905, January 31, 2008.

However, if the seller does not separately state the price of installation labor, then the seller has the burden to support the value of the non-taxable installation labor in the event of a sales tax audit. Typically, if not provided in the invoice or contract, the seller must maintain work papers in their files detailing the installation labor portion of each contract.

It is advisable to separately state installation charges to minimize issues under audit.

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**SERVICES SOLD WITH COMPUTER HARDWARE OR SOFTWARE**

- Consulting Services
  - May include non-taxable professional services
  - Separate statement typically required to preserve exemption, though not in every state.
  - May include taxable enumerated services
  - Beware broad labels – specific terminology is key
  - Separate contracts for non-taxable services may be advisable when possible

2. Consulting services

For purposes of this section, “consulting services” will be considered services other than assembly and installation services which involve the service provider’s human labor, including the following examples:

- Hardware and/or software architecture design services
- Software configuration
- Software testing
- Development and testing of system processes and procedures
- Software implementation; this may include converting manual systems to automatic data processing systems or converting present automatic data
processing systems to new systems (e.g., changing a second generation system to a third generation system.)

- Project Management
- Data migration
- Designing data storage and data retrieval systems
- Feasibility studies
- Live technical support (i.e., not provided via an automated solution), often billed on an hourly basis
- Studies to evaluate hardware or software proposals or bids

a. States which require separate statement of non-taxable services when sold in conjunction with hardware or software:

Many states require the vendor to separately state the sale price of any non-taxable services included in the sale of tangible personal property, for the services to remain non-taxable. When non-taxable services are included in the sale but the sales price for the services is not separately stated, such states will likely assert sales tax on the entire sales price. Some states statutorily require any services which are sold in conjunction with the sale of tangible personal property to be included in the gross receipts subject to tax.

b. Separate statement of consulting services is not required for exemption:

Texas is an example of a state in which unrelated exempt services are not required to be separately stated in the contract in order to maintain the exemption.

Per Texas Rule 3.330, Data Processing Services, when nontaxable unrelated services and taxable services are sold for a single charge, and the portion relating to the taxable services represents more than 5.0% of the total charge, the total charge is presumed taxable. The presumption can be overcome at the time that the transaction occurs by separately stating in the customer’s invoice the taxable and nontaxable amounts. However, if the charge for the taxable portion of the services is not separately stated at the time of the transaction, the service provider or the purchaser may later establish, through documentary evidence, the percentage of the total transaction that relates to the nontaxable unrelated service.

Nonetheless it advisable to separately state all nontaxable, “unrelated” services in Texas transactions to avoid issues on audit.

c. Consulting services taxed as an enumerated taxable service

Some states, as described in the following examples, tax a broad range of services involving human labor when performed with respect to computer hardware and software.
Connecticut’s broad imposition of tax on Computer and data processing services includes “designing, implementing or converting systems, providing consulting services, and conducting feasibility studies. Computer and Data processing services are taxable at the special 1% rate, however, the price of such services must be separately stated in the sales documentation or the entire sale will be taxed at the full state tax rate. Sec. 12-407(a)(2)(I) and (a) (37), G.S.; Sec. 12-408(1), G.S.; Reg. Sec. 12-426-27; Policy Statement 2006(8), Connecticut Department of Revenue Services, March 23, 2007

Ohio imposes tax on computer services sold for use in business. Computer services means “providing services consisting of specifying computer hardware configurations and evaluating technical processing characteristics, computer programming, and training of computer programmers and operators, provided in conjunction with and to support the sale, lease, or operation of taxable computer equipment or systems.” Ohio Admin. Code Section 5739.01(Y)(1)(b).

The broad range of services subject to sales tax in South Dakota include designing and implementing of computer systems; designing of storage and data retrieval systems; consulting services; feasibility studies; evaluation of bids; and providing of technical assistance. South Dakota Rules, Chapter 64 Revenue, Chapter 64:06:02

d. Recommendation regarding consulting contracts

Specificity of terminology is key when performing a sales tax analysis of activities performed by vendors with respect to computer hardware and computer software. Company IT personnel and technology vendor personnel often communicate in technology industry parlance that appear not only in their spoken conversations but sometimes also in the sales proposals, agreements and purchase orders that are documentation on which sales practitioners rely. For example, a “software implementation” contract may include such services as project management, software configuration, software modification, and/or testing; of which one or more could be deemed a taxable enumerated service in some jurisdictions. It is therefore important that contracts and agreements have clear definitions and/or descriptions of the exempt services being rendered to differentiate them from taxable services.

Many states generally consider consulting services to be exempt professional services if no tangible property is included in the contract. Therefore, consider putting exempt consulting services into a separate contract from those involving the sale or purchase of taxable services or tangible personal property. In situations where the use of separate contracts is not feasible, then itemize the taxable and nontaxable elements of the contract on invoices and contracts. Such
itemization will not afford an exemption, however, if the state taxes all services sold with taxable tangible personal property.

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C. Modifications to canned software

a. States in which modifications are exempt if separately stated

Many states exempt separately stated modifications to prewritten computer programs as a nontaxable service. Examples include Alabama, California, Florida, Georgia, Idaho, Indiana, Iowa, Kentucky, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, Utah, and Virginia.

b. States in which services to modify prewritten software are taxable even if separately stated

Some states tax modifications to canned software if the original software purchase was taxable. Examples of some states that tax software modifications include: Louisiana, South Dakota, and Tennessee.

c. Examples of variations on the “general rule” regarding taxability of modifications to prewritten software

(1) California

If a contract calls for significant modification to a canned program, the resulting new program can qualify as an exempt custom program if the price for the modifications exceeds 50% of the entire contract price, and if sold for a lump sum amount. The
original program should not be separately stated. If it is separately stated, it is taxable, leaving only the modifications as exempt.

(2) Connecticut
In Connecticut, modifications to canned software are taxable at as a computer and data processing service taxable at the special 1% rate, provided the sales price of the modifications have been separately stated in the sales contract and/or sales invoice.

(3) Texas
In Texas, the general rule is that modifications to canned software are taxable. The exception to the rule is that modifications are exempt if the vendor performing the modification services is not the vendor who sold the program.

D. Modifications to custom software

1. Generally exempt if custom software is exempt; e.g., Georgia and California

2. Generally taxable if custom software is taxable; e.g., Texas

3. Exceptions or variations to the above general rules: Texas

In Texas, modifications to any program are exempt provided that the modifications are done by someone other than the seller of the original software.
D. Maintenance agreements covering hardware or software or both:

1. Hardware maintenance:

Mandatory hardware maintenance and warranty repairs are generally included as part of the selling price of the product. Such charges take on the same taxability as the sale of the computer equipment. Unless a specific exemption applied to the computer sale, the mandatory hardware maintenance will also be taxed. Parts supplied under a mandatory warranty are typically not taxable to the vendor of the maintenance contract in jurisdictions where the sale of a mandatory hardware maintenance contract is taxable.

Optional hardware maintenance contracts are often exempt if separately stated. Parts supplied under an optional hardware maintenance contract are often taxable when the state does not tax the sale of optional hardware contracts.

2. Software maintenance:

a. Definitions - What’s included? What’s excluded?

Maintenance agreements for canned software packages often include live technical support services, such as telephone consultation, and software updates and/or program enhancements. Updates and program enhancements can be provided in the form of tangible personal property, i.e., on disks or tapes, or via remote telecommunications.
b. Mandatory software maintenance - canned software

Generally, most states tax mandatory software maintenance if the purchase of the original software package was taxable. Many states consider mandatory software maintenance to be taxable as part of the sale of tangible personal property.

Always consider avenues for exemption: If the software purchase qualifies for R & D, manufacturing, economic incentive or another specific exemption, it is likely that the mandatory software maintenance will also qualify for the same exemption.

c. Optional software maintenance - canned software

a. With updates received on tangible media

b. With updates received by electronic transmissions

c. Services only received with no updates received

Most states impose tax on optional software maintenance sold for canned programs. States have adopted varying policies as to when and how to tax optional software maintenance agreements. Factors affecting how the tax applies to these contracts include whether physical media is delivered and whether nontaxable portions of the optional maintenance contract are separately stated.

In Alabama, if the non-taxable portions of an optional software maintenance contract are separately stated, then only the portion representing upgrades or enhancements and new operating manuals are subject to tax.

Given the difficulty in figuring out the “true object” of these types of contracts, coupled with the unwillingness of most software vendors to separately state the sales price of any included software updates, some states have decided to tax a flat percentage of optional software maintenance contracts when the amounts for the software updates are not separately stated.

(1) In Minnesota, if there is only one charge in the optional software maintenance contract for both upgrades/enhancements and support services, then 20% of the contract price will be subject to the tax. MN. Subsection 8130.9910, Subpart 2(C)(2)(b).

(2) In Iowa, 50% of the gross receipts from the sale of a computer software maintenance or support service contract are taxable, if the fee for the taxable personal property is not billed separately from the nontaxable service. If the contract provides for technical
support services only, no tax shall be imposed. *Iowa Admin. Code 701--18.25(3)(c)*

(3) In California, 50% of the lump-sum charge for an optional software maintenance agreement is taxable when software updates delivered on tangible medium are included under the maintenance agreement. If no tangible personal property or software updates on tangible medium are transferred to the end user during the period of the maintenance contract, then tax does not apply to any portion of the charge. *CRTC Regulation 1502(f)(1)(C).*

3. Bundled Hardware and Software Maintenance

Bundled transactions include two or more products or services that are sold together for a single (lump sum) price. A bundled transaction may include both mandatory and optional components.

In general, the taxability of bundled transactions begins with an analysis of the services and products included in the package.

The following theories may apply to bundled transactions:

a. Entire lump sum amount should be taxed
b. No tax should be charged if the taxable value falls under a de-Minimis percentage
c. Tax should be prorated based on the percentage of taxable and nontaxable items in the bundled price.

California is a good example of a state for which the interpretation of the taxability of bundled hardware and software maintenance contracts has changed over time. Whereas at one time, California taxed the entire lump sum contract price for combined hardware and software maintenance, the current position taken by the State Board of Equalization (BOE) allows the vendor to pay the tax on the contract amount for the software upgrades, as determined in the records of the vendor. For instance, refer to CA Annotation 120.0009, Bundled Hardware and Software Maintenance Contracts (Optional).

Separately stating exempt and taxable portions of maintenance contracts will, however, eliminate unnecessary disagreements with the BOE.
V. REMOTE SERVICES

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A. Data Processing Services

Definition and examples of data processing services

1. Definition: Data processing services involve batch or on-line services provided by a computer owned or operated by another party.

Examples of data processing services that are taxed in some states:

a. Processing of customer information for the purpose of:
   i. Compiling and producing records of transactions,
   ii. Maintaining information,

b. Entering and retrieving information.

   This typically includes both real-time and batch processing services

c. Conversion services

   i. Converting files from one type of storage media to another, i.e., from magnetic tapes to tape cartridges or CD-ROMs.

   ii. Converting file information from a non-standard format to a standard format such as ASCII.
d. Data entry and/or keypunching
   
   i. Entry of inventory control information
   
   ii. Entry of payroll information and W-2 data
   
   iii. Keypunching & keystroke verifying cards

2. Taxability of data processing services

a. States which tax data processing services as part of gross receipts, e.g., Hawaii, New Mexico.

b. States which tax data processing services specifically by statute

Jurisdictions that have enacted legislation to tax specific services include South Dakota, Texas, and the District of Columbia. Ohio also taxes data processing services when for use in business by the consumer.

Examples of taxable data processing services in Texas include word processing, payroll and business accounting, and computerized data and information storage or manipulation. (T.A.C. Rule 3.330, Data Processing.)

Connecticut currently imposes a 1% tax on computer and data processing services.

c. States which generally exempt data processing services

Data processing services are generally excluded from the definition of a taxable sale at retail in states that don't tax services unless the true object of the contract is deemed to be the receipt, fabrication or processing of tangible personal property. If the data processing services are not taxable, then the service provider is the consumer of any paper or other materials used to produce reports or otherwise provide the service for the customer.

In California, verification of data entry is exempt but keypunching services are considered taxable fabrication of tangible property. California also considers data conversion services taxable when the deliverable provided to the purchaser is a tape or disk with data.

Examples of other states which tax data conversions from one physical media to another and data entry / keypunching services include Massachusetts and Minnesota.

d. States which exclude data processing services from other taxable enumerated services
Washington, for example, which taxes tangible personal property and certain enumerated services, excludes data processing services from its definition in §82.04.192(3)(b)(xv) of taxable Digital Automated Services.

Another example is West Virginia, which taxes tangible personal property and all but certain services, and allows an exemption for “electronic data processing services”, for which the purchaser must provide an exemption certificate to the vendor. §11-15-9(a) (21)

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**REMOTE SERVICES**

- Data processing services, cont.
- Caution: Non-taxable services with data-centric attributes are sometimes mistaken for taxable data processing services; e.g. telemarketing services.
- Caution: Data processing services are sometimes mistaken for Software as a Service or other remotely provided services
- Other considerations:
  - exemptions may apply;
  - check other taxable service statutes.

5. Other considerations

a. Some states may confuse the use of a computer in the performance of exempt service with the providing of a taxable computer service. Examples include the use of a computer to provide tele-marketing services, consulting, engineering, accounting, research and development services, etc.

b. Check "other services" statutes for possible link to data processing services

In addition to reviewing state statutes for computer services and software, it is also important to check for statutes that address information, telecommunications and other related services since these statutes might impact the taxability of data processing services.

c. Even though data processing services may be taxed in your state, always consider whether exemptions may apply such as resale, manufacturing, research & development, or other exemptions.
B. Information Services

Information services, sometimes called “canned” information services, are among taxable enumerated services in a number of states, e.g., New Jersey, New York, and Texas. While the original statutes go back to the decades of information delivered on tangible-medium, modern information services are now more likely to be accessed via the Internet.

1. Examples

   a. Legal, tax or other information services, i.e., Lexis/Nexis® service or Dunn & Bradstreet services

In states that tax information services as an enumerated service, the service is distinguishable from traditional professional services by whom has the right to receive the information provided; for example, see the New York statutory definition of “Information Services”

§1105(c)(1)

The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons, but excluding the furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons, and excluding the services of advertising or other agents, or other persons acting in a representative capacity, and information services used by newspapers, electronic news services, radio broadcasters and television broadcasters in the collection and dissemination of news, and excluding meteorological services.
Tax practitioners should pay close attention to hosted product offerings which don’t appear to rise to the level of access to application software; states such as New York which tax both SaaS and Information services have this additional means to subject a transaction to sales/use tax.

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![Remote Services Diagram]

**C. Digital Automated Services**

While other states struggle to capture modern hosted product offering transactions into sometimes outdated statutory definitions such as prewritten software or information services, the state of Washington has introduced new terminology to capture and tax certain hosted product offerings, as described in §82.04.192(3)(a):

"Digital automated service," except as provided in (b) of this subsection (3), means any service transferred electronically that uses one or more software applications.

The statute goes on to define the term further by listing those items which a Digital Automated Service is not, such as payment processing services, and other hosted products which Washington defines elsewhere in its statutes, such as “Remote Access Software”; tax practitioners should be aware of this term not just for transactions over which Washington may have jurisdiction, but for purposes of monitoring trends which other states may choose to follow.
D. CLOUD COMPUTING

1. Definition:

In briefest terms, Cloud Computing is the delivery of hosted services over the internet. The National Institute of Standards and Technology of the U.S. Department of Commerce, In Special Publication 800-145 dated September 2011 defines Cloud Computing as follows:

“Cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.”
2. Examples:
   a. Software-as-a-Service (SaaS)

   SaaS is essentially access to software is provided by the application service provider (ASP) over the internet. Generally, the SaaS provider hosts both the software and the customer’s data. This allows the customer the ability to access his data from any location.

   The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, storage, or even individual application capabilities, with the possible exception of limited user-specific application configuration settings.

   While tax practitioners struggled early on to grasp the logic by which a jurisdiction can impose its sales and use tax on a transaction in which an in-state user remotely accesses application software on a vendor’s server in another state; New York promulgated the term “constructive possession” to apply to SaaS transactions as in regulation 526.7(e)(4) as follows:

   “Transfer of possession with respect to a rental, lease or license to use, means that one of the following attributes of property ownership has been transferred:

   526.7(e)(4)(i) custody or possession of the tangible personal property, actual or constructive; (underline added)

   526.7(e)(4)(ii) the right to custody or possession of the tangible personal property;

   526.7(e)(4)(iii) the right to use, or control or direct the use of tangible personal property
b. Infrastructure-as-a-Service (IaaS)

These service contracts provide access to remote servers on a flexible basis. Capacity can be added or subtracted on demand. This enables the customer to pay for only the actual usage needed rather than be locked into a fixed periodic fee.

The consumer does not manage or control the underlying cloud infrastructure but has control over operating systems, storage, and deployed applications; and possibly limited control of select networking components (e.g., host firewalls).

Popular cloud computing terms tend to outpace state statutes and regulatory guidance, and so tax professionals must usually look to their facts patterns in order to find the descriptive wording that corresponds to current regulatory guidance. For example, California does not specifically define “Infrastructure as a Service”, but in California Reg. 1502(i), the description of rental of computers (when on and off premises) is informative with respect to California’s position on the use of remote computing resources:

“Rental of Computers. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication.”

Tax practitioners should consider whether remote access to infrastructure involves a dedicated access to a physical server, or multi-tenant access; as dedicated access to a physical server could be construed in some jurisdictions as a rental of a physical server in that jurisdiction.

1. c. Platform-as-a-Service (PaaS)

These service contracts allow software developers the use of software and product development tools over the internet.

The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, or storage, but has control over the deployed applications and possibly configuration settings for the application-hosting environment.

Again, tax practitioners should look to the specific fact patterns of the transaction under analysis, in order to research statutes and regulatory guidance applicable to transactions. “Platform-as-a-service” often reflects attributes of application software and access to databases and other information as well as use of physical computing resources, and therefore should be approached cautiously.
2. Taxability

Some states have begun publishing taxability guidance on cloud computing services. In other states, there is limited published information in the statutes and regulations regarding this latest phenomenon of web-hosted services, i.e., the remote access to and use of software, servers, or development tools. While logic would indicate that these contracts should be analyzed under the services statutes, and not as the acquisition of personal property, the taxability determination appears to be more complex in those states that have included prewritten software in their definition of tangible personal property. In fact, some states conclude the taxpayer has constructive receipt of tangible personal property even though no physical transfer of custody takes place.

Since contracts involving “Cloud Computing” often involve more than one type of product or service, a review of these contracts to determine the true object is appropriate.
E. Sourcing for data processing services, Cloud computing, and other remotely provided or remotely accessed services.

The jurisdiction to which a transaction should be “sourced” involves more complexity than required of a transaction involving a sale of traditional tangible personal property.

To the extent the transaction involves a product offering which fits the definition of a taxable enumerated service, check into possible allocation of taxable services to locations where benefit of services is received.

Taxation may occur in the state the services are performed or the state or states in which the benefit of the services will be enjoyed. When entering into contracts for taxable services, consider whether the service will be taxed 100% in the destination state, 100% in the state where the services are performed or whether the service can be apportioned into the states in which the services will be used.

In states where taxable enumerated services are sourced according to where the benefit of the service is received, services may be source according to:

- The location of the users
- the location where the benefit has been deemed to be received
- According to the principal location of the business; e.g., certain fact patterns in Texas.

Not all states have sourcing rules which specifically address sourcing of hosted product offerings, for which vendors do not always receive information from purchasers regarding location of users. Streamlined Sales Tax member states, however, have adopted the general sourcing rule, which is practical for vendors (although perhaps not so much for purchasers).
**SSTA General Sourcing Hierarchy**

**Section 310: GENERAL SOURCING RULES**

A. Except as provided in Section 310.1, the retail sale, excluding lease or rental, of a product shall be sourced as follows:

1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

4. When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

The SSTA sourcing rule does not apply to certain sales, e.g., telecommunications and as noted in the SSTA agreement, only applies to determine a seller's obligation to pay or collect and remit a sales or use tax with respect to the seller's retail sale of a product. The SSTA sourcing rule does not affect the obligation of a purchaser to remit tax on the use of the product to the taxing jurisdictions of that use. For more information, please refer to Section 310 of the SSTA agreement.

States that have not published guidance with respect to sourcing of Remote Services tend to respect taxpayer’s sourcing methodologies which are reasonable and consistently applied.
VI. CONTRACT CONSIDERATIONS

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A. True object of the contract

Understanding what is really being sold in contracts involving computer hardware and software services is critical to determining the proper taxability of part or the entire contract. Such contracts may include the transfer of any or all of these elements:

1. Tangible personal property

2. Services, both taxable and non-taxable

3. Intellectual property rights, i.e., patents, copyrights, etc.

Many states use "The True Object of the Contract" concept to help decide what the contract is "really" about. California's Regulation 1501 provides a good explanation of this concept:

"The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true objects of the contract; that is, is the real object sought by the buyer the service per se, or the property produced by the service."

"If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred."

Is the service rendered so integral to the sale of tangible personal property that it cannot be separated there from, or can the service rendered be easily separated from the sale of tangible property?
D. Bundled Transactions

While the necessity of performing a True Object analysis is becoming more routine with Remote Service purchases, it is not uncommon for the substance of a Remote Services purchase, whether or not it is documented in the contract, to reflect multiple goods and services elements which the purchaser desires equally and which are not incidental to the other elements. For instance, a “Platform as a Service” product offering may provide the customer/user access to (1) data storage and computing capacity, (2) access to and use of the vendor’s proprietary software, and (3) access to and use of databases, for a single subscription fee. In such cases, the jurisdiction may not tax each attribute and so a review of the jurisdiction’s bundled sales rule may be required for purposes of determining whether the subscription is subject to sales tax. Streamlined Sales Tax member states are required to adopt the standard SSTA definition, which provides a de minimus rule for the taxable elements included in a bundled product offering when the taxable element(s) reflect 10% or less of the entire sales price or purchase price.

E. Contract terms and provisions and Form vs. substance

It is important to understand how each state interprets contract provisions.

1. Does substance prevail over the form of the contract?

Some states base the taxability of the transaction on substance and form.

"Tax law necessarily is based upon what has been done, not what might have been done. The form of the transaction governs." (Wallace Berrie & Co. v. State Board of Equalization (1985) 40 Cal.3d 6040 Cal.3d 60, 70)
2. Does the form of the contract prevail over the substance of the transaction?

If form prevails over substance, then will separately stating the costs associated with each element included in the contract allow the exempt items and services to remain exempt?

a. Some statutes or regulations require that the separate statement of cost must be done on each invoice. Other states allow or require the separately stated costs to appear in the contract document. Be sure to understand each state's requirements for "separately stated" costs.

b. Will separating the non-taxable services into a separate agreement or purchase order from the taxable elements of the contract keep them non-taxable? Or will the state attempt to link two separate contracts or purchase orders together?

For example, while mandatory maintenance may be inseparable from the sale of hardware or software, most computer services can be sold separately from the sale of computer hardware or software. It is often prudent to draft a completely separate contract for the unrelated nontaxable services.

1. Best Practices:

a. Check definitions and terms used in the contract

Are there terms used in your contracts that have meanings that differ materially from the specific definitions given in the state tax code? Be sure to define specifically terms in your contract to avoid misunderstanding. In the alternative, avoid using terms in your contract that conflict in meaning with those used in the tax code.

b. Delivery or title clauses

Specifying delivery or title clauses in your contract may be critical to providing support for your taxability decision, particularly if the contract involves electronically transferred software. Many contracts are vague as to what is being delivered and where tangible items are being delivered.

c. Read the entire contract, paying particular attention to appendices & exhibits

You will often be given a small section of a contract to review for your input on whether tax may apply to the contact. It is important to review contracts in their entirety. This will ensure there is nothing in another section that would negatively impact your taxability decision.
Appendices and exhibits may contain a list of deliverable elements or services that will be provided under the contract. Frequently, the “deliverables” are itemized along with milestones established for payment terms. These documents can work for or against you depending upon whether or not they are consistent with the fact pattern that you have established from the rest of the contract.

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CONTRACTS INVOLVING INTELLECTUAL PROPERTY

- General Definitions & Taxability
- California - Technology Transfer Agreements
- Texas
- Virginia
- Illinois

I. CONTRACTS INVOLVING INTELLECTUAL PROPERTY - AN APPLICATION OF THE TRUE OBJECT OF THE CONTRACT TEST

A. Intellectual property

1. Definition

A product of the intellect that has commercial value, including copyrighted property such as literary or artistic works, and ideational property, such as patents, appellations of origin, business methods, and industrial processes. [The American Heritage® Dictionary of the English Language: Fourth Edition. 2000.]

2. Taxability

a. Unless the state imposes the tax on all gross receipts, most states do not attempt to impose tax on contracts involving licensing of intellectual property rights unless the rights are needed to consume or permit use of tangible personal property.

b. Some states will impose tax on the entire gross receipts of contracts involving intellectual property if any tangible personal property is transferred in conjunction with intangible rights.
c. Some states will look to the true object of a contract involving both intellectual property and tangible personal property to determine what portion, if any, is subject to tax.

B. California - Technology transfer agreements

Technology licensing or transfer agreements generally involve the right to make and sell a product or use a process that is subject to another party’s patent or copyright interest. These contracts often include services and tangible property in addition to the granting of rights relating to intellectual property. Existing computer programs and testing data are often included in technology contracts.

In California, prior to the published Board Memorandum in the Matter of Intel Corporation (1990), the Board of Equalization frequently used the gross receipts principle of taxation, contending that the “true object” of these types of contracts related to the transfer of the tangible personal property, thereby subject the entire contract to tax. As a result of the hearing before the California State Board, and based on a legal opinion from then Chief Legal Counsel Gary Jugum, the Board determined that the true object of technology transfer agreements (defined below) was the sale of both intellectual property rights and tangible personal property. The legal memorandum further concluded that only the value relative to the tangible personal property should be taxed since the state did not impose tax on intangibles.

These principles set forth in the findings behind the Intel case were later codified.

1. California definition of technology transfer agreement

Section 6012(b) (10) (D): "Technology transfer agreement means any agreement under which a person who holds a patent or copyright interest assigns or licenses
to another person the right to make and sell a product or to use a process that is subject to the patent or copyright interest."

2. Taxability of technology transfer agreements in California

Generally, **two separate and distinct types of assets** may be transferred under technology transfer agreements: tangible personal property and intellectual property.

The State of California's position is that the tax does not apply to the amount of the sale or license relating to patents or copyrights, but that the sale of any tangible personal property is subject to the tax.

California established three methods of determining the taxable amount of tangible property

The taxable amount is equal to:

a. The separately stated, reasonable price for the tangible personal property in the contract,
   or in the event where there is no separately stated price;

b. The price at which the tangible personal property was sold, leased, or offered for sale or lease, to third parties at a separate price, or in the event that there is no separately stated price and the tangible personal property has not been previously sold or leased;

c. 200 percent of the cost of materials and labor used to produce the tangible personal property subject to tax.
The remainder of the sales price, representing the amount for the intangible personal property transferred, is not taxable.

3. Cross Licensing Agreements Example:

A semiconductor company engaged in numerous cross licensing agreements with another semiconductor company for access to their intellectual properties in the creation of their own products for resale. The State of California initially attempted to assess tax on the entire gross receipts from the licensing agreements because “manufacturing packages” were transferred in addition to the rights to “make, use and sell” the products. The Board of Equalization ultimately reached the conclusion at the hearing that these contracts consisted of both intellectual property and some tangible assets. This Board decision was published as “In the matter of Intel Corporation”.

4. Contract provisions

Separately stating the selling price of the tangible property in the technology contract puts certainty into the amount subjected to tax. Here is an example contract provision.

"Article 10. Tangible Property"

“The parties agree that the tangible personal property shown in Exhibit C of this Agreement to be delivered by SELLER to PURCHASER is valued at One Thousand Dollars ($1,000)."

5. Nortel Networks, Inc. v. State Board of Equalization

In this court case, the court concluded that the State Board had exceeded its authority in attempting to exclude prewritten computer programs from the definition of technology transfer agreements. The court concluded that this contract for the transfer of both prewritten software and licenses for “Switch-Specific Programs” designed for the customer qualified as a technology transfer agreement and thus was exempt from the tax. In a similar California case involving software and switching equipment, the court held that Lucent’s software agreements (licenses) to operate telephone switching equipment were “technology transfer agreements,” and were exempt from sales tax as a matter of law. Nortel Networks, Inc. v. State Board of Equalization, Court of Appeal of California, Second District, January 18, 2011; petition for review denied, California Supreme Court, No. S190946, April 27, 2011. To the same effect: Lucent Technologies et al. v. State Board of Equalization, case number B257808, California Court of Appeal, Second Appellate District, October 8, 2015; Petition for review denied, California Supreme Court, No. S230657, January 20, 2016.
C. Other states’ approaches to contracts involving intellectual property rights

1. Texas

Copyright owners have the exclusive right to make and distribute copies of their copyrighted works, and can assign some or all of these rights to others. Since such rights are intangible, selling copyright interest is not considered a taxable transaction.

The established test in Texas for deciding whether a transaction is subject to sales tax is to determine the ultimate object or the essence of the transaction. “If the object or the essence of the sale is not tangible personal property, but rather intangible property, then the transaction is not taxable under any definition of "sale."

Bullock v. Statistical Tabulating Corp., 549 S.W.2d 166 (Tex. 1977); Geomap v. Bullock, 691 S.W.2d 98 (Tex. App.-Austin 1985, writ ref’d n.r.e.)

Since a creator of a copyrighted work may sell or assign copyright interest or even allow use by another through a licensing agreement, all such transfers, sales, assignments, and licenses by a copyright owner are considered sales of intangible personal property, and thus not taxable.
Royalties paid by a licensee not only for the intellectual property rights but also tangible personal property have generally been regarded as leases of tangible personal property subject to taxation. [Virginia Public Document Ruling No. 99-7, 01/08/1999.]

Virginia Example: Taxpayer, who had entered into licensing agreement from various licensors for the right to use “Star Wars” and “Star Trek” characters and images in his board and trade card games, was subject to sales tax for royalty payments. Under Virginia law, sale is defined as any transfer of title or possession, in any manner or by any means, of tangible personal property and any rendition of a taxable service for a consideration.

Other rulings involving the same principle include Virginia Public Document Ruling No. 07-22, 03/27/2007 and Ruling No. 08-134, 07/30/2008 both involving software and royalties.

Illinois exempts separate charges for the use of intellectual property such as patents.

In a private letter ruling, the Department of Revenue confirms that the charges for patent fees relating to the right to perform a Licensed Procedure (for medical procedures that were subject to a patent) constituted a sale of an intangible and thus, such fees should not be subject to sales and use tax in Illinois.

“It is the Department's opinion that the patent fees are not tangible personal property and are not subject to Illinois sales and use tax. These fees represent charges for the intangible right to perform patented surgical procedures.” [Illinois Private Letter Ruling No. ST 04-0010-PLR, 06/28/2004 06/28/2004]
II. CONCLUSION

The taxation of computer software and services continues to evolve, especially considering the proliferation of new products such as cloud services and the progress being made by the Streamlined Sales Tax Agreement members. The tax professional must continually keep abreast of the latest issues and rulings.
ADVANCED TOPICS IN LEASING
SALES TAX SCHOOL II
THEORY AND PRACTICE FOR THE EXPERIENCED
SALES AND USE TAX PROFESSIONAL

Learning Objectives
At the end of this section, the learner will be able to…

- Know the difference between a lease and conditional sale.
- Identify the steps in a sale and leaseback transaction.
- Recognize the concept of form versus substance.
- Identify the legal sources for the financing exemption related to sale and leaseback transactions.
- Know what the SST definition of lease/rental includes.
- Review the SST sourcing rules for lease/rental transactions.
I. BRIEF REVIEW - LEASING

A. Parties to a Lease:

1. Lessor – shall mean a person who transfers the right to possess and use property to another person under a lease.

2. Lessee – shall mean a person who acquires the right to possession and use of property under a lease or rental agreement.

B. Definition of Lease:

1. Lease (IPT Glossary Term)

   a. A contract by which one party (lessor) gives to another (lessee) the use and possession of property for a specified time and for specified payments or other consideration. Short-term leases may be referred to as “rentals”. May also be called an “operating lease” or “true” lease.
C. Lease Definition – Requirements:

1. Transfer possession or use of tangible personal property (TPP);
   a. Tangible Personal Property (IPT Glossary Term): Property, other than real property, that can be held, smelled, touched, seen, tasted, or which is otherwise perceptible to the human senses. Excludes intangible property that is evidenced by tangible things, such as stocks, bonds, and money.
   b. Real Property (IPT Glossary Term): Land and improvements to land. Includes tangible personal property that is incorporated into real property, and that meets the following tests:
      i. It is annexed, incorporated, or attached to land or other real property;
      ii. The annexation, incorporation, or attachment is intended to be permanent;
      iii. It cannot be easily removed without causing substantial damage to the land or other real property.

2. Possession or use for a specified period of time;

3. Lessee pays consideration to the lessor. Consideration is defined as “[s]omething of value (such as an act, a forbearance, or a return promise) received by a promisor from a promisee. Black’s Law Dictionary, pages 300-301 (7th ed. 1999);

4. Lessor does not transfer title to property.
D. Collection of Tax on Leases:

1. In the majority of the states, the tax is collected by the lessor from the lessee on each lease payment when made.

2. Several states allow the lessor the option of either paying tax on the purchase of the property or collecting tax on the lease payments. If the lessor chooses to pay tax on the purchase price of the property that will be leased, no tax will be due on the lease payments.

3. There are a couple of states that treat the lessor as the end user of the leased property and require the lessor to pay a use tax on the TPP. The lessor will generally recover the use tax from the lessee under terms and conditions.
contained in the agreement, which require the lessee to reimburse the lessor for the use tax.

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**CONDITIONAL SALE**

- Treated as Sale of TPP
- May be Called a "Capital" Lease
- Tax Collected At Time of Sale
- Characteristics of Conditional Sale

E. Definition of Conditional Sale:

1. Conditional Sale (**IPT Glossary Term**): A transaction where property changes hands but title (held by seller) does not transfer until the full sales price has been paid by the purchaser.

2. May also be called a **"capital" lease**.

3. Treated as the sale of TPP and sales tax collected at time of sale.

4. Characteristics of Conditional Sales

   a. A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease. A lease generally does not have a buy-out at the close of the lease. If a buy-out provision does exist, it must be at fair market value in order to maintain the character of a lease.

   b. Title transfers once all payments have been made.
II. SALE AND LEASEBACK TRANSACTIONS

A. Overview

1. What is a Sale Leaseback?

   A sale leaseback is a transaction in which an owner of tangible personal property sells the tangible personal property to a third party (e.g., leasing company or financing company) and immediately leases back the equipment.

2. What is the Business Reason for a Sale Leaseback?

   a. Companies have used sale-leasebacks to unlock the cash in assets and apply it to more productive uses, for example, paying down debt, buying equipment, or hiring more employees.

   b. Leasing companies or financial institutions often facilitates these arrangements.

3. Risk of Multiple Taxation

   a. Tax may be due on the original purchase of the TPP;

   b. Possible tax due on sale of the TPP to the lessor;

   c. Tax may be due on the lease payments.
2. Taxable Sale and Leaseback Transaction

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**Arizona:** Honeywell Bull, Inc. and CRA, Inc. v. Arizona Department of Revenue, Board of Tax Appeals, Division Two, No. 646-89-S, January 23, 1990.

**Issue:** Whether a sale-leaseback transaction is a financing transaction not subject to the Arizona transaction privilege tax.

**Holding:** The Board held that a sale and leaseback transaction of computer equipment was not a financing transaction but was a taxable sale and a taxable lease.

**Facts:** Blue Cross (“BC”), an insurance company purchased a computer from Honeywell Bull paying sales tax on the purchase. Five months after the purchase, BC entered into a sale-leaseback transaction with CRA, Inc., a leasing company. Ten months after the initial purchase of the equipment, BC issued a retroactive Arizona resale certificate to Honeywell. Honeywell and CRA filed refund claims to recover the transaction privilege tax paid on the initial purchase and on the monthly lease payments. The Department denied the refund claims.

**Board’s Reasoning:** The Board stated “[t]he Department cannot be in the ordinary course of BC’s business as required by statute and regulation. Additionally, the resale certificate was not provided at the time of the sale.

BC is not in the business of selling computers, so the resale cannot be in the ordinary course of BC’s business as required by statute and regulation. Additionally, the resale certificate was not provided at the time of sale.
CRA is liable for the transaction privilege tax on the rental receipts, despite the fact that this transaction may have been structured to facilitate financing of the computer.

B. Initial Purchase of the Equipment

Since there is a sale of TPP from the manufacturer to the lessee/buyer, this transaction will be subject to sales/use tax unless an exemption applies (e.g., resale or manufacturing).
C. Step One – Sale of TPP by Lessee to the Lessor

1. Resale Exemption:

   ➢ In general, a resale exemption should eliminate the sales/use taxes on the original purchase and the sale of the TPP to the lessor, but there may be certain conditions, which must be met to qualify.

2. Registration of Parties:

   ➢ The lessee and lessor may be required to register in order to claim the exemption.

3. Timing:

   ➢ **Michigan**: A purchaser of tangible personal property who intends to sell the property under a sale and leaseback arrangement has 90 days within which to claim a resale exemption on the original purchase. The 90-day grace period is intended to permit the purchaser to finalize its total purchase plan, including a tax-exempt resale. If the purchaser fails to claim the exemption within the 90-day period, tax is due on the lease receipts or the leasing party’s purchase of the property, even if the original purchaser paid tax on its purchase of the property. Letter Ruling 89-05 (February 10, 1989).

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**STEP TWO LEASEBACK TRANSACTION FINANCING EXEMPTION**

- Leaseback Transaction
- Form v. Substance
- Financing Exemption
  - Statute
  - Regulation
  - Ruling
  - Case Law
D. Step Two-Leaseback Transaction – Financing Exemption

1. General

   a. Many states have determined that when a sale and leaseback is, in substance, a financing arrangement, the transaction is not subject to sales and use tax.

      1. In the sales and use tax area, the sales transaction and the leaseback transaction are separate and should be reviewed accordingly.

      2. The most common issue facing sales and use tax professionals in a sales leaseback is determining whether the department of revenue and the courts will respect the form of the transaction, or will examine the substance of the steps.

   b. Form v. Substance


         In the field of taxation, administrators of the laws and the courts are concerned with the substance and realities, and formal written documents are not rigidly binding.


         The substance-over-form doctrine provides that the legal formalities of a transaction may be overlooked when the true substance of the transaction is determinative of the incidence of taxation. While this doctrine has been applied to the benefit of taxing authorities and taxpayers alike, the philosophy…is to prevent taxpayers from subverting the taxing statutes by disguising their transactions with mere legal formalisms. The doctrine only applies where the form chosen by the parties to a transaction is a fiction. The doctrine does not apply where a taxpayer later seeks to recast a completed transaction to obtain a tax advantage.

         ▶ Form of Transaction Governs:

         In this situation, the form of the transaction controls the tax treatment.

Substance of the Transaction Controls:

In the sale and leaseback area, if the lessee does not truly sell the equipment to the lessor and the TPP is not sold back to the lessee, some states view this as a financing transaction. In these states, the substance of the transaction governs.


Issue: Whether the sale-leaseback is in substance a loan, which cannot be taxed under the sales and use tax law.

Holding: The Georgia Supreme Court held that a sale and leaseback transaction was in substance a security arrangement for a loan and could not be taxed as a lease.

Facts: McCall purchased all the assets from Foote & Davis including printing equipment. McCall borrowed $3 million from the First National City Bank of New York. The loan of $3 million was actually made to Footpress Corporation. McCall sold the equipment to Footpress for $3 million. McCall then leased the equipment from Footpress. The Commissioner taxed the lease from Footpress to McCall of the printing equipment.

Court’s Reasoning: The substance of a transaction controls its tax treatment rather than the form chosen by the parties.

The Uniform Commercial Code recognizes that in some instances a sale-leaseback arrangement is neither a sale nor a lease but a security arrangement for a loan. Taxation of the repayment of secured loans was not within the intent of the legislature, which taxed leased of tangible personal property.

The states that recognize the “financing exemption” for sale and leaseback transactions have done so through statute, regulation, ruling, and/or case law.

2. Statute

a. (IPT Glossary Term). The law enacted by a legislature. The word “code” may also be used in this fashion, but can also mean a body of administrative regulations.

b. Utah. Utah Code Ann. Section 59-12-102(25)(c) provides that sale-leaseback is not taxable if sales tax was paid on the initial purchase, the transaction is
intended as a financing transaction, and the lessee capitalizes the property for financial reporting purposes under generally accepted accounting principles.

3. Regulation

a. **(IPT Glossary Term).** Typically, the published rules of an agency, adopted according to a statutory procedure, that has the force of law until overturned. Revenue regulations generally contain the revenue agency’s interpretation of the law, its directives on how taxpayers are to comply with the law, and/or its internal procedures.

b. **Missouri.** Regulation § 10-108.700(3)(D) provides that sale and leaseback will constitute nontaxable financing arrangements if the following conditions are met:

   - The lessee has paid sales or use tax on the original purchase of the TPP.
   - The lease contains a security interest in the property.

   A security interest in property is created by agreement or by operation of law to secure payment of an obligation (e.g., repayment of a debt).

   - The lessor has only a security interest and no other ownership interest in the property, and does not claim a deduction, credit, or exemption for state or federal income tax purposes, with respect to the leased property.

4. Ruling:

a. **(IPT Glossary Term).** A generic term that can be used to refer to any decision, expression, or opinion of a governmental authority on a specific matter.

b. **Massachusetts.** The Department of Revenue has concluded through a ruling that a sale and leaseback transaction will be treated as non-taxable if the facts and circumstances indicate that the transaction is merely a financing arrangement. One of the factors considered by the department is whether title and possession remain with the lessee, and the lessee retains all the benefits and burdens of ownership of the TPP. Letter Ruling 96-6 (December 27, 1996).
A. Streamlined Sales Tax (“SST”):

1. Overview

   a. The Streamlined Sales Tax Project (“SSTP”) was organized in March 2000 to develop a simplified sale and use tax system to ease the burden of sales and use tax compliance for all type of retailers.

   b. The primary task of the SSTP was to draft the “Streamlined Sales and Use Tax Agreement” (“SSUTA” or the “Agreement”), which is the foundational document for the streamlined system and which became effective on October 1, 2005. The “SSUTA” contains the substantive, administrative and governance rules, which states that are parties to SSUTA must adhere to.

   c. As this outline goes to press, 22 states have conformed their sales taxes with “SSUTA” and became members of its Governing Board. See the SST Web site at www.streamlinesalestax.org for the latest listing of states.

   d. The SSUTA provides the states with a sales and use tax system that includes uniform definitions and uniform sourcing rules.

1. Definition of “Retail Sale or Sale at Retail”

“Retail sale or sale at retail” means any sale, lease or rental for any purpose other than for resale, sublease, or subrent.”

2. Definition of “Lease or Rental”

“Lease or rental” means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend.

Lease or rental does not include:

- A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;

- A transfer or possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price does not exceed the greater of one hundred dollars or one percent of the total required payments; or

- Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A condition of this exclusion is that the operator is necessary for the equipment to perform as designed. For the purpose of this subsection, an operator must do more than maintain, inspect, or set-up the tangible personal property.

Lease or rental does include agreements covering motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 USC 7701(h)(1).

This definition shall be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, the [state commercial code], or other provisions of federal, state or local law.

This definition will be applied only prospectively from the date of adoption and will have no retroactive impact on existing leases or rentals. This definition shall neither impact any existing sale-leaseback exemption or exclusions that a state may have, nor preclude a state from adopting a sale-leaseback exemption or exclusion after the effective date of the Agreement.
C. Full/Associate Member States

1. States Adopting SST Lease or Rental Definition.

The following states have adopted the provisions of the Streamlined Tax Sales and Use Agreement (SSUTA). The citation provided is the section of the law where a “lease or rental” is defined.

**Full Member States:**

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<th>State</th>
<th>Citation</th>
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<tr>
<td>(1) Arkansas</td>
<td>AR Code Sec. 26-52-521(c)(3)</td>
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<td>(2) Indiana</td>
<td>IC 6-2.5-1-21</td>
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<td>(3) Iowa</td>
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<td>(6) Kentucky</td>
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<td>(7) Michigan</td>
<td>MI Code Sec. 205.51a(k)</td>
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<td>32 V.S.A. Sec. 9701(33); Reg. 1.9701(5)-2</td>
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<td>WA Code Sec. 82.04.040(3)(a)(b)</td>
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<td>W. VA. Code Sec. 11-15B-2(b)(29)(A)(B)</td>
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<td>(21) Wisconsin</td>
<td>WI Stats. Sec. 77.51(7)(a)(b)</td>
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**Associate Member States:**

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<td>(2) Tennessee</td>
<td>T.C.A. Sec. 67-6-102(a)</td>
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D. Provisions of SST Lease or Rental Definition

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**DEFINITION OF RETAIL SALE OR SALE AT RETAIL**

“Retail sale or sale at retail” means any sale, **lease** or **rental** for any purpose other than for resale, sublease, or subrent.”

1. Retail Sale or Sale at Retail

   “Retail sale or sale at retail” means any sale, **lease, or rental** for any purposes other than for resale, sublease, or subrent.”

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**LEASE OR RENTAL DEFINITION**

“Lease or rental” means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend.

2. Lease or Rental Definition

   “Lease or rental” means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend.
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**LEASE OR RENTAL REQUIREMENTS**

- Transfer Possession or Control of TPP
- For a Fixed or Indeterminate Term
- Consideration
- May Include Future Option to Purchase

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**LEASE OR RENTAL DOES NOT INCLUDE**

- Conditional Sale
- Lease/Rental with an Operator

3. Lease or rental does not include:
a. Conditional Sale

i. A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;

ii. A transfer of possession or control of property, under an agreement that requires the transfer upon completion of required payments, and payment of an option price does not exceed $100 or 1% of the total required payments; or

b. Equipment with an Operator

- Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A condition of this exclusion is that the operator is necessary for the equipment to perform as designed. For the purpose of this Subsection, an operator must do more than maintain, inspect, or set-up the tangible personal property.
Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A condition of this exclusion is that the operator is necessary for the equipment to perform as designed. For the purpose of this Subsection, an operator must do more than maintain, inspect, or set-up the tangible personal property.

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**LEASE OR RENTAL DOES INCLUDE TERMINAL RENTAL ADJUSTMENT CLAUSE (TRAC)**

- Agreements covering motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 USC 7701(h)(1)

4. Terminal Rental Adjustment Clause (TRAC)

Agreements covering motor vehicles and trailers, where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property, as defined in 26 USC 7701(h)(1).

a. A Terminal Rental Adjustment Clause (TRAC) involves a lease of motor vehicles or trailers. Under a TRAC lease, the lessee is responsible for an increase or decrease in the residual value of the property. The “residual” is the value of the equipment at the termination or at the end of the lease. Even though the lessee is responsible for changes in the residual value, the Internal Revenue Code (IRC) § 7701(h) treats a TRAC lease as a true lease. A “terminal rental adjustment clause” is defined in IRC § 7701(h) as “a provision of an agreement which permits or requires the rental price to be adjusted upward or downward by reference to the amount realized by the lessor under the agreement upon sale or other disposition of such property.”
5. Characterization of Lease

The definition provided in this section shall be used for the purpose of this chapter, regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, the [state commercial code], or other provision of federal, state or local law.

a. Accounting Definition of Lease

The Financial Accounting Standards Board (FASB) in its Statement No. 13, *Accounting for Leases*, puts all leases into two basic classifications: a lease is either an operating lease or capital lease. Under Generally Accepted Accounting Principles (GAAP) a lease will be an operating lease unless one of the four criteria enumerated in FASB 13 is met.

b. Federal Tax Treatment of Lease

The Internal Revenue Service is also concerned with whether a lease is a conditional sale or a true lease.

c. Uniform Commercial Code (UCC)

The Uniform Commercial Code (UCC) Article 2A deals with the commercial law aspects of leasing. Article 2A covers the lessee’s obligation to pay, warranties, risk of loss, and lessor and lessee remedies for default. Each party’s rights and obligations differ depending on whether the lease is a “lease” or a “finance lease” as defined in Article 2A.
6. Effective Date – Prospective Application

This definition will be applied only prospectively from the date of adoption and will have no retroactive impact on existing leases or rentals.

7. Treatment of Sale and Leaseback Transactions

This definition shall neither impact any existing sale-leaseback exemption or exclusions that a state may have, nor preclude a state from adopting a sale-leaseback exemption or exclusion after the effective date of the Agreement.
IV. WHERE IS TAX DUE?

A. Sourcing Rules:

1. Section 310: General Sourcing Rules

2. Sale of Tangible Personal Property

   Subsection A: The retail sale, excluding lease or rental, of a product shall be sourced as follows:

   - When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

   - When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location, where receipt by the purchaser (or the purchaser’s donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

   - When Subsections A.1 and A.2 do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller, which are maintained in the ordinary course of the seller’s business when use of this address does not constitute bad faith.

   - When Subsections A.1, A.2, and A.3 do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser’s payment instrument, if no other address is available, when use of this address does not constitute bad faith.
• When none of the previous rules of Subsections A.1, A.2, A.3, or A.4 apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

3. Lease or Rental of Tangible Personal Property:

Subsection B: The lease or rental of tangible personal property, other than property identified in Subsection C or Subsection D, shall be sourced as follows:

• For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale, in accordance with the provisions of Subsection A. Periodic payments made subsequent to the first payment are sourced to the primary property location for each period covered by the payment. The primary property location shall be as indicated by an address for the property, provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. The property location shall not be altered by intermittent use at different locations, such as use of business property that accompanies employees on business trips and service calls.

• For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale, in accordance with the provisions of Subsection A.
• This Subsection does not affect the imposition or computation of sales or use tax on leases, or rentals based on a lump sum or accelerated basis, or on the acquisition of property for lease.

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4. Lease or Rental of Motor Vehicles, Trailers, Semi-trailers, or Aircraft

Subsection C: The lease or rental of motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as transportation equipment, as defined in Subsection D, shall be sourced as follows:

• For a lease or rental that requires recurring periodic payments, each periodic payment is sourced to the primary property location. The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. This location shall not be altered by intermittent use at different locations.

• For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of Subsection A.

• This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump sum or accelerated basis, or on the acquisition of property for lease.
5. Lease or Rental of Transportation Equipment

Subsection D: The retail sale, including lease or rental, of transportation equipment shall be sourced the same as a retail sale in accordance with the provisions of Subsection A, notwithstanding the exclusion of lease or rental in Subsection A. “Transportation equipment” means any of the following:

- Locomotives and railcars that are utilized for the carriage of persons or property in interstate commerce

- Trucks and truck-tractors with a Gross Vehicle Weight Rating (GVWR) of 10,001 pounds or greater, trailers, semi-trailers, or passenger busses that are:
  
  a. Registered through the International Registration Plan; and
  
  b. Operated under authority of a carrier authorized and certificated by the U.S. Department of Transportation or another federal authority to engage in the carriage of persons or property in interstate commerce.

- Aircraft that are operated by air carriers authorized and certificated by the U.S. Department of Transportation or another federal or a foreign authority to engage in the carriage of persons or property in interstate or foreign commerce.

- Containers designed for use on and component parts attached or secured on the items set forth in Subsections D.1 through D.3.
Sales Tax School II

BREAKOUT SESSION

Computer Software and Services
Breakout Problem for Computer Software and Services

Your company has decided to implement an enterprise-wide software package that will provide seamless and efficient integration for all transactions within your company. The new software will replace most if not all of your company's current mainframe applications: general ledger, budgeting, cost accounting, accounts payable, order entry and sales, accounts receivable, fixed assets, inventory control, distribution, shipping, purchasing, material planning, and factory processing and controls.

You have been selected to act as the tax department's representative on many of the implementation teams that will reengineer your business processes to work within the framework of this new software system.

Your company has manufacturing locations in many states, including but not limited to California, New York, Oregon, Texas, and Washington. Your company is both a wholesaler and a retailer.

The software will be installed on servers that will be placed in various states through the US. Servers for foreign subsidiaries will be located throughout the world. Each server will hold a different module, such as accounts payable or general ledger, of this integrated software package.

The software vendor has submitted a single proposal to your firm covering hardware, software, bundled optional hardware and software maintenance, software customization and implementation, and user training on the software. Your company's purchasing agent and the legal department are considering the proposal.

1) Assume your company's purchasing agent realizes that how and where software is delivered can impact its taxable status, and brings the proposed transaction to you for advice. What do you tell him or her?

2) Assume the purchasing agent realizes that the taxability of these contemplated transactions may be impacted by how the contract(s) are structured and/or how the vendor prepares its invoices. What advice would you give to the purchasing agent?

3) Assume that your company's legal department has brought you the contract for this transaction prior to finalization. What advice would you provide your in-house attorney regarding specific language or clauses that should be in the contract?

NOTE: Allow 10 minutes to read this problem, and 20 minutes to discuss. Please realize that this problem does not have a specific answer but that it should provide animated discussion.
Statement of Facts

Holston Corporation (“HC”) manufactures and sells electronic equipment. Over a period beginning in 2011 and ending in 2012, HC purchased certain research and development equipment (the “Equipment”) at retail. HC paid sales tax on or accrued use tax on the purchase of the Equipment in State X.

On December 31, 2012, HC entered into two agreements with Money Bank (“Bank”). In the first agreement, entitled “Bill of Sale”, HC purportedly transferred its title in the Equipment to the Bank for a stated amount. In the second agreement, entitled “Master Agreement to Lease Equipment”, the Bank purportedly leased the Equipment back to HC for a period of three years at a stated rental. The Equipment served to secure HC’s obligations under the “Master Agreement to Lease Equipment”. At all times, the Equipment was located at HC’s premises and was used by HC in furtherance of HC’s business activities. HC was liable for all repairs and maintenance of the Equipment, for the cost of insuring the Equipment, for all taxes or assessments with respect to the Equipment, and for all risks of loss or damage to the Equipment.

Neither HC nor the Bank collected or remitted any sales or use tax in State X with respect to the “sale” or the “lease”. Commissioner Goldman issued a Notice of Assessment for sales and use tax to HC asserting that two taxable transactions occurred as a result of the party’s agreements.

Question:

1. As tax advisor to HC, what arguments can be made to contest this assessment?
CONSTITUTIONAL ISSUES

SALES TAX SCHOOL II
THEORY AND PRACTICE FOR THE EXPERIENCED
SALES AND USE TAX PROFESSIONAL

Learning Objectives

At the end of this section, the learner will be able to:

- Identify the steps to use in analyzing a state tax.
- Distinguish the role of the federal Constitution from the roles of other laws and understand the impact of U.S. Supreme Court decisions on constitutional issues.
- Know the attitudes and preferences of courts with respect to deciding constitutional issues.
- Distinguish the concepts of “facial” unconstitutionality from “as applied unconstitutionality.
- Recognize the purpose and two-fold nature of the Commerce Clause, and identify what types of commerce are and are not protected by the Clause.
- Explain the import of Complete Auto Transit v. Brady and identify the four prongs.
- Know the concept of nexus and its sources in the Constitution.
- Explain the import of Quill Corporation v. North Dakota, identify the major unresolved issues, and describe the extent to which Congress has the power to change the law as expressed in the decision.
- Explain the meaning of “apportion” as used in the second prong and cases discussed in the material.
- Recite the internal and external consistency tests.
- Describe the role of credits for taxes paid elsewhere in Commerce Clause analysis.
- Explain the compensatory tax defense and why the conventional use tax is constitutional.
- Apply the discrimination prong to a simple fact pattern.
- Explain how the fourth prong has been interpreted and applied.
- Identify the elements of the constitutional test under the Foreign Commerce Clause.
- Identify the essential features of state tax analysis under the Import/Export Clause.
- Distinguish the two primary tests that are applied under the Equal Protection Clause.
- Recognize the factors that are relevant to claims of U.S. Government immunity under the Supremacy Clause.
- Identify the Court’s primary concern in evaluating constitutional challenges under the Free Speech and Press Clauses.
- Know what is meant by “attributional nexus” in the use tax collection context.
- Identify the prongs of Brady that have been most effective and ineffective for taxpayers.
- Identify the current “hot issues” in the area.
CONSTITUTIONAL ISSUES

I. INTRODUCTION

A. Scope

The subject matter of this session is the federal Constitution as it limits the exercise of taxing power by state and local governments.

States possess broad discretion to impose taxes for the purpose of funding general purpose and special purpose government programs. Property taxes, gross receipts taxes, income taxes, and sales and use taxes are among the favorite revenue raisers. Conversely, the states routinely afford tax benefits to some taxpayers for various policy reasons. Examples of such tax benefits are exemptions or credits designed to promote the development or health of an industry, or to encourage certain behavior such as
environmental protection. The wide latitude that the states enjoy in devising their tax systems is an aspect of their sovereignty.

However, this latitude is not unlimited. The states exist as part of a federal system that has a national government, with its own objectives and guarantees. Many of these objectives and guarantees are contained in the Constitution of the United States. In some situations, state and local exercise of the taxing power comes into conflict with the Constitution. This conflict may be the result of a single state taxing statute, or of the interplay among different provisions. In either event, once the court system has identified the conflict, the offending state tax provisions become unenforceable.

This material provides basic information about the various federal constitutional limitations on the power of state and local governments to impose taxes and collection obligations. These limitations emanate primarily from the Commerce Clause (Article I, Section 8, Clause 3), Due Process Clause (Fourteenth Amendment), Import-Export Clause (Article I, Section 10, Clause 2), Equal Protection Clause (Fourteenth Amendment), Supremacy Clause (Article VI, Clause 2), and from various provisions of the First Amendment. Over the years, many state assertions of taxing power have been stricken as violating one or more of these provisions and the nature of our system is such that additional constitutional defects will inevitably be found in current and future state and local tax schemes.

Although many tax professionals are not lawyers, they generally represent the first line of defense against unlawful taxation. Therefore, a basic familiarity with the relevant constitutional doctrines empowers the tax professional to identify issues that might otherwise go unnoticed.

This material focuses on federal constitutional issues. It is not intended to supplant other important elements of state tax analysis, which generally include reference to local law such as state constitutions, state statutes, and state regulations. Federal constitutional law is derived entirely from the text of the United States Constitution and from judicial decisions interpreting it. Although other American courts decide federal constitutional issues from time to time, the ultimate authority on such issues is the Supreme Court of the United States.

B. Uniform Impact of Constitution

Under Article VI, Clause 2 of the Constitution, the Constitution, together with laws enacted by Congress under authority of the Constitution, is the Supreme Law of the Land. All federal, state, and local laws, including tax laws, must conform, and all judges in the country are bound to adhere to the Constitution and to United States Supreme Court decisions interpreting it. If a law is challenged and is found not to conform, it is deemed unconstitutional and accordingly, unenforceable. Thus, although different states may accord different tax treatment to the same type of business activity or transaction, the Constitution theoretically has the same meaning and applicability in every state (although this does not prevent different interpretations of the same constitutional provision in
different states). Moreover, with few exceptions the applicability of constitutional limitations in the context of taxation does not depend upon the type of tax imposed or the label the state employs to identify it. The same principles are applied to taxes on discrete events (for example, sales and use taxes), on aggregations of business activity over time (income and gross receipts taxes), and on wealth (property taxes). As a result, not all the relevant cases are sales and use tax cases.

C. Hierarchy of Laws

In the United States, laws are enacted at three levels of government: local, state and federal. These levels are hierarchical in nature. For example, a local tax must not only be authorized by state statute or constitutional provision, it must also be consistent with the federal Constitution. In the same way, a state sales tax statute might be valid under its own state constitution but run afoul of the federal Constitution. A questionable tax measure must be scrutinized at each level, in a systematic manner. In general, one begins by examining the tax under state or local statute or ordinance, and federal constitutionality is considered last.

The determination whether a law (including a tax law) is constitutional is a judicial function, and the United States Supreme Court is the ultimate authority on such matters. Thus, whenever confronted with an issue that the U.S. Supreme Court has not previously decided, judges of other courts resort to the principles announced in prior Supreme Court precedents, with the objective of deciding the issue as the Supreme Court would be expected to decide it. The Supreme Court accepts a small percentage of the tax cases it is asked to hear, but over the nation’s history, it has produced a substantial body of decisions in the context of state and local taxation.

D. Additional Points about Constitutional Analysis

1. Challenging a tax statute on constitutional grounds is difficult. It is rare for a revenue agency to refrain from attempting to enforce a tax due to a belief that it is unconstitutional. Thus, the taxpayer generally has only a judicial remedy. However, courts are reluctant to strike down statutes, and often work hard to find an analytical approach that allows the tax to stand.

2. Courts generally seek to avoid constitutional issues, and therefore, will decide a case on non-constitutional grounds if it is possible to do so. However, some cases cannot be resolved without addressing constitutional issues, and are decided based on the protections afforded by the Constitution.

3. Courts generally adhere to precedent, and a lower court is required to follow the controlling precedents of higher courts. However, state taxes can be drawn and implemented in so many ways that a precedent directly addressing the issue at hand is often unavailable. Opinions as to the correct application of constitutional principles, therefore, often differ, and the differences are not necessarily limited to the parties that have the dispute; the nine justices of the United States Supreme
Court often disagree. When this occurs, the votes of a majority of the justices determine the outcome. It follows that a legal opinion is in substance a prediction of how a court would rule, and that the reliability of such predictions varies dramatically according to the issue at hand.

4. There are two ways a law can violate the Constitution. It may be “facially” unconstitutional, meaning that the defect can be discerned from its text. Alternatively, the law may be unconstitutional “as applied”, which generally means that the unconstitutional effect of the law does not follow immediately from its text, but is rather a consequence of its application. A constitutional defect may not arise from a statute standing alone, but from its effect when combined with other provisions. Another “as applied” constitutional violation may result from the manner in which the laws are administered rather than their literal text. The distinction between “facial” and “as applied” defects is not always clear, nor is it imperative that a tax professional be able to draw the distinction. It is important, however, to understand that evaluating the constitutionality of a statute often requires consideration of its actual operation and interplay with other provisions, as well as its text.

5. Some cases involve more than one constitutional provision or issue. Although this can be confusing, it is simply a consequence of the fact that a law must be consistent with all the provisions of the Constitution.

6. Because of a federal law called the Tax Injunction Act, state and local tax cases involving federal constitutional issues usually begin in the state court system. However, the Supreme Court of the United States may review decisions of state courts that involve federal statutory or constitutional issues; after all state judicial review processes have been exhausted.
II. COMMERCE CLAUSE

Slide 3

A. Origins – the business of America is business

1. Articles of Confederation

   a. After the Revolutionary War, a weak national government was established under the Articles of Confederation. The objective was to concentrate power in the state legislatures, which would be more susceptible to the popular will than would be expected of a strong central government.

   b. The states were joined together in a “league of friendship”. There was no executive or judicial department. The sole organ of government was a one-house Congress. Each state had a single vote in Congress, and legislation had to be passed by nine votes. Because there was no executive, legislation could not be enforced. A unanimous vote was required to amend the Articles. Congress had no power to tax. It raised money by requesting it from the states. It had no power to regulate commerce or resolve conflicts among states.

   c. However, conflicts between states emerged as a serious problem. The states argued over boundaries, enacted protective tariff laws against one another, established their own customs services, and printed their own currencies that had value only within their boundaries. With regard to shipping, the smaller states were at the mercy of the larger states. Virginia passed a law declaring that vessels failing to pay duty in her ports might be seized by any person and prosecuted, “one half to the use of the informer and the other half to the use of the commonwealth”. The law was not aimed at Spain or England, but at the cargoes of Pennsylvania,
Maryland, and Massachusetts. Madison wrote: “Most of our political evils may be traced to our commercial ones...” New Jersey, placed between Philadelphia and New York, was likened to a cask tapped at both ends; and North Carolina, between Virginia and South Carolina, to a patient bleeding at both arms.”

2. Adoption of the Constitution

a. These conditions ultimately became intolerable, leading to pressure for revision of the Articles of Confederation. Eventually, a convention of the states was assembled for this purpose. In 1787 the convention adopted the Constitution, ratification of which by the minimum nine states was completed in 1788. The First and Fourteenth Amendments, which are also relevant to this session, were added later, with ratification by the required number of states completed in 1791 and 1868, respectively.

b. The Constitution differs from the Articles of Confederation in fundamental ways. Rather than a single branch of government, there are three. Rather than a unicameral legislature with no power to enforce the laws it enacts, there is a Congress comprised of two houses, an executive branch charged with enforcement of the laws, and a judicial branch charged with interpreting them. Most importantly, the Constitution vests in Congress the power to regulate interstate and foreign commerce, restricts the states from taxing imports and exports, prevents interference with freedom of expression and religion, prohibits government establishment of religion, and requires that citizens be afforded due process and equal protection of the law.

c. The Congressional power over commerce, in the view of early and current Supreme Court justices, was the primary catalyst leading to adoption of the Constitution. For example, in Camps Newfound/Owatonna v. Town of Harrison 117 S. Ct. 1590 (1997), the Court quoted from an opinion in an 1824 case as follows: “If there was any one object riding over every other in the adoption of the Constitution, it was to keep the commercial intercourse among the States free from all invidious and partial restraints.”

B. Importance of historical perspective

1. Shows the central role of taxation in the establishment of American government.

2. It explains the underlying basis for tools of constitutional analysis, particularly with respect to the Commerce Clause.
3. Where the tools do not work well (which is not infrequent), it provides a guide for evaluating taxes.

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**COMMERCCE CLAUSE TEXT**

Congress shall have power ... to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Art. I, Sec. 8, Cl. 3

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**TWO-FOLD NATURE OF THE COMMERCE CLAUSE**

- Affirmative grant of power to Congress (explicit)
- “Dormant” or “negative” Commerce Clause (implied)
C. Commerce Clause Text

1. Affirmative grant of power to Congress.
2. No mention of a restriction on state powers
3. No mention of taxation
4. Although the Commerce Clause consists of a single sentence, it is really three grants of power which are occasionally referred to separately as the “Interstate Commerce Clause”, the “Foreign Commerce Clause”, and the “Indian Commerce Clause”.
D. Two-Fold Nature of the Commerce Clause

1. The Commerce Clause is an affirmative grant of power to Congress. Congress has exercised this power many times, for example, in regulating interstate transportation, interstate telecommunications, interstate sales of energy, and the interstate securities trade. In only a few instances, however, has Congress enacted laws regulating state taxing power. Examples include Public Law 86-272, the Railroad Revitalization and Regulatory Reform Act, and the Internet Tax Freedom Act.

2. Although the Commerce Clause does not expressly address the states’ authority, the Court has interpreted the Clause not only as an affirmative grant of power to Congress, but also as a negative restriction on state power. This negative restriction on state power, known as the “dormant” or “negative” Commerce Clause, forbids the states from enacting laws that interfere with the objective of assuring that business within the scope of the Clause is transacted without the obstacles that prompted the adoption of the Constitution. Most of the tax cases under the “dormant” or “negative” Commerce Clause involve taxation of interstate commerce.

3. The negative Commerce Clause has proved extremely difficult to implement. Without any guidance in the text of the Clause, the Court has struggled to develop principles that advance the purposes of the Clause while respecting the needs of the states for revenue. The many variations in state tax measures and fact patterns have frustrated the Court’s efforts to establish a formulation that permits easy determination whether a particular taxing measure is or is not consistent with the Commerce Clause. The Court has referred to its own decisions under the Clause as a “quagmire”. Three contemporary justices have argued that the negative Commerce Clause was poorly conceived and that the Court, which essentially created it, should now abandon it. See dissenting opinion of Justice Thomas, in which Justices Scalia and Rehnquist (now deceased) joined, in *Camps Newfound/Owatonna v. Town of Harrison*, cited above. However, the remaining six justices have not shared this view, and therefore the Commerce Clause as discussed in these materials represents the current law.

4. This much is now clear: *neither interstate nor foreign commerce is constitutionally immune from state or local taxation*. The reader must set aside any preconception that interstate or foreign commerce cannot be taxed. Rather, the ultimate question now, in the Commerce Clause analysis of a state taxing measure, is how the measure affects interstate or foreign commerce. If the effect is considered unacceptable, the tax is stricken; otherwise it is upheld. Subsequent paragraphs discuss the tools used to make these determinations.
5. Some state laws expressly confer favorable tax treatment on interstate or foreign commerce. These provisions may be intended to implement federal constitutional requirements, but that is not always the case. The Commerce Clause protects against state laws that could harm commerce; it does not prevent a state from treating interstate commerce more favorably than intrastate commerce. Thus, state laws favoring commerce are not reliable sources to consult for the purpose of identifying and understanding federal constitutional limitations.

E. *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076 (1977) is often cited as the source of the modern test for evaluating state taxes under the Commerce Clause. Although a prior line of decisions had relied on the manner in which the law was drafted, the test articulated in *Complete Auto* focuses instead on the effect of the tax on interstate commerce. A copy of *Complete Auto Transit v. Brady* is included with these materials.

**Facts:** Complete Auto Transit was a Michigan corporation engaged in the business of transporting cars by truck for General Motors. GM assembled the cars outside of Mississippi. Cars were then shipped by rail to a location within Mississippi, and within 48 hours, Complete Auto loaded them on its trucks and transported them to Mississippi dealers. The Mississippi Tax Commission levied a tax against Complete Auto for the privilege of doing business in the state. The tax was 5% of the gross income from operating a business for the transportation of property.

**Primary issue:** The issue was whether the tax, which by its terms was imposed on the privilege of doing business, violated the Commerce Clause. The activity within Mississippi was the completion of interstate transportation, and the tax, therefore, was characterized as being imposed on the privilege of engaging in interstate commerce, which would render it invalid based on prior decisions.

**Court’s reasoning:** The Court examined the prior decisions relied upon by Complete Auto and observed that those cases focused on drafting formalism rather than on the effect of the taxes on interstate commerce. In particular, the Court noted that taxes imposed on the “privilege of engaging in business” were invalidated in the context of interstate activity,
while other taxes levied on other incidents (for example, a “franchise”) were sustained, when there was no difference in the economic impacts of the taxes. Reasoning that the practical economic effect of the tax, rather than the way it is labeled in the state’s law, should be determinative, the Court overruled its prior precedent embracing the formalistic approach. In the wake of this decision, a tax will survive a Commerce Clause challenge, regardless of the manner in which it is drafted, provided the tax:

1. Is applied to an activity which has a substantial nexus with the taxing state,
2. Is fairly apportioned,
3. Does not discriminate against interstate commerce, and
4. Is fairly related to the services provided by the state.

This means that even a tax levied on the “privilege” of engaging in interstate commerce will be upheld if it satisfies these four elements, or “prongs”.

**Holding:** The Mississippi tax did not violate the Commerce Clause and was upheld.

F. Additional points about *Complete Auto*:

1. The four prongs were not developed in *Complete Auto*, and do not really represent a new “test” announced in that decision. Rather, the prongs can be found in the prior decisions of the Court. The principal import of *Complete Auto* was its categorical abandonment of drafting formalism as a predicate for constitutional decisions. The reason *Complete Auto* is often cited as though it were the source of the four-part test may be its unusual recitation of all four elements in one decision, which also stressed that they, rather than verbiage, would control future Commerce Clause analysis.

2. Other than abandoning drafting formalism and reaffirming the four prongs, *Complete Auto* left unresolved questions as to whether other elements in prior case law remain. In addition, application of the four prongs has proved difficult in a wide variety of specific fact patterns, to the point that some justices favor abandoning them.

3. In application, there is some overlap between the four prongs.
G. Application of the *Complete Auto* Test

When considering whether a tax may violate the Commerce Clause, the tax professional separately measures the tax against each of the four *Complete Auto* prongs, and attempts to make judgments about whether the tax is vulnerable to attack. A useful resource in this exercise is the body of prior precedent that shows how the components of the test have been applied. The same principles and precedents apply regardless of the type of tax involved. The following text illustrates the application of each prong in a few of the major cases.

1. **First prong.** The tax must be applied to an activity with a substantial *nexus* with the taxing state. Nexus in this context refers to the nature of the connection with the state that justifies its exercise of taxing power. Without the requisite connection, the power cannot be exercised. For example, a state would clearly lack the authority to tax real property located in another state, or to tax a transaction occurring elsewhere between parties that have no relationship with the state. Although the results in these extreme examples would seem self-evident, in other tax contexts the nexus issue is the subject of heated debate. In the context of sales and use taxes, most of the controversy involves the efforts of states to impose a use tax collection duty on sellers with little or no contact with those states. The inquiry in each case generally consists of examining the facts to discern the character of the seller’s connection with the state, accompanied by argument as to whether that connection is sufficient.

Although identified in *Complete Auto* as an element of Commerce Clause analysis, there is also a nexus concept in the cases decided under the Due Process Clause of the Fourteenth Amendment, and the two nexus concepts are often discussed together. Like the Commerce Clause, the Due Process Clause is cryptic, providing merely that no state shall “deprive any person of life, liberty, or property without due process of law….” However, this provision is the basis for a substantial body of cases involving the exercise of long arm jurisdiction, whereby
a state requires nonresidents to defend suits (often personal injury suits) brought within its own courts. The latest Supreme Court decision on tax nexus is *Quill Corporation v. North Dakota* 112 S. Ct. 1904 (1992), a copy of which is included with these materials. In *Quill*, the two nexus concepts are distinguished, with the Court reaching different conclusions with respect to each of them.

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FIRST PRONG EXAMPLE: QUILL


**Facts:** Quill Corporation was a mail order distributor of office equipment and supplies with offices and warehouses in Illinois, California, and Georgia. Quill maintained no offices, employees, or property in North Dakota. It did business through catalogs, ads in national magazines, and telemarketing. Orders were shipped via U.S. Mail or by common carrier.

North Dakota’s use tax statute required retailers to collect the use tax from the customer at the time of the purchase and remit the tax to the state. A person who engaged in a regular or systematic solicitation in the state was defined as a "retailer". Three or more advertisements in a twelve-month period were considered “regular or systematic solicitation” under the statute. Quill did not collect the use tax on sales made to its mail order customers in North Dakota. The tax commissioner filed suit to require Quill to pay use taxes on all such sales.

**Primary issue:** Whether North Dakota could require an out-of-state mail order seller, which had neither outlets nor sales representatives in the state, to collect a use tax on goods purchased for use in the State. The issue was *not* whether the state could levy the tax on the use of tangible personal property within its borders. The same issue had been decided against Illinois in *National Bellas Hess v. Illinois Department of Revenue*, 87 S.Ct. 1389 (1967), and North Dakota asked the Court to overrule that decision.
Court’s reasoning: The Court reviewed its nexus decisions under the Due Process Clause and Commerce Clause, and concluded that the nexus requirements under the two clauses are different.

The Due Process Clause is concerned with the fundamental fairness of governmental activity. It requires some minimum contact with the State that gives “notice” or “fair warning” that the person is subject to the state’s jurisdiction. By purposefully directing its activities at North Dakota residents, Quill had “fair warning” that its activity may be subject to the state’s jurisdiction. Although it had no physical presence in the state, Quill had established sufficient “minimum contacts” with the state to be subject to the use tax collection duty. The tax was related to the benefits that Quill received from its access to the state's market.

Turning to the Commerce Clause, the Court observed that the “substantial nexus” requirement of that clause is not concerned as much about fairness as it is with the effects of state regulation on the national economy. The purpose of the substantial nexus requirement is to make sure that state tax laws do not burden interstate commerce. It is different from the “minimum contacts” requirement of the Due Process Clause. A tax may pass muster under the Due Process Clause, but fail under the Commerce Clause where, as in Quill, the seller purposefully directs its marketing activity to state residents but lacks a physical presence within the state.

Adhering to its prior decision in National Bellas Hess, the Court established a “bright line” test for establishing “substantial nexus” for the use tax collection duty under the Commerce Clause. For a “substantial nexus” to exist, a taxpayer must have a physical presence in the state. The nature and extent of the physical presence required remains controversial.

Holding: The North Dakota attempt to require Quill to collect its use tax violated the Commerce Clause, but not the Due Process Clause.

b. The overriding importance of Quill is that it explicitly offers Congress the opportunity to resolve the hotly contested use tax collection issue. By holding the North Dakota scheme invalid only on Commerce Clause grounds, the Court invited Congress to exercise its power under that provision and enact legislation changing the result if it deems such a change appropriate.
c. Additional points about nexus:

(1) The meaning of the *Complete Auto* nexus requirement is clouded when the language used in the decision is compared with some of the Court’s other rulings. For example, in *National Geographic Society v. California Board of Equalization*, 97 S. Ct. 1386 (1977), decided shortly after *Complete Auto*, the Court held that a company making mail order sales from out of state could be required to collect the state’s use tax, because the seller maintained offices within the state whose activities were unrelated to the mail order business. Thus, there was nexus with the seller, but not with the selling activity to which the tax was applied. The opinion suggests that this “taxpayer nexus” is sufficient where the issue involves the collection of a tax that the seller can recover from the customer, rather than a direct tax on the seller. However, in *D.H. Holmes v. McNamara*, 108 S. Ct. 1619 (1988), the Court upheld a use tax assessed against a retailer with respect to catalogs distributed from locations outside the state to in-state residents. The retailer had stores within the state and controlled the distribution of the catalogs. The Court found “nexus aplenty”, without discussion of the distinction between direct taxes and the collection duty, and without saying whether either the presence of the stores or the retailer’s control over distribution of the catalogs would alone have been sufficient for nexus. It follows that the language of *Complete Auto*, which refers to a nexus between the state and the activity taxed, cannot be taken literally to apply in all situations.

(2) The “bright line” of *Quill* is sometimes difficult to locate. The nature and extent of the connection necessary to constitute a “physical presence” remains controversial. Additional comment on this appears in the “Hot Issues” material in Part 2.
(3) The applicability of the physical presence requirement in the context of other taxes is controversial. An important example is the question whether a state can impose its income and franchise taxes on an out-of-state intangible holding company that has no physical presence, but licenses trademarks to affiliates operating within the state. See A&F Trademark, Inc. v. Tolson, 605 S.E.2d 187 (N.C. App. 2004), cert. denied, 126 S. Ct. 353 (2005) (physical presence not required); Lanco, Inc. v. Director of Taxation, 908 A.2d 176 (NJ 2006) (no physical presence required), cert. denied, 127 S. Ct. 2974 (2007).

(4) There are other contexts in which the application of the nexus prong is problematic. Consider, for example, a tax on the consumption of fuel in interstate commerce within the state. See, e.g., Moran Towing Corp. v. Urbach, 99 N.Y.2d 443, 757 N.Y.S. 2d 513 (N.Y. 2003).

2. Second prong. Independently of nexus, the tax must be fairly apportioned. The central purpose of this prong of the Complete Auto test is to make sure that a state taxes only its fair share of an interstate transaction or business. This requirement protects against multiple taxation, although it does not depend upon whether the taxpayer has actually been subjected to multiple taxation.

“Apportionment” often connotes the application of an arithmetic formula. Although there are contexts in which formulaic apportionment is required, that is not always the case. A tax involving interstate activity may be deemed “fairly apportioned” even though a state is permitted to tax 100% of the amount paid. This is illustrated by the Supreme Court’s decision in Oklahoma Tax Commission v. Jefferson Lines, Inc, 115 S. Ct. 1331 (1995).

**Facts:** Oklahoma taxed sales in the state of certain goods and services, including transportation for hire. Jefferson Lines, a Minnesota corporation, operated as a common carrier in Oklahoma. It did not collect or remit the sales taxes on tickets it had sold in Oklahoma for bus travel from Oklahoma to other states (but did collect the tax for travel which took place entirely in Oklahoma).

**Primary issue:** Whether Oklahoma’s sales tax on the full price of a ticket purchased in Oklahoma for bus travel from Oklahoma to another state is consistent with the Commerce Clause, or whether additional apportionment is required. The Court had previously stricken a similar tax in *Central Greyhound Lines, Inc. v. Mealey*, 68 S. Ct. 1260 (1948), and the taxpayer maintained that the same result was required here.

**Court’s reasoning:** The central purpose of the apportionment prong is to ensure that each state taxes only its fair share of an interstate transaction. To determine if a tax is fairly apportioned the Court applies two tests, one for “internal consistency” and the other for “external consistency”. Both tests must be satisfied to sustain the tax.

1. **Internal Consistency.** The internal consistency test asks, hypothetically, whether the imposition of the identical tax by every state in the Union would place interstate commerce at a disadvantage compared to intrastate commerce. This inquiry does not depend upon whether any other state actually imposes such a tax. It relates instead to the structure of the tax at issue. A lack of internal consistency shows as a matter of law that a state is
attempting to take more than its fair share of taxes from the interstate transaction (this test is discussed further below). The Court noted that the Oklahoma tax was imposed on the payment for bus transportation and the commencement of that transportation, both of which occurred within the state. If every other state had the same tax, the Oklahoma traveler would nevertheless be subject to the tax only once – in Oklahoma.

(2) External Consistency. If a tax is internally consistent, it is next examined for external consistency. The external consistency test looks to the economic justification for the state’s claim upon the value taxed, to discover whether the tax reaches beyond the portion of value that is attributable to economic activity within the taxing state. The Court reviewed its prior precedents upholding taxes on local discrete events (such as sales taxes and severance taxes), without any division of the tax base among different states. The Court reasoned that a tax on the sale of services can also be treated as a local instate event, and falls on the purchaser who is unlikely to be exposed to a second tax by another state. Observing that the Oklahoma tax resembled a conventional sales tax, the Court found that the tax satisfied the external consistency test.

**Holding:** The tax is both internally and externally consistent, and does not violate the Commerce Clause.

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### LEARNING FROM JEFFERSON LINES

- "Apportion" does not always mean "divide"
- "Local incident"
  - may be identified for services as analogy to sale of tangible personal property, and
  - may allow a state to tax 100% of an interstate service
- Tax must be internally, externally consistent
- Taxation by multiple states is not necessarily unconstitutional

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**b. Additional points about apportionment:**

(1) An example of a tax that might fail the internal consistency test is a sales tax applied to interstate sales on both an origin and destination basis (an origin basis where title passes within the state before shipment; a destination basis where possession passes
within the state after shipment). Imagine a second state with the identical tax, and an interstate sale of goods between the two states. The transaction is ultimately subjected to two taxes, but there would be only one tax if the transaction occurred entirely within one state. Thus, the parties are effectively penalized for engaging in an interstate transaction, and the tax fails the internal consistency test. This may explain in part why the test has also been associated with the discrimination prong of Complete Auto.

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**INTERNAL CONSISTENCY TEST EXAMPLE**

Imagine a state (State of Anxiety) that:
- Imposes a use tax
- Denies credit for sales tax paid at origin

- What can purchaser do to avoid two taxes?

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(2) An important element in the application of the internal consistency test is the availability of a credit for tax paid in another state. Although the availability of a credit may save a tax from violating the test, issues remain unresolved. One such issue is how to determine in all cases when a state is entitled to assert the tax, and when it is required to allow the credit.

(3) In some cases, application of the external consistency test is straightforward. For example, a state income tax on 100% of the income derived from a multistate business would obviously exact more than the state’s “fair share” from the multistate taxpayer. Conversely, Jefferson Lines and other cases indicate that taxes on discrete events such as conventional sales and use taxes will generally satisfy the test. See also Goldberg v. Sweet, 109 S. Ct. 582 (1989) (treating an interstate telephone call as a discrete local event that can be taxed entirely in one state). Between these extremes, application of the test will require considerable factual development and theorizing. Explanations of the test tend to be rather abstract, as in the Goldberg declaration that the tax must be limited to that “portion of the revenues from the interstate activity
which reasonably reflects the in-state component of the activity being taxed”.

3. **Third prong.** The tax must not discriminate against interstate commerce. This prong of the *Complete Auto* test represents one of the only constants in the tortured history of the Commerce Clause. The discrimination may be apparent on the face of the state taxing statutes, or may be apparent only after analysis of their practical operation. In either event, it is probably safe to say that more taxpayers have won Commerce Clause challenges based on discrimination than on any other ground.

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<td>• Inversely proportional to stock issuer’s NC income tax (i.e., activity in NC)</td>
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Facts: North Carolina levied an intangible personal property tax on a fraction of the value of corporate stock owned by state residents that was inversely proportional to the corporation’s exposure to the State’s income tax. Under this scheme, a corporation doing all of its business within the state would pay a corporate income tax on 100% of its income, and resident owners of stock in the corporation could deduct 100% of the stock for intangible tax purposes and owe no tax. Stock in a corporation doing no business in North Carolina, on the other hand, would be taxable on 100% of its value. Between these extremes the deduction allowed to resident owners of stock was equal to the percentage of business conducted within the state by the corporate issuer of the stock. Fulton Corporation, a North Carolina company, owned shares in five corporations that did no business or earned no income in North Carolina and therefore were not subject to the state’s corporate income tax. The stock in these corporations was subject to the tax on 100% of its value. Fulton also owned stock in a corporation that did 46% of its business in North
North Carolina, with the result that its stock was subject to the intangibles tax on 54% of value.

**Primary issue:** Whether the intangibles tax violated the Commerce Clause by discriminating against interstate commerce, and specifically, whether the intangible tax satisfied the “compensatory tax” exception from the prohibition against discrimination.

**Court’s reasoning:** There is no doubt the tax facially discriminates against interstate commerce, because it taxes stock only to the extent that the issuing corporation engages in commerce outside North Carolina. This discourages investment in companies conducting interstate business in favor of purely domestic enterprises, and thereby discourages domestic companies from conducting business outside the state. However, an otherwise discriminatory (against interstate commerce) tax may be upheld if it is “compensatory” or “complementary” to another tax, so that that there is ultimately no discrimination against commerce.

Three conditions are necessary for a valid compensatory tax:

1. The state must identify the intrastate tax burden for which it is attempting to compensate, and the intrastate tax must serve some purpose for which the state may otherwise impose a burden on interstate commerce.

2. The tax on interstate commerce must approximate, but not exceed, the tax on intrastate commerce.

3. The compensating taxes must fall on substantially equivalent events.

None of the three conditions for a compensatory tax defense was present. The intangible tax on shares of stock was not compensatory with respect to the income tax on the earnings of the corporate issuers of the stock. It is unlikely that a state can ever show that two taxes are equivalent outside the limited confines of sales and use taxes. For this reason, it is important to examine any tax that is termed a “use tax”, to assure that it is truly compensatory with respect to the sales tax. Merely assigning the “use tax” label to a tax does not establish that it functions as a conventional, compensating use tax. If it does not function in this manner, it may be unconstitutionally discriminatory.

**Holding:** The North Carolina tax discriminated against interstate commerce and was not saved from invalidity by the compensatory tax defense.

**Facts:** Missouri imposed state sales and use taxes of 4.225%, and an additional 1.5% state use tax that was not paired with a state sales tax. Local jurisdictions levied sales taxes at rates ranging from zero to 3.5%. Thus, the combined state and local sales tax rates varied from 4.225% to 7.725%, but the combined state and local use tax rates was a fixed 5.725%. In 53.5% of the local jurisdictions the 1.5% state use tax exceeded the local sales tax. Analysis of the aggregate statewide effect of the scheme showed that it placed a lighter burden on interstate commerce than on intrastate commerce.

**Primary issue:** Whether the additional 1.5% use tax violated the Commerce Clause because in some local jurisdictions it exceeded the local sales tax rate.

**Court’s reasoning:** Although the additional use tax by its terms appears to violate the Commerce Clause’s “cardinal rule of nondiscrimination”, a use tax may be saved from unconstitutionality if it is a valid compensatory tax. In fact, there is an obvious necessity for use taxes to complement sales taxes. However, Missouri’s additional 1.5% use tax did not satisfy the test for a compensatory tax because in some Missouri jurisdictions the use tax exceeds the sales tax. That this is not the case in all the state’s local jurisdictions does not cure the defect. Discrimination in some jurisdictions is not rendered inconsequential by advantages given to interstate commerce elsewhere in the state. Discrimination is appropriately assessed with reference to the specific subdivision of the state in which applicable laws reveal differential treatment.
Holding: The Missouri tax violated the Commerce Clause prohibition on discriminating against interstate commerce.

c. Additional points about discrimination:

(1) The cases discussed show that a discriminatory tax can in theory survive a Commerce Clause challenge through a showing that the tax is “compensatory” in relation to a tax on intrastate business, but it is unlikely that any tax other than a conventional use tax could qualify as compensatory. But even on this point, strongly implied in the Supreme Court decisions, there is uncertainty. For example, in *Tennessee Gas Pipeline v. Urbach*, 96 N.Y. 2d 124, 726 N.Y.S.2d 350 (N.Y. 2001), New York’s highest court held that a tax on the out-of-state purchase of natural gas consumed in New York satisfied the requirements of a valid compensatory tax in relation to gross earnings taxes imposed on instate sellers of gas. Because the gross earnings taxes were said to be passed on to consumers in rates, the court found the tax on imported gas compensatory.

(2) However, as *Associated Industries* demonstrates, the mere fact that the levy is a use tax does not assure that it satisfies the requirements of the compensatory tax defense to be constitutional. Even with a conventional use tax, the rate must not exceed the sales tax rate. Also, a tax may be labeled a “use tax” but operate in a way that fails the test. For example, in *Maryland v. Louisiana*, 101 S. Ct. 2114 (1981), the state argued unsuccessfully that a “use tax” on resources produced from the federal outer continental shelf compensated for the state’s own severance tax. Because all taxes denominated “use taxes” do not operate in the same way, they must be examined carefully to ascertain whether they truly meet the requirements of the defense.

(3) Because discrimination has proved the most potent of the four prongs for taxpayers raising Commerce Clause objections, it merits special attention in the examination of a state tax for constitutional validity.

(4) Other examples of unconstitutional discrimination include a use tax on property imported from another state that is applied to a higher base than the tax on instate property, *Halliburton Oil Well Cementing Co. v. Reily*, 83 S. Ct. 1201 (1963); an occasional sale exemption for instate purchases without a corresponding use tax exemption for property purchased elsewhere, *Id.*; a flat axle tax on trucks that is disproportionately higher for interstate trucks than for domestic trucks, *American Trucking Associations v. Scheiner*, 107 S. Ct. 2829 (1987); and a property tax exemption for summer

(5) Although most of the decisions involve state statutes that “facially” discriminate against interstate commerce, it is possible for the discrimination to exist only in the application. A simple illustration would be a tax that by its terms is imposed equally on both interstate and intrastate business, but which is enforced only against interstate business.

(6) The Commerce Clause does not prohibit discrimination *in favor of* interstate commerce. This does not mean that such differential treatment would necessarily be constitutional, but any defect would be based on the application of other constitutional provisions.
(7) The courts sometimes say that discrimination against interstate commerce will be allowed if the state can show a legitimate local purpose and the absence of reasonable nondiscriminatory alternatives.

4. **Fourth prong.** The tax must be fairly related to the services provided by the state. The purpose of this test is to ensure that a state’s tax burden is not placed upon persons who do not benefit from services provided by the state. The test is satisfied if the tax is proportional to the activity taxed. It does not entail, despite its wording, a comparison between the measure of the tax and the value or cost of government services and benefits conferred by the taxing state.

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**FOURTH PRONG EXAMPLE: COMMONWEALTH EDISON**

- Montana coal severance tax
- 90% of coal shipped out of state
- Tax rate up to 30% of price
- “Tailored tax”?
- Fairly related to benefits conferred by state?


**Facts:** Montana had approximately 25% of the nation’s known coal reserves, and 50% of its low-sulfur coal reserves. It imposed a tax on the severance of coal at a rate up to 30% of the contract price. Approximately 90% of the coal was destined for consumption outside the state.

**Primary issue:** Whether the tax violated the fourth prong, on the ground that it was overwhelmingly shouldered by out of state entities that received only limited government services from Montana. The taxpayers also claimed discrimination.

**Court’s reasoning:** The tax is computed at the same rate regardless of its destination and therefore is not discriminatory. The Commerce Clause does not give citizens of one state an unqualified right of access to another state’s resource at “reasonable prices”. The taxpayers’ real objection is to the rate of the tax, as too high given the services the coal mining industry receives. However, the tax need not be intended to reimburse the state for services to that industry, nor is the state’s power to tax an activity limited
to the value of the services provided to the activity. A tax is not an assessment of benefits, but a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established, and safeguarded by the devotion of taxes to public purposes. As long as the measure of the tax is in proportion to the activity, it will be upheld under the fourth prong.

**Holding:** The tax does not violate the Commerce Clause. It is not discriminatory and is measured by the amount of coal mined, therefore satisfying the third and fourth prongs.

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**LEARNING FROM COMMONWEALTH EDISON**

- Tax imposed before goods enter stream of commerce not immune from scrutiny
- Tax may be valid though borne mostly by out of state consumers. “Tailored tax” not mentioned
- Fourth prong requires reasonable relationship with level of activity, not with cost of government services

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b. Additional points about the fourth prong:

1. As with many Commerce Clause cases, there was a strong dissent in *Commonwealth Edison*. In the view of the three dissenters, the taxpayers were entitled to pursue their claim that the Montana levy was a “tailored tax”, i.e., one designed so that its impact is on nonresidents. The dissenters were especially concerned that a mineral-rich state could exploit its “monopoly” power with excessive taxes shifted to consumers outside the state, who lack the same ability to influence legislation as instate interests.

2. The Court’s unwillingness to compare the measure of the tax with the value of the benefits conferred may be understandable, as this would be extremely difficult for a court to do. Nevertheless, the test as expressed in *Complete Auto* bears little relation to its application in *Commonwealth Edison*.

3. The only remaining function of the fourth prong is to reach “flat” taxes – those that are not measured by the activity taxed, as
in *American Trucking Assns v. Scheiner*, 107 S. Ct. 2829 (1987, relating to the Pennsylvania axle tax. However, this makes the fourth prong difficult to distinguish from the apportionment prong, and therefore does not appear to have much independent vitality. See also, *Owner-Operator Independent Drivers Assn. v. Bower*, 325 Ill. App.3d 1045, 757 N.E.2d 627 (Ill. 1st DCA 2001), appeal denied, 198 Ill.2d 595, 766 N.E.2d 241 (Ill. 2002).

III. FOREIGN COMMERCE CLAUSE

A. When a state tax affects foreign commerce, the Court has held that in addition to applying the four prongs of *Complete Auto*, two further questions must be answered:

1. Does the tax create a risk of multiple international taxation, and
2. Does the tax prevent the federal government from "speaking with one voice" when regulating commercial relations with foreign governments?
If the tax in question fails either test, the tax is unconstitutional under the Foreign Commerce Clause.

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### FOREIGN COMMERCE CLAUSE EXAMPLE: ITEL CONTAINERS

- TN sales tax on leased cargo containers delivered in TN
- Credit for tax imposed elsewhere
- U.S. Gov’t supported TN


**Facts:** Itel was a U.S. based company that leased cargo containers used exclusively in international commerce. The containers were delivered in Tennessee, which imposed a sales tax on the leases. Tennessee law also allowed a credit for any tax paid in another jurisdiction on the same transaction. Both sides agreed that the tax met the *Complete Auto* test. The United States Executive Branch, as a “friend of the court”, filed a brief supporting the position of Tennessee that the tax was constitutional.

**Primary issues:** The primary issues involved whether Tennessee's sales tax on lease proceeds violated international Container Conventions signed by the United States. However, the tax was also challenged on other grounds, including the Foreign Commerce Clause. In particular, Itel argued that allowing taxation by Tennessee invited multiple taxation by other nations and interfered with the federal government’s ability to speak with one voice in regulating commercial relations with foreign governments.

**Court’s reasoning:** The tax is imposed on a discrete event that occurs in Tennessee. The Foreign Commerce Clause does not require that a state refrain from taxing any business transaction that is also potentially subject to taxation by a foreign sovereign. The credit for taxes paid elsewhere reduces, if not eliminates, the prospect of multiple taxation. Further, the existence of other federal restrictions on state taxation of international cargo containers supports the inference that the Tennessee tax is permitted. With the federal government’s brief asserting that the tax did not interfere with its ability to speak with one voice, the Court found no reason to disagree.

**Holding:** The tax did not violate the Foreign Commerce Clause.
C. Additional points about the Foreign Commerce Clause:

1. The *Itel* decision distinguished another case involving international shipping containers, *Japan Line, Ltd. v. County of Los Angeles* 99 S. Ct. 1913 (1979). *Japan Line* involved a California property tax on cargo containers owned by a Japanese company. Property taxes had been imposed on the containers in Japan. The Court held the California tax unconstitutional. The Court noted that, under international “custom”, the nation of domicile could impose a tax on the full value of instrumentalities of commerce. A state also seeking to tax the same property would inevitably cause multiple taxation. The Court also found that the California tax interfered with the federal government’s ability to speak with one voice in foreign affairs.

2. It is debatable whether *Itel* is consistent with *Japan Line*. *Itel* can be read as retreating from the “multiple international taxation” and “one voice” tests.

3. Some believe the only real distinction between *Itel* and *Japan Line* is the position of the Executive Branch, which is stressed in *Itel*. In *Japan Line* the Executive Branch filed a brief supporting the taxpayer, but in *Itel* it supported the state. Critics of such emphasis point out that Executive Branch policies change with different administrations, while the meaning of the Constitution, at least in theory, does not. On the other hand, it is noteworthy that the Tennessee tax could be viewed as imposed on a discrete event within the taxing state, which seems to be treated more favorably than other taxes.

4. Other interesting Foreign Commerce Clause cases include *Container Corporation v. Franchise Tax Board*, 113 S. Ct. 1095 (1983) (apportioned tax on worldwide income not a violation) and *Wardair Canada v. Florida Department of Revenue* 106 S. Ct. 2369 (1986) (tax on instate sales of fuel to be used exclusively
in foreign commerce not a violation, although in this case the Executive branch supported the taxpayer).

5. The “one voice” theory is also found in the decisions under the Import/Export Clause.

IV. IMPORT/EXPORT CLAUSE

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IMPORT/EXPORT CLAUSE

No State shall, without the Consent of the Congress, lay any Impost or Duty on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws; and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States...

Art. I, Sec. 10, Cl. 2

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IMPORT/EXPORT CLAUSE APPLICATION

- Prohibits discrimination against imports
- Prohibits taxation while in transit
- Prohibits interference with "one voice"
- Does not prevent nondiscriminatory taxes on imported property that is not in transit

A. The Import/Export Clause forbids a state "impost or duty" on imports or exports. Its purposes are to promote the free flow of goods between the states (particularly to prevent seaboard states from charging heavy duties on goods destined for “inland” states), to enable the federal government to regulate and speak with one voice in matters of foreign commercial relations, and to entitle the federal government to all revenues derived from imposts and duties on imports. Taxes levied in the past have tested the reach of this clause. An example is the Georgia property tax.

**Facts:** Georgia imposed a property tax on tires shipped from other countries to its Georgia warehouse, where they were stored for later distribution to franchised dealers in other states. The tax was nondiscriminatory, that is, it was applied generally to property within the jurisdiction, and did not selectively target imports.

**Primary issue:** Whether the Georgia property tax violated the Import/Export Clause.

**Court’s reasoning:** In an opinion that closely resembles a dormant Commerce Clause analysis, the Court reviewed the history and purposes of the Import/Export Clause and concluded that a nondiscriminatory property tax was not a prohibited “impost or duty.” The tax was imposed irrespective of the place of origin of the property taxed, rather than selectively on imports. Also, the tires were “no longer in import transit” when the tax was imposed. As the tax was not an impost or duty, it did not deprive the federal government of any revenues from imposts or duties. The Clause does not require preferential treatment by allowing property to escape from uniform taxes based on its origin. And the tax did not inhibit the free follow of goods between states. Although such a tax imposed by a seaboard state may increase the cost of goods to “inland” consumers, this is in return for benefits (such as police and fire protection) actually conferred by the taxing state. The Clause prevents exactions that are really transit fees for moving through state, not non-discriminatory property taxes. However, the Clause prohibits even nondiscriminatory taxes on goods that are merely in transit through a state.

**Holding:** The tax was constitutional.
C. Additional points about the Import/Export Clause:

1. The continuing scope of the protection of property “in transit” is unclear, particularly after *Itel*. That case found no violation of the Import/Export Clause (or the Foreign Commerce Clause) in Tennessee’s sales tax on leases of cargo containers delivered in the state for use in international shipping. Another case has held that the fact that goods are stored in a customs-bonded warehouse does not protect them from nondiscriminatory property taxes. *See, R.J. Reynolds Tobacco Co. v. Durham County*, 107 S. Ct. 499 (1986).

2. The three justices who would abolish the dormant Commerce Clause doctrine (see the discussion at II.D.3) have expressed the view that the Import/Export Clause is the true constitutional source of protection for interstate commerce.

V. **EQUAL PROTECTION CLAUSE**
A. Rational relationship standard (also called the rational basis test). The Equal Protection Clause requires a state to afford equal protection of its laws to all persons who are similarly situated. However, in practice this provision is rarely the basis for striking down a statute. The courts allow the states wide latitude in classifying persons and commercial activities. Generally, a classification, including a classification for tax purposes, will be upheld if it rationally furthers a legitimate state interest, and the courts rarely question a state’s judgment as to whether an interest is furthered or is legitimate. This is the test that is most commonly applied.


Facts: In 1978, the voters of California approved Proposition 13, which limits increases in the assessment of unsold real property for ad valorem tax purposes. Increases may not exceed 2% annually. However, with few exceptions, a sale of the property triggers an assessment at current appraised value. The taxes imposed on similar properties were thus substantially different if one had been the subject
of a recent sale and the other had not. In 1988 Stephanie Nordlinger, who had previously lived in a Los Angeles apartment, purchased a home for $170,000, and her next tax assessment was $170,100. Similar homes in her area, which had not sold recently, were assessed for one-fifth of her assessment. Her tax was only slightly less than that paid by a pre-1976 owner of a $2.1 million Malibu beachfront home.

**Issue:** Is this differential treatment a violation of the Equal Protection Clause?

**Court’s reasoning:** The Equal Protection Clause does not prevent the states from differentiating between classes or persons, but instead prevents them from treating differently persons who are in all relevant respects alike. The rational relationship standard applies in this case, and it requires only a plausible policy reason for the classification. The plausible policy need not be expressed.

Proposition 13 is rationally supported by two legitimate considerations of policy. One is the state interest in preservation and stability of local neighborhoods by discouraging rapid turnovers of property. The other is the notion that a new owner does not have the same reliance interest as a longtime owner in the level of property taxation. The new owner has more control over his tax expense, as he was not required to buy. Even though not expressed in Proposition 13, these policies supported it.

**Held:** Proposition 13 does not violate the Equal Protection Clause. It advances legitimate state interests.

**Facts:** Vermont imposed a motor vehicle use tax on cars purchased outside of Vermont but later registered in the state. Vermont residents were allowed a credit for sales taxes paid in other states, but no such credit was given to new residents who had not yet established residency at the time of purchase. Williams purchased a car in Illinois, paid a sales tax on the purchase, and subsequently moved to Vermont. Vermont refused to give him credit for the sales tax paid to Illinois. The stated purpose of the use tax was to raise revenue for maintenance and improvement of Vermont's highways and roads. The state court dismissed the suit without allowing the taxpayers a trial.

**Issue:** Can Vermont constitutionally discriminate in the giving of a tax credit to residents while not giving the credit to those who had not yet established residency?

**Court’s reasoning:** The only justification for imposing the tax on the taxpayers, other than to raise revenue is to require them to help support Vermont roads. However, this same rationale would require taxation of Vermont residents that paid a sales tax on their vehicle purchases in other states. Residence at the time of purchase is an arbitrary basis for classification.

**Holding:** The taxpayers’ suit should not have been dismissed. Unless administered in some way that prevents the discrimination suggested by the text of the law, it is unconstitutional even under the rational relationship standard.

B. **Strict scrutiny standard.** When a state law impairs the exercise of fundamental rights (such as First Amendment rights) or differentiates on the basis of “suspect classifications” (such as race, religion or national origin), the generous “rational relationship” test is not applied. In its place, the Court applies a more demanding standard, sometimes called “strict scrutiny”, which means that the state must show a compelling state interest in maintaining the classification. States almost always lose when a compelling state interest must be demonstrated. Tax cases involving this more exacting standard are sometimes argued under the Equal Protection Clause or other provisions such as the First Amendment, or a combination of provisions. Examples of such cases are discussed subsequently.

C. **Additional points about equal protection:**

1. Despite the deferential rational relationship standard, there is often disagreement among the justices, and a justice may change his or her mind about a prior decision. *Nordlinger* followed another case in which a West Virginia property tax was stricken. As in *Nordlinger*, property that had recently been sold was assessed at higher levels of value than other property. However, this was the result of the unilateral actions of a tax assessor, not a statutory or constitutional mandate. *Allegheny Pittsburgh Coal Co. v. Webster County*, 109 S. Ct. 633
Justice Thomas, who voted with the unanimous court in *Allegheny Pittsburgh Coal*, expressed misgivings about it in *Nordlinger*. And in *Armour v. City of Indianapolis*, 132 S. Ct. 2073 (2012), three justices dissented from a decision holding that administrative burden was a sufficient basis for denying refunds to homeowners who had paid special assessments up front, while forgiving all amounts owed by homeowners who had elected to pay in installments.

2. The *Williams v. Vermont* court employed an analysis that resembled Commerce Clause reasoning. It also declined to address whether a state must in all instances allow a credit for sales tax paid in another state. A useful exercise for the School II student would be to apply the internal consistency test discussed in the Commerce Clause material.

VI. SUPREMACY CLAUSE

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**SUPREMACY CLAUSE**

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby ....

Art. 6, Cl. 2

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**SUPREMACY CLAUSE APPLICATION**

- Controlling law throughout nation
- Taxation of federal government and contractors
A. The Supremacy Clause declares that the United States Constitution and its laws are the supreme law of the land. One of the earliest Supreme Court cases, *McCulloch v. Maryland* 4 Wheat. 316, 431, 4 L.Ed. 579 (1819) determined that this clause prohibited any state tax directly imposed on the federal government.

Due to subsequent Court decisions, this early prohibition has slowly eroded such that today federal immunity from state taxation is at best a patchwork quilt. The federal government itself has contributed to this lack of clarity by voluntarily relinquishing its immunity in some situations and asserting immunity in others (see the 1940 Buck Act.)

The principal relevance of the Supremacy Clause for state tax purposes arises in the context of federal government contractors.

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**SUPREMACY CLAUSE EXAMPLE: U.S. v. NEW MEXICO**

- N.M. gross receipts and use taxes
- “Cost plus” contracts to manage Gov’t owned atomic labs
- Contractors purchased tp in their own names; title passed to Gov’t per contracts
- Payment made with Gov’t funds
- Gov’t approval not required for each purchase

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**Facts:** New Mexico imposed a gross receipts and compensating use tax on purchases made by U.S. Government contractors working on construction projects for the Department of Energy under "cost plus" contracts. Under these contracts the U.S. was obligated to reimburse the contractors for all allowable costs including taxes. The contractors involved held contracts to manage Government facilities. The contracts provided that title to all property acquired in performing them passed directly from the contractors’ vendors to the federal Government. Payments to those vendors were made by drafting an account consisting of U.S. Government funds. However, the contractors made such purchases in their own names. Contract language contained some references to “agency” for the Government.

**Primary issue:** Can the New Mexico gross receipts tax and compensating use tax be imposed on contractors working on Government contracts, when the taxes are ultimately borne by the U.S., without violating the Supremacy Clause?

**Court’s reasoning:** There is no federal immunity from state taxation simply because the tax has an effect on the United States, or even because the federal Government shoulders
the entire economic burden of the levy. There is also no immunity where the state tax falls on the earnings of a Government contractor, or where a use tax is imposed on the use of federal property in private hands. The contractor’s use of the property in the latter situation is for a profitmaking activity that the state can tax. Nor does it matter that a contractor’s purchases are paid for with Government funds. Tax immunity exists only when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate. The private contractors in this case were not so closely connected to the federal Government as to be considered agencies or instrumentalities of the United States.

**Holding:** The New Mexico tax did not violate the Supremacy Clause.

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**LEARNING FROM U.S. v. NEW MEXICO**

- No federal immunity exists merely because:
  - Gov’t bears economic burden of the tax
  - Tax is on use of Gov’t property in private hands
  - Tax is paid with Gov’t funds
- Immunity exists only when tax falls directly on Gov’t or contractor cannot realistically be viewed as separate from Gov’t

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**C. Additional points about the Supremacy Clause:**

1. Like the Commerce Clause case law, the decisions involving Government contractors have been inconsistent over the years, but there is a clear trend toward liberalizing the rules in favor of the states. Even when the United States is a party, as in the *New Mexico* case, the Court is inclined to restrict the availability of immunity.

2. The Court’s treatment of the immunity issue contrasts with its Commerce Clause formulation that focuses on the “practical economic effect” of the tax. Where immunity is concerned, it seems that formalism prevails over the economic effect.

3. Despite the Court’s liberalization, taxes that discriminate against Government contractors remain vulnerable to attack.

4. Where there is no federal constitutional immunity, in some common situations state law will furnish a basis for avoiding a sales or use tax. The chief
example is the availability in some states of purchase for resale treatment for contractor purchases due to the title clauses in the Government contracts.

VII. FIRST AMENDMENT

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FIRST AMENDMENT

Congress* shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

*Applies to states as well as Congress

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FIRST AMENDMENT APPLICATION

• Establishment Clause
• Free Exercise Clause
• Speech and Press Clauses
• Other

A. Establishment Clause. This portion of the First Amendment prohibits the federal and state governments from passing laws that result in government sponsorship of religion. This Clause was at issue in Texas Monthly v. Bullock, 109 S. Ct. 890 (1989). There, the Court struck down a sales tax exemption narrowly provided to religious publications, but not other, nonsectarian publications. This narrow focus of the exemption was fatal, as it was effectively a state subsidy to religious organizations. The Court also held the exemption was not required by the Free Exercise Clause.

B. Free Exercise Clause. In contrast with the Establishment Clause, the Free Exercise Clause prohibits the government from interfering with the practice of religious beliefs. In Jimmy Swaggert Ministries v. Board of Equalization, 110 S. Ct. 688 (1990), the Court upheld a nondiscriminatory sales tax on sales of religious publications. The
Court found that neither collection and payment of the tax nor registration and reporting imposed constitutionally significant burdens on the practice of religious beliefs. The Court was careful to point out that the tax did not operate as a “prior restraint”, that is, it did not require payment of the tax as a precondition to practicing any religion. It also left open the possibility that a more onerous tax might not be upheld.

C. Free Speech and Press Clauses. These provisions of the First Amendment protect the free and open expression of ideas. To the extent that they are threatened by governmental action, including taxation, the Court will intervene. Thus, in *Minneapolis Star and Tribune v. Minnesota Commissioner of Revenue*, 103 S. Ct. 1365 (1983), the Court struck down a “use tax” on the cost of paper and ink consumed in printing publications, but which exempted the first $100,000 consumed in any calendar year. The Court noted that the state had singled out the press for special treatment, and targeted a small group of newspapers that pay more than $100,000 annually for paper and ink (14 of 388 newspapers). Relying on its decision in *Grosjean v. American Press Company*, 56 S. Ct. 444 (1936), the Court observed that taxes of this kind can act as an effective censor, and the political constraints that might act as a check on it are weakened. The state would have to show a compelling state interest to justify such a tax, and has not done so. This is another example of a levy labeled “use tax” that did not operate as a conventional use tax and was held invalid. The Court noted the characteristics of a conventional use tax that were not present.
In contrast, the Court in *Leathers v. Medlock*, 111 S. Ct. 1438 (1991) upheld the extension of Arkansas’ generally applicable sales tax to cable television operators, who objected that the tax was not imposed on satellite television, newspapers, or magazines. Although cable television is engaged in speech and is part of the press, the Court held the fact that it is taxed differently than other media does not raise First Amendment concerns. Differential taxation of members of the press does not implicate the First Amendment unless it presents the danger of suppressing particular ideas. The general applicability of the sales tax appears to have saved it.

D. Other First Amendment considerations. Although state poll taxes would seem to raise First Amendment issues, they have been held invalid on equal protection grounds, *Harper v. Virginia State Board of Elections*, 86 S. Ct. 1079 (1966).

E. Additional points about the First Amendment:

1. Discrimination based on the content of speech is likely to be stricken. Note that in the context of religious freedom, a tax on publication or expression may be subject to attack as violation of distinct clauses of the First Amendment, the Free Exercise Clause, and the Free Speech Clause.

2. Discrimination on the basis of format (without regard to content) may be sustained.

3. The Court has struggled to decide whether “commercial speech” (e.g., advertising) enjoys the same constitutional protection as other speech. *See, AT&T v. Rudolph*, 2007 WL 647564 (E.D. Ky. 2007) (statute prohibiting display of tax as separate line item on customer bills violated First Amendment).

4. The privacy of customer information that would permit the state to match customer identification with purchasing habits has been held to be protected by the First Amendment. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154 (W.D. WA
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2010) (North Carolina could not require production of such information in order to determine Amazon’s tax liability).

VIII. HOT ISSUES

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B. Refunds: when must a state refund unconstitutional taxes? In McKesson Corp. v. Division of Alcoholic Beverages, 110 S. Ct. 2238 (1990), the Court essentially held that there must be a remedy for an invalid tax. If the state requires timely payment of taxes under threat of penalty, it must afford the taxpayer a clear and certain post payment remedy if the tax is declared invalid. As a practical matter, this generally means refunding the unlawful tax. And a state cannot “bait and switch,” offering a refund remedy in its statutes and then arguing that the taxpayer should have contested the tax prior to payment, Reich v. Collins, 115 S. Ct. 547 (1994). However, issues remain. Some states maintain that the requirement for meaningful backward looking relief is limited to taxes that were constitutionally invalid (as distinguished from unlawful as a matter of state law), e.g., Miller v. Johnson Controls, 296 S.W.3d 392 (KY 2009), cert. denied, 130 S.Ct. 3324 (2010); Cf., City of Houston v. Harris County Outdoor Advertising Assn., 879 S.W.2d 322 (TX Civ. App. 1994). Other cases limit the measure
of relief, e.g. Macy’s Department Stores v. San Francisco, 143 Cal App. 4th 1444 (CA 1st DCA 2007), cert. denied, 127 S. Ct. 3006 (2007). Still others read McKesson and Reich as being satisfied as long as there is a procedural mechanism for relief even though relief is denied, e.g., Dryden v. Madison County, 727 So.2d 245 (Fla. 1999), cert. denied, 119 S. Ct. 2367 (1999); South Central Bell v. State of Alabama, 789 So.2d 147 (Ala. 2000).

C. Retroactive taxation: Is it constitutional for a state to change the law to increase the tax burden for prior activities? In United States v. Carlton, 114 S. Ct 2018 (1994) the Court stated that it is only necessary that retroactive Congressional legislation promote a “legitimate legislative purpose furthered by rational means,” and upheld a retroactive change to the federal estate tax law which was intended to correct a “mistake” and embodied a “modest period of retroactivity” slightly greater than one year. This decision is regularly relied on by states and taxpayers in disputes over the constitutionality of retroactive taxation, e.g., Miller v. Johnson Controls, 296 S.W.3d 392 (KY 2009), cert. denied, 130 S. Ct. 3324 (2010). City of Modesto v. National Med., Inc., 128 Cal. App. 4th 518 (CA App. 2005) (“legislative body must act promptly and establish only a moderate period of retroactivity”; invalidating retroactive legislation that applied to tax years four to eight years in the past). See also, Armco Steel Corp. v. Department of Treasury, 358 N.W.2d 839 (Mich. 1984); Triple-S Management, Corp. v. Municipal Revenue Collection Center, No. KLAN200701749 and No. KLAN200800249 slip op. (P.R. July 17, 2008) (unpublished). The same effect as retroactive imposition of a tax occurs when a court determines that an exemption was available for prior periods but decides to apply its decision only prospectively, Exelon Corporation v. Department Of Revenue, 234 Ill.2d 266, 917 N.E.2d 899 (IL 2009).

D. Nexus resulting from visits within the state. How much “physical presence” by a seller’s employees is sufficient to create nexus? See, e.g., Town Crier, Inc. v. Department Of Revenue, 315 Ill.App.3d 286, 733 N.E.2d 780 (IL 1st DCA 2000) (30 deliveries in seller’s own trucks into state and five installations in two years created nexus); Arizona Department Of Revenue v. Care Computer Systems, 197 Ariz. 414, 4 P.3d 469 (AZ Ct. App. 2000) (annual average of one sales visit and 21 days of training in state created nexus); Dynamic Information Systems v. Washington Department of Revenue, 2000 WL 33267349 (WA Bd. Tax App. 2000) (95 days of sales visits over seven years created nexus; Orvis Co., Inc. v. Tax Appeals Tribunal of State of N.Y., 86 N.Y.2d 165, 630 N.Y.S.2d 680 (NY 1995), cert. denied, 116 S. Ct. 518 (1995) (visits by sales employees created nexus; burden to show visits were limited or sporadic was on remote seller); Vermont Information Processing, Inc. v. Commissioner, New York State Dept. of Taxation and Finance, 86 N.Y.2d 165, 630 N.Y.S.2d 680 (NY 1995), cert. denied, 116 S. Ct. 518 (1995) (41 troubleshooting visits over three years, after the sales occurred, created nexus). Pearle Health Services, Inc. v. Taylor, 799 S.W. 2d 655 (TN 1990) (visits every six to eight weeks by product representatives and every 15 to 18 months by a quality control inspector created nexus). Compare, In re Appeal of Intercard, Inc., 270 Kan. 346, 14 P. 3d 1111 (KS 2000) (11 installation visits in four years did not establish nexus); Share International v. Department of Revenue, 676 So.2d 1362 (FL 1996) (trade shows within state for three days each year did not create nexus).
E. Attributional nexus: under what circumstances can nexus be “attributed” to an out of state seller based on relationships with another that has a physical presence with the taxing state? In *Scripto, Inc. v. Carson*, 80 S. Ct. 619 (1960), a Georgia seller had independent salespersons in Florida who solicited sales. It had no property or regular full time employees in Florida, and argued that the independent salespersons did not create nexus for it. The Court disagreed, holding that whether the sales personnel were employees or independent contractors was constitutionally insignificant. This decision has been the conceptual basis for cases involving a myriad of fact patterns. In general, if an instate activity provides significant support to a remote seller's ability to establish and maintain a market within the state, the courts find nexus. Examples include:

1. Related entity nexus, *e.g., Current, Inc. v. State Board of Equalization*, 24 Cal.App.4th 382, 29 Cal.Rptr.2d 407 (CA Ct. App. 1994) (rejecting contention that extensive physical presence within the taxing state of out of state mail order seller’s parent corporation created nexus for the out of state seller); *Borders Online, Inc. v. State Board of Equalization*, 129 Cal.App.4th 1179, 29 Cal. Rptr. 3d 176 (CA 1st DCA 2005) (online book seller had nexus, where policy allowed customer to exchange or return books for credit card credit at affiliate stores within state; instate stores were acting as agents of remote seller, and were engaged in "selling" by supporting the remote seller's sales efforts); *Bloomingdales by Mail, Ltd. v. Commonwealth of Pennsylvania*, 130 Pa. Comm. 190, 567 A.2d 773 (PA 1989), *affirmed*, 527 Pa. 347, 591 A.2d 1047 (PA 1991) (neither close relationship of instate affiliate, similarity of products, nor fact that on two occasions the instate stores accepted returns of mail order merchandise, established nexus for out of state mail order seller); *SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, 585 A.2d 666 (CT 1991) (rejecting claim that distinct identities of mail order seller and affiliated instate retailer should be disregarded so that presence of instate retailer would create nexus for remote seller). Some states have enacted laws to challenge some of the reasoning in judicial decisions. See, *e.g.*, Ark Code Sec. 26-53-124 (requiring a remote seller to collect the use tax if there is a requisite ownership relationship with an instate retailer and sells similar products under a similar name or the instate retailer's employees or facilities are used to promote sales for the remote seller); Ky. Revised Statute Sec. 139.340 (providing that a representative within the state that receives or exchanges returned merchandise sold by the out of state seller creates a collection duty for the seller); Conn. Statute Sec. 12-407 (ownership or control of or by a retailer within the state in a similar line of business creates use tax collection duty).

2. Other attribution, *e.g., Amazon.com LLC v. New York Dept of Taxation & Finance*, 913 N.Y.S.2d 129 (NY App. 2010) (rejecting claim that NY statute creating rebuttable presumption of nexus for Amazon as a result of links on its associates’ websites was facially unconstitutional, but remanding for consideration of as-applied challenge); *Dell Catalog Sales v. Commissioner of Revenue Services*, 48 Conn. Supp. 170, 834 A. 2d 812 (CT Super. 2003) (sales of service contracts to purchasers of computers from remote seller, and performance
of service contracts within state by contractor did not create nexus for remote seller, where frequency of service calls not established); State v. Dell International, Inc., 922 So. 2d 1257 (LA 1st Cir. Ct. App. 2006), writ denied, 930 So. 2d 979 (LA 2006) (distinguishing the Connecticut case and holding that Dell had not clearly proved lack of nexus for summary judgment purposes); Scholastic Books Clubs v. State Board of Equalization, 207 Cal.App.3d 734, 255 Cal. Rptr. 77 (CA 1st DCA 1989) (distribution of catalogs, acceptance of orders and payments by teachers for out of state book seller created nexus); America Online, Inc. v. Johnson, 2002 WL 1751434 (TN Ct. App. 2002) (implying that presence of leased equipment or relationships with instate telecommunications companies that facilitated dial-up connections with AOL servers outside the state might create nexus). See also, Annox, Inc. v. Kentucky Revenue Cabinet, 2003 WL 23011589 (KY Bd. Tax App. 2003), affirmed, Case No. 03-CI-1606 (Franklin County Cir. Ct. 2005) (property tax case in which court said physical presence not required, but rationale for finding nexus for reseller of telecommunications service includes interconnection agreements allowing use of local telephone company networks within state, as well as installation, repair, and other services of local telcos within the state). See also Electronic Commerce session materials.

Although not involving a dispute over attributional nexus, in Town Fair Tire Centers v. Commissioner of Revenue, 911 N.E.2d 1157 (MA 2009) the court rejected a state’s attempt to require collection of use tax by a seller with nexus in the state, where there was insufficient evidence that customers purchased for use in the state and no statutory presumption to that effect).

F. Drop shipments: A sells to B who sells to C. A drop ships directly to C in the taxing state, where B lacks nexus. Under what circumstances can the taxing state require A to collect its sales or use tax? The answer may depend upon whether B's shipment originates in the taxing state. In Lyon Metal Products, Inc. v. State Board of Equalization, 58 Cal.App.4th 906, 68 Cal.Rptr.2d 285 (Ct. App. 1997), cert denied, 118 S. Ct. 2298 (1998), the seller (A) shipped to its purchaser’s (B’s) customer (C) from an instate warehouse, and state law “deemed” the seller to be a retailer required to collect tax on the retail selling price. The seller argued unsuccessfully that the tax discriminated against interstate commerce as it applied only because the intermediate purchaser lacked nexus. In Steelcase, Inc. v. Director, Division of Taxation, 13 N.J.Tax 182 (N.J. Tax Ct. 1993) and Steelcase, Inc. v. Crystal, 238 Conn. 571, 680 A.2d 289 (Conn. 1996), the shipments originated outside the taxing state and the taxes were stricken. See also Technical Assistance Advisements 94A-060 (FL DOR 1994), 00A-079 (FL DOR 2000), 00A-044 (FL DOR 2000) 07A-043 (FL DOR 2007).

G. Taxation of services. The principal constitutional issues here relate to the sourcing of services. Because a service is not tangible, concepts of "title" and "possession" do not generally apply, and "use" can be applied only by constructing a new definition for it. The two primary ways of sourcing such services are where the costs of performance are incurred, or where the benefit of the service is considered to be received. The first approach suggests a framework that is based on observable events; the second is
essentially an abstraction. See, e.g., Western Wireless, Corp. v. Department of Revenue, 665 N.W. 2d 73 (S.D. 2003), cert. denied, 124 S. Ct. 933 (2003) (upholding use tax on billing services performed entirely outside the state).

H. Electronic commerce: This subject is covered in detail in a separate session.

I. Taxation affecting Native Americans

IX. CONCLUSION

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CONCLUSION

- Constitution exists largely because of taxes
- Constitutional safeguards have been highly effective in restraining state taxing power
- Tax professional familiarity value added
THE UNITED STATES CONSTITUTION

(See Note 1)

We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

Article. I.

Section 1.

All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

Section. 2.

Clause 1: The House of Representatives shall be composed of Members chosen every second Year by the People of the several States, and the Electors in each State shall have the Qualifications requisite for Electors of the most numerous Branch of the State Legislature.

Clause 2: No Person shall be a Representative who shall not have attained to the Age of twenty five Years, and been seven Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State in which he shall be chosen.

Clause 3: Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons. (See Note 2)

The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New-York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

Clause 4: When vacancies happen in the Representation from any State, the Executive Authority thereof shall issue Writs of Election to fill such Vacancies.
Clause 5: The House of Representatives shall choose their Speaker and other Officers; and shall have the sole Power of Impeachment.

Section 3.

Clause 1: The Senate of the United States shall be composed of two Senators from each State, chosen by the Legislature thereof, (See Note 3) for six Years; and each Senator shall have one Vote.

Clause 2: Immediately after they shall be assembled in Consequence of the first Election, they shall be divided as equally as may be into three Classes. The Seats of the Senators of the first Class shall be vacated at the Expiration of the second Year, of the second Class at the Expiration of the fourth Year, and of the third Class at the Expiration of the sixth Year, so that one third may be chosen every second Year; and if Vacancies happen by Resignation, or otherwise, during the Recess of the Legislature of any State, the Executive thereof may make temporary Appointments until the next Meeting of the Legislature, which shall then fill such Vacancies. (See Note 4)

Clause 3: No Person shall be a Senator who shall not have attained to the Age of thirty Years, and been nine Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State for which he shall be chosen.

Clause 4: The Vice President of the United States shall be President of the Senate, but shall have no Vote, unless they be equally divided.

Clause 5: The Senate shall choose their other Officers, and also a President pro tempore, in the Absence of the Vice President, or when he shall exercise the Office of President of the United States.

Clause 6: The Senate shall have the sole Power to try all Impeachments. When sitting for that Purpose, they shall be on Oath or Affirmation. When the President of the United States is tried, the Chief Justice shall preside: And no Person shall be convicted without the Concurrence of two thirds of the Members present.

Clause 7: Judgment in Cases of Impeachment shall not extend further than to removal from Office, and disqualification to hold and enjoy any Office of honor, Trust or Profit under the United States: but the Party convicted shall nevertheless be liable and subject to Indictment, Trial, Judgment and Punishment, according to Law.

Section 4.

Clause 1: The Times, Places and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators.
Clause 2: The Congress shall assemble at least once in every Year, and such Meeting shall be on the first Monday in December, (See Note 5) unless they shall by Law appoint a different Day.

Section. 5.

Clause 1: Each House shall be the Judge of the Elections, Returns and Qualifications of its own Members, and a Majority of each shall constitute a Quorum to do Business; but a smaller Number may adjourn from day to day, and may be authorized to compel the Attendance of absent Members, in such Manner, and under such Penalties as each House may provide.

Clause 2: Each House may determine the Rules of its Proceedings, punish its Members for disorderly Behaviour, and, with the Concurrence of two thirds, expel a Member.

Clause 3: Each House shall keep a Journal of its Proceedings, and from time to time publish the same, excepting such Parts as may in their Judgment require Secrecy; and the Yeas and Nays of the Members of either House on any question shall, at the Desire of one fifth of those Present, be entered on the Journal.

Clause 4: Neither House, during the Session of Congress, shall, without the Consent of the other, adjourn for more than three days, nor to any other Place than that in which the two Houses shall be sitting.

Section. 6.

Clause 1: The Senators and Representatives shall receive a Compensation for their Services, to be ascertained by Law, and paid out of the Treasury of the United States. (See Note 6) They shall in all Cases, except Treason, Felony and Breach of the Peace, be privileged from Arrest during their Attendance at the Session of their respective Houses, and in going to and returning from the same; and for any Speech or Debate in either House, they shall not be questioned in any other Place.

Clause 2: No Senator or Representative shall, during the Time for which he was elected, be appointed to any civil Office under the Authority of the United States, which shall have been created, or the Emoluments whereof shall have been increased during such time; and no Person holding any Office under the United States, shall be a Member of either House during his Continuance in Office.

Section. 7.

Clause 1: All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.

Clause 2: Every Bill which shall have passed the House of Representatives and the Senate, shall, before it become a Law, be presented to the President of the United States; If he approve he shall sign it, but if not he shall return it, with his Objections to that House in which it shall have originated, who shall enter the Objections at large on their Journal, and proceed to reconsider it.
If after such Reconsideration two thirds of that House shall agree to pass the Bill, it shall be sent, together with the Objections, to the other House, by which it shall likewise be reconsidered, and if approved by two thirds of that House, it shall become a Law. But in all such Cases the Votes of both Houses shall be determined by yeas and Nays, and the Names of the Persons voting for and against the Bill shall be entered on the Journal of each House respectively. If any Bill shall not be returned by the President within ten Days (Sundays excepted) after it shall have been presented to him, the Same shall be a Law, in like Manner as if he had signed it, unless the Congress by their Adjournment prevent its Return, in which Case it shall not be a Law.

Clause 3: Every Order, Resolution, or Vote to which the Concurrence of the Senate and House of Representatives may be necessary (except on a question of Adjournment) shall be presented to the President of the United States; and before the Same shall take Effect, shall be approved by him, or being disapproved by him, shall be repassed by two thirds of the Senate and House of Representatives, according to the Rules and Limitations prescribed in the Case of a Bill.

Section. 8.

Clause 1: The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

Clause 2: To borrow Money on the credit of the United States;

Clause 3: To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

Clause 4: To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

Clause 5: To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

Clause 6: To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;

Clause 7: To establish Post Offices and post Roads;

Clause 8: To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

Clause 9: To constitute Tribunals inferior to the supreme Court;

Clause 10: To define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations;
Clause 11: To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;

Clause 12: To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;

Clause 13: To provide and maintain a Navy;

Clause 14: To make Rules for the Government and Regulation of the land and naval Forces;

Clause 15: To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repel Invasions;

Clause 16: To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the Authority of training the Militia according to the discipline prescribed by Congress;

Clause 17: To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings;--And

Clause 18: To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

Section. 9.

Clause 1: The Migration or Importation of such Persons as any of the States now existing shall think proper to admit, shall not be prohibited by the Congress prior to the Year one thousand eight hundred and eight, but a Tax or duty may be imposed on such Importation, not exceeding ten dollars for each Person.

Clause 2: The Privilege of the Writ of Habeas Corpus shall not be suspended, unless when in Cases of Rebellion or Invasion the public Safety may require it.

Clause 3: No Bill of Attainder or ex post facto Law shall be passed.

Clause 4: No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken. (See Note 7)

Clause 5: No Tax or Duty shall be laid on Articles exported from any State.
Clause 6: No Preference shall be given by any Regulation of Commerce or Revenue to the Ports of one State over those of another: nor shall Vessels bound to, or from, one State, be obliged to enter, clear, or pay Duties in another.

Clause 7: No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

Clause 8: No Title of Nobility shall be granted by the United States: And no Person holding any Office of Profit or Trust under them, shall, without the Consent of the Congress, accept of any present, Emolument, Office, or Title, of any kind whatever, from any King, Prince, or foreign State.

**Section. 10.**

Clause 1: No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

Clause 2: No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it's inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Clause 3: No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

**Article. II.**

**Section. 1.**

Clause 1: The executive Power shall be vested in a President of the United States of America. He shall hold his Office during the Term of four Years, and, together with the Vice President, chosen for the same Term, be elected, as follows

Clause 2: Each State shall appoint, in such Manner as the Legislature thereof may direct, a Number of Electors, equal to the whole Number of Senators and Representatives to which the State may be entitled in the Congress: but no Senator or Representative, or Person holding an Office of Trust or Profit under the United States, shall be appointed an Elector.

Clause 3: The Electors shall meet in their respective States, and vote by Ballot for two Persons, of whom one at least shall not be an Inhabitant of the same State with themselves. And they shall
make a List of all the Persons voted for, and of the Number of Votes for each; which List they shall sign and certify, and transmit sealed to the Seat of the Government of the United States, directed to the President of the Senate. The President of the Senate shall, in the Presence of the Senate and House of Representatives, open all the Certificates, and the Votes shall then be counted. The Person having the greatest Number of Votes shall be the President, if such Number be a Majority of the whole Number of Electors appointed; and if there be more than one who have such Majority, and have an equal Number of Votes, then the House of Representatives shall immediately chuse by Ballot one of them for President; and if no Person have a Majority, then from the five highest on the List the said House shall in like Manner chuse the President. But in chusing the President, the Votes shall be taken by States, the Representation from each State having one Vote; A quorum for this Purpose shall consist of a Member or Members from two thirds of the States, and a Majority of all the States shall be necessary to a Choice. In every Case, after the Choice of the President, the Person having the greatest Number of Votes of the Electors shall be the Vice President. But if there should remain two or more who have equal Votes, the Senate shall chuse from them by Ballot the Vice President. (See Note 8)

Clause 4: The Congress may determine the Time of chusing the Electors, and the Day on which they shall give their Votes; which Day shall be the same throughout the United States.

Clause 5: No Person except a natural born Citizen, or a Citizen of the United States, at the time of the Adoption of this Constitution, shall be eligible to the Office of President; neither shall any Person be eligible to that Office who shall not have attained to the Age of thirty five Years, and been fourteen Years a Resident within the United States.

Clause 6: In Case of the Removal of the President from Office, or of his Death, Resignation, or Inability to discharge the Powers and Duties of the said Office, (See Note 9) the Same shall devolve on the Vice President, and the Congress may by Law provide for the Case of Removal, Death, Resignation or Inability, both of the President and Vice President, declaring what Officer shall then act as President, and such Officer shall act accordingly, until the Disability be removed, or a President shall be elected.

Clause 7: The President shall, at stated Times, receive for his Services, a Compensation, which shall neither be encreased nor diminished during the Period for which he shall have been elected, and he shall not receive within that Period any other Emolument from the United States, or any of them.

Clause 8: Before he enter on the Execution of his Office, he shall take the following Oath or Affirmation:--"I do solemnly swear (or affirm) that I will faithfully execute the Office of President of the United States, and will to the best of my Ability, preserve, protect and defend the Constitution of the United States."

Section 2.

Clause 1: The President shall be Commander in Chief of the Army and Navy of the United States, and of the Militia of the several States, when called into the actual Service of the United States; he may require the Opinion, in writing, of the principal Officer in each of the executive
Departments, upon any Subject relating to the Duties of their respective Offices, and he shall have Power to grant Reprieves and Pardons for Offences against the United States, except in Cases of Impeachment.

Clause 2: He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Clause 3: The President shall have Power to fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session.

Section 3.

He shall from time to time give to the Congress Information of the State of the Union, and recommend to their Consideration such Measures as he shall judge necessary and expedient; he may, on extraordinary Occasions, convene both Houses, or either of them, and in Case of Disagreement between them, with Respect to the Time of Adjournment, he may adjourn them to such Time as he shall think proper; he shall receive Ambassadors and other public Ministers; he shall take Care that the Laws be faithfully executed, and shall Commission all the Officers of the United States.

Section 4.

The President, Vice President and all civil Officers of the United States, shall be removed from Office on Impeachment for, and Conviction of, Treason, Bribery, or other high Crimes and Misdemeanors.

Article III.

Section 1.

The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.
Section 2.

Clause 1: The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;--to all Cases affecting Ambassadors, other public Ministers and Consuls;--to all Cases of admiralty and maritime Jurisdiction;--to Controversies to which the United States shall be a Party;--to Controversies between two or more States;--between a State and Citizens of another State; (See Note 10)--between Citizens of different States, --between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Clause 2: In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

Clause 3: The Trial of all Crimes, except in Cases of Impeachment, shall be by Jury; and such Trial shall be held in the State where the said Crimes shall have been committed; but when not committed within any State, the Trial shall be at such Place or Places as the Congress may by Law have directed.

Section 3.

Clause 1: Treason against the United States, shall consist only in levying War against them, or in adhering to their Enemies, giving them Aid and Comfort. No Person shall be convicted of Treason unless on the Testimony of two Witnesses to the same overt Act, or on Confession in open Court.

Clause 2: The Congress shall have Power to declare the Punishment of Treason, but no Attainder of Treason shall work Corruption of Blood, or Forfeiture except during the Life of the Person attainted.

Article IV.

Section 1.

Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof.
Section. 2.

Clause 1: The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.

Clause 2: A Person charged in any State with Treason, Felony, or other Crime, who shall flee from Justice, and be found in another State, shall on Demand of the executive Authority of the State from which he fled, be delivered up, to be removed to the State having Jurisdiction of the Crime.

Clause 3: No Person held to Service or Labour in one State, under the Laws thereof, escaping into another, shall, in Consequence of any Law or Regulation therein, be discharged from such Service or Labour, but shall be delivered up on Claim of the Party to whom such Service or Labour may be due. (See Note 11)

Section. 3.

Clause 1: New States may be admitted by the Congress into this Union; but no new State shall be formed or erected within the Jurisdiction of any other State; nor any State be formed by the Junction of two or more States, or Parts of States, without the Consent of the Legislatures of the States concerned as well as of the Congress.

Clause 2: The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; and nothing in this Constitution shall be so construed as to Prejudice any Claims of the United States, or of any particular State.

Section. 4.

The United States shall guarantee to every State in this Union a Republican Form of Government, and shall protect each of them against Invasion; and on Application of the Legislature, or of the Executive (when the Legislature cannot be convened) against domestic Violence.

Article. V.

The Congress, whenever two thirds of both Houses shall deem it necessary, shall propose Amendments to this Constitution, or, on the Application of the Legislatures of two thirds of the several States, shall call a Convention for proposing Amendments, which, in either Case, shall be valid to all Intents and Purposes, as Part of this Constitution, when ratified by the Legislatures of three fourths of the several States, or by Conventions in three fourths thereof, as the one or the other Mode of Ratification may be proposed by the Congress; Provided that no Amendment which may be made prior to the Year One thousand eight hundred and eight shall in any Manner affect the first and fourth Clauses in the Ninth Section of the first Article; and that no State, without its Consent, shall be deprived of its equal Suffrage in the Senate.
Article. VI.

Clause 1: All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation.

Clause 2: This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Clause 3: The Senators and Representatives before mentioned, and the Members of the several State Legislatures, and all executive and judicial Officers, both of the United States and of the several States, shall be bound by Oath or Affirmation, to support this Constitution; but no religious Test shall ever be required as a Qualification to any Office or public Trust under the United States.

Article. VII.

The Ratification of the Conventions of nine States, shall be sufficient for the Establishment of this Constitution between the States so ratifying the Same.

done in Convention by the Unanimous Consent of the States present the Seventeenth Day of September in the Year of our Lord one thousand seven hundred and Eighty seven and of the Independence of the United States of America the Twelfth In witness whereof We have hereunto subscribed our Names,

GO WASHINGTON--Presidt. and deputy from Virginia

[Signed also by the deputies of twelve States.]

Delaware

Geo: Read
Gunning Bedford jun
John Dickinson
Richard Bassett
Jaco: Broom

Maryland

James MCHenry
Dan of ST ThoS. Jenifer
DanL Carroll.
Virginia

John Blair--
James Madison Jr.

North Carolina

WM Blount
RichD. Dobbs Spaight.
Hu Williamson

South Carolina

J. Rutledge
Charles 1ACotesworth Pinckney
Charles Pinckney
Pierce Butler.

Georgia

William Few
Abr Baldwin

New Hampshire

John Langdon
Nicholas Gilman

Massachusetts

Nathaniel Gorham
Rufus King

Connecticut

WM. SamL. Johnson
Roger Sherman

New York

Alexander Hamilton

New Jersey

Wil: Livingston
David Brearley.
NOTES

Note 1: This text of the Constitution follows the engrossed copy signed by Gen. Washington and the deputies from 12 States. The small superior figures preceding the paragraphs designate Clauses, and were not in the original and have no reference to footnotes.

The Constitution was adopted by a convention of the States on September 17, 1787, and was subsequently ratified by the several States, on the following dates: Delaware, December 7, 1787; Pennsylvania, December 12, 1787; New Jersey, December 18, 1787; Georgia, January 2, 1788; Connecticut, January 9, 1788; Massachusetts, February 6, 1788; Maryland, April 28, 1788; South Carolina, May 23, 1788; New Hampshire, June 21, 1788.

Ratification was completed on June 21, 1788.

The Constitution was subsequently ratified by Virginia, June 25, 1788; New York, July 26, 1788; North Carolina, November 21, 1789; Rhode Island, May 29, 1790; and Vermont, January 10, 1791.

In May 1785, a committee of Congress made a report recommending an alteration in the Articles of Confederation, but no action was taken on it, and it was left to the State Legislatures to proceed in the matter. In January 1786, the Legislature of Virginia passed a resolution providing for the appointment of five commissioners, who, or any three of them, should meet such commissioners as might be appointed in the other States of the Union, at a time and place to be agreed upon, to take into consideration the trade of the United States; to consider how far a uniform system in their commercial regulations may be necessary to their common interest and their permanent harmony; and to report to the several States such an act, relative to this great object, as, when ratified by them, will enable the United States in Congress effectually to provide for the same. The Virginia commissioners, after some correspondence, fixed the first Monday in September as the time, and the city of Annapolis as the place for the meeting, but only four other States were represented, viz: Delaware, New York, New Jersey, and Pennsylvania; the
commissioners appointed by Massachusetts, New Hampshire, North Carolina, and Rhode Island failed to attend. Under the circumstances of so partial a representation, the commissioners present agreed upon a report, (drawn by Mr. Hamilton, of New York,) expressing their unanimous conviction that it might essentially tend to advance the interests of the Union if the States by which they were respectively delegated would concur, and use their endeavors to procure the concurrence of the other States, in the appointment of commissioners to meet at Philadelphia on the Second Monday of May following, to take into consideration the situation of the United States; to devise such further provisions as should appear to them necessary to render the Constitution of the Federal Government adequate to the exigencies of the Union; and to report such an act for that purpose to the United States in Congress assembled as, when agreed to by them and afterwards confirmed by the Legislatures of every State, would effectually provide for the same.

Congress, on the 21st of February, 1787, adopted a resolution in favor of a convention, and the Legislatures of those States which had not already done so (with the exception of Rhode Island) promptly appointed delegates. On the 25th of May, seven States having convened, George Washington, of Virginia, was unanimously elected President, and the consideration of the proposed constitution was commenced. On the 17th of September, 1787, the Constitution as engrossed and agreed upon was signed by all the members present, except Mr. Gerry of Massachusetts, and Messrs. Mason and Randolph, of Virginia. The president of the convention transmitted it to Congress, with a resolution stating how the proposed Federal Government should be put in operation, and an explanatory letter. Congress, on the 28th of September, 1787, directed the Constitution so framed, with the resolutions and letter concerning the same, to "be transmitted to the several Legislatures in order to be submitted to a convention of delegates chosen in each State by the people thereof, in conformity to the resolves of the convention."

On the 4th of March, 1789, the day which had been fixed for commencing the operations of Government under the new Constitution, it had been ratified by the conventions chosen in each State to consider it, as follows: Delaware, December 7, 1787; Pennsylvania, December 12, 1787; New Jersey, December 18, 1787; Georgia, January 2, 1788; Connecticut, January 9, 1788; Massachusetts, February 6, 1788; Maryland, April 28, 1788; South Carolina, May 23, 1788; New Hampshire, June 21, 1788; Virginia, June 25, 1788; and New York, July 26, 1788.

The President informed Congress, on the 28th of January, 1790, that North Carolina had ratified the Constitution November 21, 1789; and he informed Congress on the 1st of June, 1790, that Rhode Island had ratified the Constitution May 29, 1790. Vermont, in convention, ratified the Constitution January 10, 1791, and was, by an act of Congress approved February 18, 1791, "received and admitted into this Union as a new and entire member of the United States."

Note 2: The part of this Clause relating to the mode of apportionment of representatives among the several States has been affected by Section 2 of amendment XIV, and as to taxes on incomes without apportionment by amendment XVI.

Note 3: This Clause has been affected by Clause 1 of amendment XVII.

Note 4: This Clause has been affected by Clause 2 of amendment XVIII.
Note 5: This Clause has been affected by amendment XX.

Note 6: This Clause has been affected by amendment XXVII.

Note 7: This Clause has been affected by amendment XVI.

Note 8: This Clause has been superseded by amendment XII.

Note 9: This Clause has been affected by amendment XXV.

Note 10: This Clause has been affected by amendment XI.

Note 11: This Clause has been affected by amendment XIII.

This information has been compiled from the U.S. Code. The U.S. Code is published by the Law Revision Counsel of the U.S. House of Representatives.

Updated September 20, 2004
The Bill of Rights: A Transcription

The Preamble to The Bill of Rights

Congress of the United States
begun and held at the City of New-York, on
Wednesday the fourth of March, one thousand seven hundred and eighty nine.

THE Conventions of a number of the States, having at the time of their adopting the Constitution, expressed a desire, in order to prevent misconstruction or abuse of its powers, that further declaratory and restrictive clauses should be added: And as extending the ground of public confidence in the Government, will best ensure the beneficent ends of its institution.

RESOLVED by the Senate and House of Representatives of the United States of America, in Congress assembled, two thirds of both Houses concurring, that the following Articles be proposed to the Legislatures of the several States, as amendments to the Constitution of the United States, all, or any of which Articles, when ratified by three fourths of the said Legislatures, to be valid to all intents and purposes, as part of the said Constitution; viz.

ARTICLES in addition to, and Amendment of the Constitution of the United States of America, proposed by Congress, and ratified by the Legislatures of the several States, pursuant to the fifth Article of the original Constitution.

Note: The following text is a transcription of the first ten amendments to the Constitution in their original form. These amendments were ratified December 15, 1791, and form what is known as the "Bill of Rights."

Amendment I

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

Amendment II

A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed.
Amendment III

No Soldier shall, in time of peace be quartered in any house, without the consent of the Owner, nor in time of war, but in a manner to be prescribed by law.

Amendment IV

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Amendment VI

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

Amendment VII

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.
Amendment VIII

Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

Amendment IX

The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people.

Amendment X

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Amendments 11-27

Note: The capitalization and punctuation in this version is from the enrolled original of the Joint Resolution of Congress proposing the Bill of Rights, which is on permanent display in the Rotunda of the National Archives Building, Washington, D.C.
Supreme Court of the United States

COMPLETE AUTO TRANSIT, INC.,
Appellant,
v.
Charles R. BRADY, Jr., etc.

No. 76-29.

Decided March 7, 1977.
Rehearing Denied April 18, 1977.

See 430 U.S. 976, 97 S.Ct. 1669.

Action was brought by motor carrier, which transported to Mississippi dealers motor vehicles manufactured outside the state, for refund of sales taxes. The Chancery Court, Hinds County, upheld assessment, and carrier appealed. The Supreme Court of Mississippi, 330 So.2d 268, affirmed, and the United States Supreme Court noted probable jurisdiction. The Supreme Court, Mr. Justice Blackmun, held that where no claim was made that activity in question was not sufficiently connected to state to justify tax, that tax was not fairly related to benefits provided carrier, that tax discriminated against interstate commerce, or that tax was not fairly apportioned, application of Mississippi sales tax on privilege of doing business in Mississippi to motor carrier's interstate activity, which consisted of transportation in Mississippi of motor vehicles manufactured outside state to Mississippi dealers, was not per se unconstitutional as in violation of the commerce clause but rather was valid under principle that interstate commerce must pay its own way; overruling Spector Motor Service v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573. Code Miss.1942, §§ 10105, 10109(2); U.S.C.A.Const. art. 1, § 8, cl. 3.

**1076 Syllabus [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

*274 A Mississippi tax on the privilege of doing business in the State held not to violate the Commerce Clause when it is applied to an interstate activity (here the transportation by motor carrier in Mississippi to Mississippi dealers of cars manufactured outside the State) with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. Spector Motor Service v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573, overruled. Pp. 1079-1084.

330 So.2d 268, Miss., affirmed.

Alan W. Perry, Jackson, Miss., for appellant.
Mr. Justice BLACKMUN delivered the opinion of the Court.

Once again we are presented with "the perennial problem of the validity of a state tax for the privilege of carrying on within a state, certain activities' related to a corporation's operation of an interstate business.' Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 101, 95 S.Ct. 1538, 1539, 44 L.Ed.2d 1 (1975), quoting Memphis Gas Co. v. Stone, 335 U.S. 80, 85, 68 S.Ct. 1475, 1477, 92 L.Ed.1832 (1948). The issue in this case is whether**1077 Mississippi runs afoul of the Commerce Clause, U.S. Const., Art. I, s 8, cl. 3, when it applies the tax it imposes on 'the privilege of . . . doing business' within the State to appellant's activity in interstate commerce. The Supreme Court of Mississippi unanimously sustained the tax against *275 appellant's activity in interstate commerce. The Supreme Court of Mississippi unanimously sustained the tax against *275 appellant's constitutional challenge. 330 So.2d 268 (1976). We noted probable jurisdiction in order to consider anew the applicable principles in this troublesome area. 429 U.S. 813, 97 S.Ct. 52, 50 L.Ed.2d 72 (1976).

I

The taxes in question are sales taxes assessed by the Mississippi State Tax Commission against the appellant, Complete Auto Transit, Inc., for the period from August 1, 1968, through July 31, 1972. The assessments were made pursuant to the following Mississippi statutes:

'There is hereby levied and assessed and shall be collected, privilege taxes for the privilege of engaging or continuing in business or doing business within this state to be determined by the application of rates against gross proceeds of sales or gross income or values, as the case may be, as provided in the following sections.' Miss.Code Ann., 1942, s 10105 (1972 Supp.), as amended. [FN1]

FN1. The statute is now s 27-65-13 of the State's 1972 Code.

'Upon every person operating a pipeline, railroad, airplane, bus, truck, or any other transportation business for the transportation of persons or property for compensation or hire between points within this State, there is hereby levied, assessed, and shall be collected, a tax equal to five per cent of the gross income of such business . . . .' s 10109(2), as amended. [FN2]

FN2. This statute is now s 27-65-19(2) of the 1972 Code. It was amended, effective August 1, 1972, to exclude the transportation of property 1972 Miss. Laws, c. 506, s 2. Section 10109, as codified in 1942, imposed a tax on gross income from all transportation, with gross income defined to exclude 'so much thereof as is derived from business conducted in commerce between this State and other States of the United States . . . which the State of Mississippi is prohibited from taxing under the Constitution of the United States of America.' In 1955, this exclusionary language was eliminated and the statute was amended to cover only transportation 'between points within this state.' 1955 Miss. Laws, c. 109, s 10. The amendment gave the statute essentially the form it possessed during the period relevant here. It might be argued that the statute as so amended evinces an intent to reach only intrastate commerce, and that it should be so construed. Appellant, however, does not make that argument, and the Supreme Court of Mississippi clearly viewed that statute as applying to both intrastate commerce and interstate commerce.
We are advised by the appellee that the tax has been applied only to commercial transactions in which a distinct service is performed and payment made for transportation from one point within the State to another point within the State. Tr. of Oral Arg. 34-35, 38.

Any person liable for the tax is required to add it to the gross sales price and, 'insofar as practicable,' to collect it at the time the sales price is collected. § 10117, as amended. [FN3]

FN3. This statute is now § 27-65-31 of the 1972 Code. Violation of the requirements of the section is a misdemeanor. Ibid.

Appellant is a Michigan corporation engaged in the business of transporting motor vehicles by motor carrier for General Motors Corporation. General Motors assembles outside Mississippi vehicles that are destined for dealers within the State. The vehicles are then shipped by rail to Jackson, Miss., where, usually within 48 hours, they are loaded onto appellant's trucks and transported by appellant to the Mississippi dealers. App. 47-48, 78-79, 86-87. Appellant is paid on a contract basis for the transportation from the railhead to the dealers. [FN4] Id., 50-51, 68.

FN4. The parties understandably go to great pains to describe the details of the bills of lading, and the responsibility of various entities for the vehicles as they travel from the assembly plant to the dealers. Appellant seeks to demonstrate that the transportation it provides from the railhead to the dealers is part of a movement in interstate commerce. Appellee argues that appellant's transportation is intrastate business, but further argues that even if the activity is part of interstate commerce, the tax is not unconstitutional. Brief for Appellant 11-14; Brief for Appellee 12-24; Reply Brief for Appellant 14-16. The Mississippi courts, in upholding the tax, assumed that the transportation is in interstate commerce. For present purposes, we make the same assumption.

By letter dated October 5, 1971, the Mississippi Tax Commission *277 informed appellant that it was being assessed taxes and interest totaling $122,160.59 for the sales of transportation services during the three-year period from August 1, 1968, through July 31, 1971. [FN5] Remittance within 10 days was requested. Id., at 9-10. By similar letter dated December 28, 1972, the Commission advised appellant of an assessment of $42,990.89 for the period from August 1, 1971, through July 31, 1972. Id., at 11-12. Appellant paid the assessments under protest and, in April 1973, pursuant to § 10121.1, as amended, of the 1942 Code (now § 27-65-47 of the 1972 Code), instituted the present refund action in the Chancery Court of the First Judicial District of Hinds County.

FN5. Although appellant had been operating in Mississippi since 1960, App. 77, the state audit and assessment covered only the period beginning August 1, 1968. Id., at 37-38. No effort had been made to apply the tax to appellant for any period prior to that date.

Appellant claimed that its transportation was but one part of an interstate movement, and that the taxes assessed and paid were unconstitutional as applied to operations in interstate commerce. App. 4, 6-7. The Chancery Court, in an unreported opinion, sustained the assessments. Id., at 99-102.

The Mississippi Supreme Court affirmed. It concluded:

'It will be noted that Taxpayer has a large
operation in this State. It is dependent upon the State for police protection and other State services the same as other citizens. It should pay its fair share of taxes so long, but only so long, as the tax does not discriminate against interstate commerce, and there is no danger of interstate commerce being smothered by cumulative taxes of several states. There is no possibility of any other state duplicating the tax involved in this case. 330 So.2d, at 272.

Appellant, in its complaint in Chancery Court, did not allege that its activity which Mississippi taxes does not have a *278 sufficient nexus with the State; or that the tax discriminates against interstate commerce; or that the tax is unfairly apportioned; or that it is unrelated to services provided by the State. [FN6] No such claims were made before the Mississippi Supreme Court, and although appellant argues here that a tax on 'the privilege of engaging in interstate commerce' creates an unacceptable risk of discrimination and undue burdens, Brief for Appellant 20-27, it does not claim that discrimination or undue burdens exist in fact.


Appellant's attack is based solely on decisions of this Court holding that a tax on the 'privilege' of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce. See, e. g., Spector Motor Service v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951); Freeman v. Hewit, 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946). This rule looks only to the fact that the incidence of the tax is the 'privilege of doing business'; it deems irrelevant any consideration of the practical effect of the tax. The rule reflects an underlying philosophy that interstate commerce requires that**1079 should enjoy a sort of 'free trade' immunity from state taxation. [FN7]

FN7. The Court summarized the 'free trade' view in Freeman v. Hewit, 329 U.S., at 252, 67 S.Ct. at 276:

'(T)he Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States. . . . This limitation on State power . . . does not merely forbid a State to single out interstate commerce for hostile action. A State is also precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States. It is immaterial that local commerce is subjected to a similar encumbrance.'

*279 Appellee, in its turn, relies on decisions of this Court stating that '(i)t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business,' Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254, 58 S.Ct. 546, 548, 82 L.Ed. 823 (1938). These decisions [FN8] have considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge when the tax is
applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.


Over the years, the Court has applied this practical analysis in approving many types of tax that avoided running afoul of the prohibition against taxing the 'privilege of doing business,' but in each instance it has refused to overrule the prohibition. Under the present state of the law, the Spector rule, as it has come to be known, has no relationship to economic realities. Rather it stands only as a trap for the unwary draftsman.

II

The modern origin of the Spector rule may be found in Freeman v. Hewit, supra. [FN9] At issue in Freeman was the application *280 of an Indiana tax upon 'the receipt of the entire gross income' of residents and domiciliaries. 329 U.S., at 250, 67 S.Ct., at 275. Indiana sought to impose this tax on income generated when a trustee of an Indiana estate instructed his local stockbroker to sell certain securities. The broker arranged with correspondents in New York to sell the securities on the New York Stock Exchange. The securities were sold, and the New York brokers, after deducting expenses and commission, transmitted the proceeds to the Indiana broker who in turn delivered them, less his commission, to the trustee. The Indiana Supreme Court sustained the tax, but this Court reversed.

Mr. Justice Frankfurter, speaking for five Members of the Court, announced a blanket prohibition against any state taxation imposed directly on an interstate transaction. He explicitly deemed unnecessary to the decision of the case any showing of **1080 discrimination against interstate commerce or error in apportionment of the tax. Id., at 254, 256-257, 67 S.Ct., at 277, 278-79. He recognized that a State could constitutionally tax local manufacture, impose license taxes on corporations doing business in the State, tax property within the State, and tax the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce. Id., at 255, 67 S.Ct., at 278. Nevertheless, a direct tax on interstate sales, even if fairly apportioned and nondiscriminatory, was held to be

FN9. Although we mention Freeman as the starting point, elements of the views expressed therein, and the positions that underlie that debate, were evident in prior opinions. Compare State Tax on Railway Gross Receipts, 15 Wall. (82 U.S.) 284, 21 L.Ed. 164 (1873), with Fargo v. Michigan, 121 U.S. 230, 7 S.Ct. 857, 30 L.Ed. 888 (1887); and compare Di Santo v. Pennsylvania, 273 U.S. 34, 47 S.Ct. 267, 71 L.Ed. 524 (1927), and Cooney v. Mountain States Tel. Co., 294 U.S. 384, 55 S.Ct. 477, 79 L.Ed. 934 (1935), with Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 58 S.Ct. 546, 82 L.Ed. 823 (1938). See generally P. Hartman, State Taxation of Interstate Commerce (1953); Barrett, State Taxation of Interstate Commerce 'Direct Burdens,' 'Multiple Burdens,' or What Have You?, 4 Vand.L.Rev. 496 (1951), and writings cited therein at 496 n. 1; Dunham, Gross Receipts Taxes on Interstate Transactions, 47 Colum.L.Rev. 211 (1947).
Mr. Justice Rutledge, in a lengthy concurring opinion, argued that the tax should be judged by its economic effects rather than by its formal phrasing. After reviewing the Court's prior decisions, he concluded: 'The fact is that 'direct incidence' of a state tax or regulation . . . has long since been discarded as being in itself sufficient to outlaw state legislation.' Id., at 265-266, 67 S.Ct., at 283-284. In his view, a state tax is unconstitutional *281 only if the activity lacks the necessary connection with the taxing state to give 'jurisdiction to tax,' id., at 271, 67 S.Ct., at 286, or if the tax discriminates against interstate commerce, or if the activity is subject to multiple taxation. Id., at 276-277, 67 S.Ct., at 289. [FN10]

FN10. Mr. Justice Rutledge agreed with the result the Court reached in Freeman because of his belief that the apportionment problem was best solved if States other than the market State were forbidden to impose unapportioned gross receipts taxes of the kind Indiana sought to exact.

The rule announced in Freeman was viewed in the commentary as a triumph of formalism over substance, providing little guidance even as to formal requirements. See P. Hartman, State Taxation of Interstate Commerce 200-204 (1953); Dunham, Gross Receipts Taxes on Interstate Transactions, 47 Colum.L.Rev. 211 (1947). Although the rule might have been utilized as the keystone of a movement toward absolute immunity of interstate commerce from state taxation, [FN11] the Court consistently has indicated that 'interstate commerce may be made to pay its way,' and has moved toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology.

FN11. A consistent application of the doctrine of immunity for interstate commerce, of course, would have necessitated overruling the cases approved by the Freeman Court that upheld taxes whose burden, although indirect, fell on interstate commerce.

The narrowing of the rule to one of draftsmanship and phraseology began with another Mississippi case, Memphis Gas Co. v. Stone, 335 U.S. 80, 68 S.Ct. 1475, 92 L.Ed. 1832 (1948). Memphis Natural Gas Company owned and operated a pipeline running from Louisiana to Memphis. Approximately 135 miles of the line were in Mississippi.

Mississippi imposed a 'franchise or excise' tax measured by 'the value of the capital used, invested or employed in the exercise of any power, privilege or right enjoyed by (a corporation) within this state.' Miss. Code Ann., 1942, s 9313. The Mississippi Supreme Court upheld the tax, and this Court affirmed.

In an opinion for himself and two others, Mr. Justice Reed *282 noted that the tax was not discriminatory, that there was no possibility of multiple taxation, that the amount of the tax was reasonable, and that the tax was properly apportioned to the investment in Mississippi. 335 U.S., at 87-88, 68 S.Ct., at 1478-79. He then went on to consider whether the tax was 'upon the privilege of doing interstate business within the state.' Id., at 88, 68 S.Ct., at 1479. He drew a distinction between a tax on 'the privilege of doing interstate business' and a tax on 'the privilege of exercising corporate functions within the State,' and held that while the former is unconstitutional, the latter is not barred by the Commerce Clause. Id., at 88-93, 68 S.Ct., at 1481. He then approved the tax there at issue because 'there is no attempt to tax the privilege of doing an interstate business or to secure **1081 anything from the corporation by this statute except compensation for the protection of the enumerated local activities of

'maintaining, keeping in repair, and otherwise in manning the facilities." Id., at 93, 68 S.Ct., at 1482.

Mr. Justice Black concurred in the judgment without opinion. Id., at 96, 68 S.Ct., at 1483. Mr. Justice Rutledge provided the fifth vote, stating in his concurrence:

'(I)t is enough for me to sustain the tax imposed in this case that it is one clearly within the state's power to lay in so far as any limitation of due process or 'jurisdiction to tax' in that sense is concerned; it is nondiscriminatory, that is, places no greater burden upon interstate commerce than the state places upon competing intrastate commerce of like character; is duly apportioned, that is, does not undertake to tax any interstate activities carried on outside the state's borders; and cannot be repeated by any other state.' Id., at 96-97, 68 S.Ct., at 1483-1484. (footnotes omitted).

Four Justices dissented, id., at 99, 68 S.Ct., at 1485, on the grounds that it had not been shown that the State afforded any protection in return for the tax, [FN12] and that, therefore, the tax must be viewed as one on the 'privilege' of engaging in interstate commerce. The dissenters recognized that an identical effect could be achieved by an increase in the ad valorem property tax, id., at 104, 68 S.Ct., at 1487 but would have held, notwithstanding, that a tax on the 'privilege' is unconstitutional.

The prohibition against state taxation of the 'privilege' of engaging in commerce that is interstate was reaffirmed in Spector Motor Service v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951), a case similar on its facts to the instant case. The taxpayer there was a Missouri corporation engaged exclusively in interstate trucking. Some of its shipments originated or terminated in Connecticut. Connecticut imposed on a corporation a 'tax or excise upon its franchise for the privilege of carrying on or doing business within the state,' measured by apportioned net income. Id., at 603-604, n. 1, 71 S.Ct. at 509. Spector brought suit in federal court to enjoin collection of the tax as applied to its activities. The District Court issued the injunction. The Second Circuit reversed. This Court, with three Justices in dissent, in turn reversed the Court of Appeals and held the tax unconstitutional as applied.

The Court recognized that 'where a taxpayer is engaged both in intrastate and interstate commerce, a state may tax the privilege of carrying on intrastate business and, within reasonable limits, may compute the amount of the charge by applying the tax rate to a fair proportion of the taxpayer's business done within the state, including both interstate and intrastate.' Id., at 609-610, 71 S.Ct., at 512 (footnote omitted). It held, nevertheless, that a tax on the 'privilege' of doing business is unconstitutional if applied against what is exclusively interstate commerce. The dissenters argued, on the other hand, id., at 610, 71 S.Ct., at 512, that there is no constitutional difference between an 'exclusively interstate' business and a 'mixed' business, and that a fairly apportioned and nondiscriminatory tax on either type is not ask recompense. Id., at 83-84, 68 S.Ct., at 1476-77. The plurality then relied on the Supreme Court of Mississippi's holding that the State did provide protection that could properly be the subject of a tax.

FN12. In arriving at this conclusion, the dissent relied upon a construction of a stipulation entered into by the parties, 335 U.S., at 100-101, 68 S.Ct., at 1485-86, and upon an independent review of the record. The plurality rejected the dissent's reading of the stipulation and noted, in addition, that the question presented in the petition for certiorari did not raise a claim that the State was providing no service for which it could
prohibited by the Commerce Clause.

The Spector rule was applied in *Railway Express Agency v. Virginia*, 347 U.S. 359, 74 S.Ct. 558, 98 L.Ed. 337 (1954) (Railway Express I), to declare unconstitutional a State's 'annual license tax' levied on gross receipts for the 'privilege of doing business in this State.' The Court, by a 5-to-4 vote, held that the tax on gross receipts was a tax on the privilege of doing business rather than a tax on property in the State, as Virginia contended.

Virginia thereupon revised the wording of its statute to impose a 'franchise tax' on 'intangible property' in the form of 'going concern' value as measured by gross receipts. The tax was again asserted against the Agency which in Virginia was engaged exclusively in interstate commerce. This Court's opinion, buttressed by two concurring opinions and one concurrence in the result, upheld the reworded statute as not violative of the Spector rule. *Railway Express Agency v. Virginia*, 358 U.S. 434, 79 S.Ct. 411, 3 L.Ed.2d 450 (1959) (Railway Express II). In upholding the statute, the Court's opinion recognized that the rule against taxing the 'privilege' of doing interstate business had created a situation where 'the use of magic words or labels' could 'disable an otherwise constitutional levy.' *Id.*, at 441, 79 S.Ct., at 416.

There was no real economic difference between the statutes in Railway Express I and Railway Express II. The Court long since had recognized that interstate commerce may be made to pay its way. Yet under the Spector rule, the economic realities in Railway Express I became irrelevant. The *Spector* rule had come to operate only as a rule of draftsmanship, and served only to distract the courts and parties from their inquiry into whether the challenged tax produced results forbidden by the Commerce Clause.

On the day it announced Railway Express II, the Court further confirmed that a State, with proper drafting, may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause. In *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959), the Court held that net income from the interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the tax. Limited in that way, the tax could be levied even though the income was generated exclusively by interstate sales. Spector was distinguished, briefly and in passing, as a case in which 'the incidence' of the tax 'was the privilege of doing business.' *358 U.S.*, at 464, 79 S.Ct., at 365.

Thus, applying the rule of Northwestern Cement to the facts of Spector, it is clear that Connecticut could have taxed the apportioned net income derived from the exclusively interstate commerce. It could not, however, tax the 'privilege' of doing business as measured by the apportioned net income. The reason for attaching constitutional significance to a semantic difference is difficult to discern.

The unsatisfactory operation of the Spector rule is well demonstrated by our recent case of *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 95 S.Ct. 1538, 44 L.Ed.2d 1 (1975). Colonial was a Delaware corporation with an interstate pipeline running through Louisiana for approximately 258 miles. It maintained a work force and pumping stations in Louisiana to keep the pipeline flowing, but it did no intrastate business in that State. *Id.*, at 101-102, 95 S.Ct., at 1539-40. In 1962, Louisiana imposed on Colonial a franchise tax for 'the privilege of carrying on or doing business' in the State. The Louisiana Court of Appeal invalidated the *tax as violative of the rule of Spector*. *Colonial Pipeline Co. v. Moton*, 228 So.2d 718 (La.App.1969). The Supreme Court of
Louisiana refused review. 255 La. 474, 231 So.2d 393 (1970). The Louisiana Legislature, perhaps recognizing that it had run afoul of a rule of words rather than a rule of substance, then redrafted the statute to levy the tax, as an alternative incident, on the 'qualification to carry on or do business in this state or the actual doing of business within this state in a corporate form.' Again, the Court of Appeal held the tax unconstitutional as applied to the appellant. Colonial Pipeline Co. v. Agerton, 275 So.2d 834 (La.App.1973). But this time the Louisiana Supreme Court upheld the new tax. 289 So.2d 93 (La.1974).

**1083** By a 7-to-1 vote, this Court affirmed. No question had been raised as to the propriety of the apportionment of the tax, and no claim was made that the tax was discriminatory. 421 U.S., at 101, 95 S.Ct., at 1539. The Court noted that the tax was imposed on that aspect of interstate commerce to which the State bore a special relation, and that the State bestowed powers, privileges, and benefits sufficient to support a tax on doing business in the corporate form in Louisiana. Id., at 109, 95 S.Ct., at 1543. Accordingly, on the authority of Memphis Gas, the tax was held to be constitutional. The Court distinguished Spector on the familiar ground that it involved a tax on the privilege of carrying on interstate commerce, while the Louisiana Legislature, in contrast, had worded the statute at issue 'narrowly to confine the impost to one related to appellant's activities within the State in the corporate form.' 421 U.S., at 113-114, 95 S.Ct., at 1546. [FN13]

FN13. Five Members of the Court joined in the opinion distinguishing Spector. Two concurred in the judgment, but viewed Spector as indistinguishable and would have overruled it. 421 U.S., at 114-116, 95 S.Ct., at 1546-47. One also viewed Spector as indistinguishable, but felt that it was an established precedent until forthrightly overruled. Id., at 116.

*287* While refraining from overruling Spector, the Court noted: '(D)ecisions of this Court, particularly during recent decades, have sustained nondiscriminatory, properly apportioned state corporate taxes upon foreign corporations doing an exclusively interstate business when the tax is related to a corporation's local activities and the State has provided benefits and protections for those activities for which it is justified in asking a fair and reasonable return.' Id., at 108, 95 S.Ct., at 1543.

One commentator concluded: 'After reading Colonial, only the most sanguine taxpayer would conclude that the Court maintains a serious belief in the doctrine that the privilege of doing interstate business is immune from state taxation.' Hellerstein, State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline, 62 Va.L.Rev. 149, 188 (1976). [FN14]


III

In this case, of course, we are confronted with a situation like that presented in Spector. The tax is labeled a privilege tax 'for the privilege of . . . doing business' in Mississippi, s 10105 of the State's 1942 Code, as amended, and the activity taxed is, or has been assumed to be, interstate commerce. We note again that no claim is made that the activity is not sufficiently connected to the State to justify a tax, or that the tax is not
fairly related to benefits provided the taxpayer, or that the tax discriminates against interstate commerce, or that the tax is not fairly apportioned.

*288 The view of the Commerce Clause that gave rise to the rule of Spector perhaps was not without some substance. Nonetheless, the possibility of defending it in the abstract does not alter the fact that the Court has rejected the proposition that interstate commerce is immune from state taxation:

'It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.' Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254, 58 S.Ct. 546, 548, 82 L.Ed. 823 (1938).' Colonial Pipeline Co. v. Traigle, 421 U.S., at 108, 95 S.Ct., at 1543.

Not only has the philosophy underlying the rule been rejected, but the rule itself **1084 has been stripped of any practical significance. If Mississippi had called its tax one on 'net income' or on the 'going concern value' of appellant's business, the Spector rule could not invalidate it. There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect. Simply put, the Spector rule does not address the problems with which the Commerce Clause is concerned. [FN15] Accordingly, we now reject the rule of *289 Spector Motor Service, Inc. v. O'Connor, that a state tax on the 'privilege of doing business' is per se unconstitutional when it is applied to interstate commerce, and that case is overruled.

**1084 It might be argued that 'privilege' taxes, by focusing on the doing of business, are easily tailored to single out interstate businesses and subject them to effects forbidden by the Commerce Clause, and that, therefore, 'privilege' taxes should be subjected to a per se rule against their imposition on interstate business. Yet property taxes also may be tailored to differentiate between property used in transportation and other types of property, see Railway Express II, 358 U.S. 434, 79 S.Ct. 411, 3 L.Ed.2d 450 (1959); an income tax could use different rates for different types of business; and a tax on the 'privilege of doing business in corporate form' could be made to change with the nature of the corporate activity involved. Any tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State. See Freeman v. Hewit, 329 U.S., at 265-266, n. 13, 67 S.Ct., at 283 (concurring opinion). A tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce. We perceive no reason, however, why a tax on the 'privilege of doing business' should be viewed as creating a qualitatively different danger so as to require a per se rule of unconstitutionality. It might also be argued that adoption of a rule of absolute immunity for interstate commerce (a rule that would, of course, go beyond Spector) would relieve this Court of difficult judgments that on occasion will have to be made. We believe, however, that administrative convenience, in this instance, is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way.'
There being no objection to Mississippi's tax on appellant except that it was imposed on nothing other than the 'privilege of doing business' that is interstate, the judgment of the Supreme Court of Mississippi is affirmed.

It is so ordered.

430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326

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State brought declaratory judgment action seeking declaration that out-of-state retailer was required to collect and remit applicable state use tax. Retailer's motion for summary judgment was granted by the District Court, Burleigh County, South Central Judicial District, Benny A. Graff, J., and state appealed. The North Dakota Supreme Court, VandeWalle, J., 470 N.W.2d 203, reversed. On petition for writ of certiorari, the Supreme Court, Justice Stevens, held that: (1) mail-order business did not need to have physical presence in state in order to permit state to require business to collect use tax from its in-state customers, but (2) physical presence in state was required for business to have "substantial nexus" with taxing state required by commerce clause.

Reversed and remanded.

Justice White concurred in part and dissented in part and filed opinion.

Justice Scalia concurred in part and concurred in judgment and filed opinion, in which Justice Kennedy and Justice Thomas joined.

[1] COMMERCE k62.71
83k62.71
Formerly 83k62.70

[1] CONSTITUTIONAL LAW k281.5
92k281.5

[2] CONSTITUTIONAL LAW k281.5
92k281.5
Due process requires both that some definite link or minimum connection exist between state and the person, property or transaction it seeks to tax, and that income attributed to state for tax purposes be rationally related to values connected with taxing state. U.S.C.A. Const.Amend. 14.

[3] CONSTITUTIONAL LAW k285.4
92k285.4
Mail-order business did not need to have physical presence in state in order to permit state, consistent with requirements of due process, to require it to collect use tax from its in-state customers; overruling National Bellas Hess, Inc. v. Department of Revenue of Ill., 87 S.Ct. 1389. U.S.C.A. Const.Amend. 14.
[3] TAXATION k1206
371k1206
Mail-order business did not need to have physical presence in state in order to permit state, consistent with requirements of due process, to require it to collect use tax from its in-state customers; overruling National Bellas Hess, Inc. v. Department of Revenue of Ill., 87 S.Ct. 1389. U.S.C.A. Const.Amend. 14.

[4] CONSTITUTIONAL LAW k285.4
92k285.4
Imposition of duty to collect use tax on out-of-state mail order business with no sales force and insignificant tangible property in state did not violate due process, where business annually mailed 24 tons of catalogs and flyers into state and had annual sales approaching $1 million to in-state customers. U.S.C.A. Const.Amend. 14.

[4] TAXATION k1218
371k1218
Imposition of duty to collect use tax on out-of-state mail order business with no sales force and insignificant tangible property in state did not violate due process, where business annually mailed 24 tons of catalogs and flyers into state and had annual sales approaching $1 million to in-state customers. U.S.C.A. Const.Amend. 14.

[5] COMMERCE k12
83k12
Commerce clause is more than affirmative grant of power; it has negative sweep as well and prohibits certain state actions that interfere with interstate commerce.

[6] COMMERCE k62.80
83k62.80
Interstate commerce may be required, consistent with commerce clause, to pay its fair share of state taxes. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[7] COMMERCE k74.5(1)
83k74.5(1)
Vendor whose only contacts with taxing state are by mail or common carrier lacks "substantial nexus" with state and may not be required, consistent with commerce clause, to collect use tax from its in-state customers. U.S.C.A. Const. Art. 1, § 8, cl. 3. See publication Words and Phrases for other judicial constructions and definitions.

[8] COMMERCE k62.71
83k62.71
Formerly 83k62.70

[9] COMMERCE k62.71
83k62.71
Formerly 83k62.70
Corporation may have "minimum contacts" with taxing state, as required by due process clause, and yet lack "substantial nexus" with state as required by commerce clause.

[9] CONSTITUTIONAL LAW k281.5
92k281.5
Corporation may have "minimum contacts" with taxing state, as required by due process clause, and yet lack "substantial nexus" with state as required by commerce clause. U.S.C.A. Const.Amend. 14; U.S.C.A. Const. Art. 1, § 8, cl. 3.

[10] COMMERCE k62.71
83k62.71
Formerly 83k62.70

[10] CONSTITUTIONAL LAW k281.5
92k281.5

**1905 Syllabus [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

Respondent North Dakota, through its Tax Commissioner, filed an action in state court to require petitioner Quill Corporation--an out-of-state mail-order house with neither outlets nor sales representatives in the State--to collect and pay a use tax on goods purchased for use in the State. The trial court ruled in Quill's favor. It found the case indistinguishable from National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505, which, in holding that a similar Illinois statute violated the Fourteenth Amendment's Due Process Clause and created an unconstitutional burden on interstate commerce, concluded that a "seller whose only connection with customers in the State is by common carrier or the ... mail" lacked the requisite minimum contacts with the State. Id., at 758, 87 S.Ct., at 1392. The State Supreme Court reversed, concluding, inter alia, that, pursuant to Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326, and its progeny, the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in Bellas Hess; and that, with respect to the Due Process Clause, cases following Bellas Hess had not construed minimum contacts to require physical presence within a State as a prerequisite to the legitimate exercise of state power.

Held:

1. The Due Process Clause does not bar enforcement of the State's use tax against Quill. This Court's due process jurisprudence has evolved substantially since Bellas Hess, abandoning formalistic tests focused on a defendant's presence...
within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of the federal system of Government, to require it to defend the suit in that State. See Shaffer v. Heitner, 433 U.S. 186, 212, 97 S.Ct. 2569, 2584, 53 L.Ed.2d 683. Thus, to the extent that this Court's decisions have indicated that the Clause requires a physical presence in a State, they are overruled. In this case, Quill has purposefully directed its activities at North Dakota residents, the magnitude of those contacts are more than sufficient for due process purposes, and the tax is related to the benefits Quill receives from access to the State. Pp. 1909-1911.

2. The State's enforcement of the use tax against Quill places an unconstitutional burden on interstate commerce. Pp. 1911-1916.

*a299* a) Bellas Hess was not rendered obsolete by this Court's subsequent decision in Complete Auto, supra, which set forth the four-part test that continues to govern the validity of state taxes under the Commerce Clause. Although Complete Auto renounced an analytical approach that looked to a statute's formal language rather than its practical effect in determining a state tax statute's validity, the Bellas Hess decision did not rely on such formalism. Nor is Bellas Hess inconsistent with Complete Auto. It concerns the first part of the Complete Auto test and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause. Pp. 1911-1913.

(b) Contrary to the State's argument, a mail-order house may have the "minimum contacts" with a taxing State as required by the Due Process Clause and yet lack the "substantial nexus" with the State required by the Commerce Clause. These requirements are not identical and are animated by different constitutional concerns and policies. Due process concerns the fundamental fairness of governmental activity, and the touchstone of due process nexus analysis is often identified as "notice" or "fair warning." In contrast, the Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy. P. 1913.

(c) The evolution of this Court's Commerce Clause jurisprudence does not indicate repudiation of the Bellas Hess rule. While **1907** cases subsequent to Bellas Hess and concerning other types of taxes have not adopted a bright-line, physical presence requirement similar to that in Bellas Hess, see, e.g., Standard Pressed Steel Co. v. Department of Revenue of Wash., 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719, their reasoning does not compel rejection of the Bellas Hess rule regarding 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 rule remains good law. Pp. 1914-1916.
(d) The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve. P. 1916.

470 N.W.2d 203 (N.D.1991), reversed and remanded.

STEVENS, J., delivered the opinion for a unanimous Court with respect to Parts I, II, and III, and the opinion of the Court with respect to Part IV, in which REHNQUIST, C.J., and BLACKMUN, O'CONNOR, and SOUTER, JJ., joined. SCALIA, J., filed an opinion concurring in part and concurring in the judgment, in which KENNEDY and THOMAS, JJ., joined. WHITE, J., filed an opinion concurring in part and dissenting in part, post, p. 1916.

*300 John E. Gaggini argued the cause for petitioner. With him on the brief were Don S. Harnack, Richard A. Hanson, James H. Peters, Nancy T. Owens, and William P. Pearce.

Nicholas J. Spaeth, Attorney General of North Dakota, argued the cause for respondent. With him on the brief were Laurie J. Loveland, Solicitor General, Robert W. Wirtz, Assistant Attorney General, and Alan H. Friedman, Special Assistant Attorney General.*


For U.S. Supreme Court Briefs See:
1991 WL 538776 (Resp.Brief)
1992 WL 551426 (Reply.Brief)

For Transcript of Oral Argument See:

*301 Justice STEVENS delivered the opinion of the Court.

This case, like National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), involves a State's attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State. In Bellas Hess we held that a similar Illinois statute violated the Due Process Clause of the Fourteenth Amendment and created an unconstitutional burden on interstate commerce. In particular, we ruled that a "seller whose only connection with customers in the State is by common carrier or the United States mail" lacked the requisite minimum contacts with the State. Id., at 758, 87 S.Ct., at 1392.
In this case, the Supreme Court of North Dakota declined to follow Bellas Hess because "the tremendous social, economic, commercial, and legal innovations" of the past quarter-century have rendered its holding "obsole[te]." 470 N.W.2d 203, 208 (1991). Having granted certiorari, 502 U.S. 808, 112 S.Ct. 49, 116 L.Ed.2d 27, we must either reverse the State Supreme Court or overrule Bellas Hess. While we agree with much of the state court's reasoning, we take the former course.

I

Quill is a Delaware corporation with offices and warehouses in Illinois, California, and Georgia. None of its employees work or reside in North Dakota, and its ownership of tangible property in that State is either insignificant or nonexistent. [FN1] Quill sells office equipment and supplies; it solicits business through catalogs and flyers, advertisements in national periodicals, and telephone calls. Its annual national sales exceed $200 million, of which almost $1 million are made to about 3,000 customers in North Dakota. It is the sixth largest vendor of office supplies in the State. It delivers all of its merchandise to its North Dakota customers by mail or common carrier from out-of-state locations.

FN1. In the trial court, the State argued that because Quill gave its customers an unconditional 90-day guarantee, it retained title to the merchandise during the 90-day period after delivery. The trial court held, however, that title passed to the purchaser when the merchandise was received. See App. to Pet. for Cert. A40-A41. The State Supreme Court assumed for the purposes of its decision that that ruling was correct. 470 N.W.2d 203, 217, n. 13 (1991). The State Supreme Court also noted that Quill licensed a computer software program to some of its North Dakota customers that enabled them to check Quill's current inventories and prices and to place orders directly. Id., at 216-217. As we shall explain, Quill's interests in the licensed software does not affect our analysis of the due process issue and does not comprise the "substantial nexus" required by the Commerce Clause. See n. 8, infra.

As a corollary to its sales tax, North Dakota imposes a use tax upon property purchased for storage, use, or consumption within the State. North Dakota requires every "retailer maintaining a place of business in" the State to collect the tax from the consumer and remit it to the State. N.D.Cent.Code § 57-40.2-07 (Supp.1991). In 1987, North Dakota amended the statutory definition of the term "retailer" to include "everyone who engages in regular or systematic solicitation of a consumer market in this state." § 57-40.2-01(6). State regulations in turn define "regular or systematic solicitation" to mean three or more advertisements within a 12-month period. N.D.Admin.Code § 81-04.1-01-03.1 (1988).
Thus, since 1987, mail-order companies that engage in such solicitation have been subject to the tax even if they maintain no property or personnel in North Dakota.

Quill has taken the position that North Dakota does not have the power to compel it to collect a use tax from its North Dakota customers. Consequently, the State, through its Tax Commissioner, filed this action to require Quill to pay taxes (as well as interest and penalties) on all such sales made after July 1, 1987. The trial court ruled in Quill's favor, finding the case indistinguishable from Bellas Hess; specifically, it found that because the State had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no "nexus to allow the state to define retailer in the manner it chose." App. to Pet. for Cert. A41.

The North Dakota Supreme Court reversed, concluding that "wholesale changes" in both the economy and the law made it inappropriate to follow Bellas Hess today. 470 N.W.2d, at 213. The principal economic change noted by the court was the remarkable growth of the mail-order business "from a relatively inconsequential market niche" in 1967 to a "goliath" with annual sales that reached "the staggering figure of $183.3 billion in 1989." Id., at 208, 209. Moreover, the court observed, advances in computer technology greatly eased the burden of compliance with a "welter of complicated obligations" imposed by state and local taxing authorities. Id., at 215 (quoting Bellas Hess, 386 U.S., at 759-760, 87 S.Ct., at 1393).

Equally important, in the court's view, were the changes in the "legal landscape." With respect to the Commerce Clause, the court emphasized that Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), rejected the line of cases holding that the direct taxation of interstate commerce was impermissible and adopted instead a "consistent and rational method of inquiry [that focused on] the practical effect of [the] challenged tax." Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 443, 100 S.Ct. 1223, 1234, 63 L.Ed.2d 510 (1980). This and subsequent rulings, the court maintained, indicated that the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in Bellas Hess.

Similarly, with respect to the Due Process Clause, the North Dakota court observed that cases following Bellas Hess had not construed "minimum contacts" to require physical presence within a State as a prerequisite to the legitimate exercise of state power. The state court then concluded that "the Due Process requirement of a 'minimal connection' to establish nexus is encompassed within the Complete Auto test" and that the relevant inquiry under the latter test was whether "the state has provided some protection, opportunities, or benefit for which it can expect a return." 470 N.W.2d, at 216.

Turning to the case at hand, the state court emphasized that North Dakota had
created "an economic climate that fosters demand for" Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill into the State every year. Id., at 218-219. Based on these facts, the court concluded that Quill's "economic presence" in North Dakota depended on services and benefits provided by the State and therefore generated "a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax." Id., at 219. [FN2]

FN2. The court also suggested that, in view of the fact that the "touchstone of Due Process is fundamental fairness" and that the "very object" of the Commerce Clause is protection of interstate business against discriminatory local practices, it would be ironic to exempt Quill from this burden and thereby allow it to enjoy a significant competitive advantage over local retailers. 470 N.W.2d, at 214-215.

II

[1] As in a number of other cases involving the application of state taxing statutes to out-of-state sellers, our holding in Bellas Hess relied on both the Due Process Clause and the Commerce Clause. Although the "two claims are closely related," Bellas Hess, 386 U.S., at 756, 87 S.Ct., at 1391, the Clauses pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause. See, e.g., Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).

The two constitutional requirements differ fundamentally, in several ways. As discussed at greater length below, see Part IV, infra, the Due Process Clause and the Commerce Clause reflect different constitutional concerns. Moreover, while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce, see International Shoe Co. v. Washington, 326 U.S. 310, 315, 66 S.Ct. 154, 157, 90 L.Ed. 95 (1945), it does not similarly have the power to authorize violations of the Due Process Clause.

Thus, although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.

"'Due process' and 'commerce clause' conceptions are not always sharply separable in dealing with these problems.... To some extent they overlap. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes 'undue.' But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with
economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones. International Harvester Co. v. Department of Treasury, 322 U.S. 340, 353, 64 S.Ct. 1019, 1032-1033, 88 L.Ed. 1313 (1944) (Rutledge, J., concurring in part and dissenting in part).

Heeding Justice Rutledge's counsel, we consider each constitutional limit in turn.

III

[2][3] The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954), and that the "income attributed to the State for tax purposes must be rationally related to **1910 'values connected with the taxing State,' " Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197 (1978) (citation omitted). Here, we are concerned primarily with the first of these requirements. Prior to Bellas Hess, we had held that that requirement was satisfied in a variety of circumstances involving use taxes. For example, the presence of sales personnel in the State [FN3] or the maintenance of local retail stores in the State [FN4] justified the exercise of that power because the seller's local activities were "plainly accorded the protection and services of the taxing State." Bellas Hess, 386 U.S., at 757, 87 S.Ct., at 1391. The furthest extension of that power was recognized in Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), in which the Court upheld a use tax despite the fact that all of the seller's in-state solicitation was performed by independent contractors. These cases all involved some sort of physical presence within the State, and in Bellas Hess *307 the Court suggested that such presence was not only sufficient for jurisdiction under the Due Process Clause, but also necessary. We expressly declined to obliterate the "sharp distinction ... between mail-order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as a part of a general interstate business." 386 U.S., at 758, 87 S.Ct., at 1392.


Our due process jurisprudence has evolved substantially in the 25 years since Bellas
Hess, particularly in the area of judicial jurisdiction. Building on the seminal case of International Shoe Co. v. Washington, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945), we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" Id., at 316, 66 S.Ct., at 158 (quoting Milliken v. Meyer, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940)). In that spirit, we have abandoned more formalistic tests that focused on a defendant's "presence" within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State. In Shaffer v. Heitner, 433 U.S. 186, 212, 97 S.Ct. 2569, 2584, 53 L.Ed.2d 683 (1977), the Court extended the flexible approach that International Shoe had prescribed for purposes of in personam jurisdiction to in rem jurisdiction, concluding that "all assertions of state-court jurisdiction must be evaluated according to the standards set forth in International Shoe and its progeny."

Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State. As we explained in Burger King Corp. v. Rudzewicz, 471 U.S. 462, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985):

"Jurisdiction in these circumstances may not be avoided merely because the defendant did not physically *308 enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat **1911 personal jurisdiction there." Id., at 476, 105 S.Ct. at 2184 (emphasis in original).

Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has "fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." Shaffer v. Heitner, 433 U.S., at 218, 97 S.Ct., at 2587 (STEVENS, J., concurring in judgment). In "modern commercial life" it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. Thus,
to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.

[4] In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

*309 IV

[5] Article I, § 8, cl. 3, of the Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." It says nothing about the protection of interstate commerce in the absence of any action by Congress. Nevertheless, as Justice Johnson suggested in his concurring opinion in Gibbons v. Ogden, 9 Wheat. 1, 231-232, 239, 6 L.Ed. 23 (1824), the Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well. The Clause, in Justice Stone's phrasing, "by its own force" prohibits certain state actions that interfere with interstate commerce. South Carolina State Highway Dept. v. Barnwell Brothers, Inc., 303 U.S. 177, 185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938).

[6] Our interpretation of the "negative" or "dormant" Commerce Clause has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers. See generally P. Hartman, Federal Limitations on State and Local Taxation §§ 2:9-2:17 (1981). Our early cases, beginning with Brown v. Maryland, 12 Wheat. 419, 6 L.Ed. 678 (1827), swept broadly, and in Leloup v. Port of Mobile, 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. See, e.g., Sanford v. Poe, 69 F. 546 (CA6 1895), aff'd sub nom. Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 220, 17 S.Ct. 305, 308, 41 L.Ed. 683 (1897). Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256-258, 58 S.Ct. 546, 549-550, 82 L.Ed. 823 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in Freeman v. Hewit, 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would "impos[e] a direct tax on
interstate sales." Most recently, in Complete Auto Transit, Inc. v. Brady, 430 U.S., at 285, 97 S.Ct., at 1082, we renounced the Freeman approach as "attaching constitutional significance to a semantic difference." We expressly overruled one of **1912 Freeman's progeny, Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951), which held that a tax on "the privilege of doing interstate business" was unconstitutional, while recognizing that a differently denominated tax with the same economic effect would not be unconstitutional.

Spector, as we observed in Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441, 79 S.Ct. 411, 416, 3 L.Ed.2d 450 (1959), created a situation in which "magic words or labels" could "disable an otherwise constitutional levy." Complete Auto emphasized the importance of looking past "the formal language of the tax statute [to] its practical effect," 430 U.S., at 279, 97 S.Ct., at 1079, and set forth a four-part test that continues to govern the validity of state taxes under the Commerce Clause. [FN5]

FN5. Under our current Commerce Clause jurisprudence, "with certain restrictions, interstate commerce may be required to pay its fair share of state taxes." D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31, 108 S.Ct. 1619, 1623, 100 L.Ed.2d 21 (1988); see also Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-624, 101 S.Ct. 2946, 2957, 69 L.Ed.2d 884 (1981) ("It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business") (internal quotation marks and citation omitted).

[7] Bellas Hess was decided in 1967, in the middle of this latest rally between formalism and pragmatism. Contrary to the suggestion of the North Dakota Supreme Court, this timing does not mean that Complete Auto rendered Bellas Hess "obsolete." Complete Auto rejected Freeman and Spector's formal distinction between "direct" and "indirect" taxes on interstate commerce because that formalism allowed the validity of statutes to hinge on "legal terminology," "draftsmanship and phraseology." 430 U.S., at 281, 97 S.Ct., at 1080. Bellas Hess *311 did not rely on any such labeling of taxes and therefore did not automatically fall with Freeman and its progeny.

While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, Bellas Hess is not inconsistent with Complete Auto and our recent cases. Under Complete Auto 's four-part test, we will sustain a tax against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S., at 279, 97 S.Ct., at 1079. Bellas Hess concerns the first of these tests
and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause.

Thus, three weeks after Complete Auto was handed down, we cited Bellas Hess for this proposition and discussed the case at some length. In National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 559, 97 S.Ct. 1386, 1392, 51 L.Ed.2d 631 (1977), we affirmed the continuing vitality of Bellas Hess' "sharp distinction ... between mail-order sellers with [a physical presence in the taxing] State and those ... who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business." We have continued to cite Bellas Hess with approval ever since. For example, in Goldberg v. Sweet, 488 U.S. 252, 263, 109 S.Ct. 582, 589, 102 L.Ed.2d 607 (1989), we expressed "doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. See National Bellas Hess ... (receipt of mail provides insufficient nexus)." See also D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626, 101 S.Ct. 2946, 2958, 69 L.Ed.2d 884 (1981); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S., at 437, 100 S.Ct., at 1231; National Geographic Society, **1913 430 U.S., at 559, 97 S.Ct., at 1391. For these reasons, we disagree with the State Supreme Court's conclusion *312 that our decision in Complete Auto undercut the Bellas Hess rule.

The State of North Dakota relies less on Complete Auto and more on the evolution of our due process jurisprudence. The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process "minimum contacts" test, then that corporation also meets the Commerce Clause "substantial nexus" test. We disagree. Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies.

Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimize the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these
structural ills. See generally The Federalist Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce, see, e.g., Philadelphia v. New Jersey, 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978), and bars state regulations that unduly burden interstate commerce, see, e.g., Kassel v. Consolidated Freightways Corp. of Del., 450 U.S. 662, 101 S.Ct. 1309, 67 L.Ed.2d 580 (1981).

*313 [8][9][10] The Complete Auto analysis reflects these concerns about the national economy. The second and third parts of that analysis, which require fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce. [FN6] Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause. [FN7]

FN6. North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the Bellas Hess rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000- plus taxing jurisdictions. See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 759-760, 87 S.Ct. 1389, 1393, 18 L.Ed.2d 505 (1967) (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations") (footnotes omitted); see also Shaviro, An Economic and Political Look at Federalism in Taxation, 90 Mich.L.Rev. 895, 925-926 (1992).

FN7. We have sometimes stated that the "Complete Auto test, while responsive to Commerce Clause dictates, encompasses as well ... due
process requirement[s]." Trinova Corp. v. Michigan Dept. of Treasury, 498 U.S. 358, 373, 111 S.Ct. 818, 828, 112 L.Ed.2d 884 (1991). Although such comments might suggest that every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause, it does not follow that the converse is as well true: A tax may be consistent with due process and yet unduly burden interstate commerce. See, e.g., Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).

*314 The State Supreme Court reviewed our recent Commerce Clause decisions and concluded that those rulings signaled a "retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach" and thus supported its decision not to apply Bellas Hess. 470 N.W.2d, at 214 (citing Standard Pressed Steel Co. v. Department of Revenue of Wash., 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719 (1975), and Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987)). Although we agree with the state court's assessment of the evolution of our cases, we do not share its conclusion that the Commerce Clause ruling of Bellas Hess is no longer good law.

First, as the state court itself noted, 470 N.W.2d, at 214, all of these cases involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of Bellas Hess or compel that it be overruled. Second, and more importantly, although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established "bright-line" tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that Bellas Hess established for sales and use taxes, that silence does not imply repudiation of the Bellas Hess rule.

Complete Auto, it is true, renounced Freeman and its progeny as "formalistic." But not all formalism is alike. Spector 's formal distinction between taxes on the "privilege of doing business" and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood "only as a trap for the unwary draftsman." Complete Auto, 430 U.S., at 279, 97 S.Ct. at 1079. In contrast, the bright-line rule of Bellas Hess furthers the ends of the dormant Commerce Clause. Undue *315 burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. Bellas Hess followed the latter approach and created a safe harbor for vendors "whose only connection with customers in the [taxing] State is by common carrier or the United
States mail." Under Bellas Hess, such vendors are free from state-imposed duties to collect sales and use taxes. [FN8]

FN8. In addition to its common-carrier contacts with the State, Quill also licensed software to some of its North Dakota clients. See n. 1, supra. The State "concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus." Brief for Respondent 46. We agree. Although title to "a few floppy diskettes" present in a State might constitute some minimal nexus, in National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 556, 97 S.Ct. 1386, 1390, 51 L.Ed.2d 631 (1977), we expressly rejected a " 'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.

Like other bright-line tests, the Bellas Hess rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office. Cf. National Geographic Society v. California Bd. of Equalization, **1915 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977); Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960). This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit is important, for as we have so frequently noted, our law in this area is something of a "quagmire" and the "application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of *316 taxation." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457-458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959).

Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. [FN9] Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in Bellas Hess.

FN9. It is worth noting that Congress has, at least on one occasion, followed a similar approach in its regulation of state taxation. In response to this Court's indication in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 79 S.Ct. 357, 359, 3 L.Ed.2d 421 (1959), that, so long as the taxpayer has an adequate nexus
with the taxing State, "net income from the interstate operations of a foreign corporation may be subjected to state taxation," Congress enacted Pub.L. 86-272, codified at 15 U.S.C. § 381. That statute provides that a State may not impose a net income tax on any person if that person's "only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled ... outside the State." Ibid. As we noted in Heublein, Inc. v. South Carolina Tax Comm'n, 409 U.S. 275, 280, 93 S.Ct. 483, 487, 34 L.Ed.2d 472 (1972), in enacting § 381, "Congress attempted to allay the apprehension of businessmen that 'mere solicitation' would subject them to state taxation.... Section 381 was designed to define clearly a lower limit for the exercise of [the State's power to tax]. Clarity that would remove uncertainty was Congress' primary goal." (Emphasis supplied.)

Notwithstanding the benefits of bright-line tests, we have, in some situations, decided to replace such tests with more contextual balancing inquiries. For example, in Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983), we reconsidered a bright-line test set forth in Public Util. Comm'n of R.I. v. Attleboro Steam & Electric Co., 273 U.S. 83, 47 S.Ct. 294, 71 L.Ed. 54 (1927). Attleboro distinguished between state regulation of wholesale sales of electricity, which was constitutional as an "indirect" regulation of interstate commerce, and state regulation of retail sales of electricity, which was unconstitutional as a "direct regulation" of commerce. In Arkansas Electric, we considered whether to follow the mechanical test set out in Attleboro, or the balance-of-interests test applied in our Commerce Clause cases.” 461 U.S., at 390-391, 103 S.Ct., at 1916. We first observed that "the principle of stare decisis counsels us, here as elsewhere, not lightly to set aside specific guidance of the sort we find in Attleboro." Id., at 391, 103 S.Ct., at 1916. In deciding to reject the Attleboro analysis, we were influenced by the fact that the "mechanical test" was "anachronistic," that the Court had rarely relied on the test, and that we could "see no strong reliance interests" that would be upset by the rejection of that test. 461 U.S., at 391-392, 103 S.Ct., at 1916. None of those factors obtains in this case. First, the Attleboro rule was "anachronistic" because it relied on formal distinctions between "direct" and "indirect" regulation (and on the regulatory counterparts of our Freeman line of cases); as discussed above, Bellas Hess turned on a different logic and thus remained sound after the Court repudiated an analogous distinction in Complete Auto. Second, unlike the Attleboro rule, we have, in our decisions, frequently relied on the Bellas Hess rule in the last 25 years, see supra, at 1912, and we have never intimated in our review of sales or use taxes that Bellas Hess was unsound. Finally, again unlike the Attleboro rule, the Bellas Hess rule has
engendered substantial reliance and has become part of the basic framework of a sizable industry. The "interest in stability and orderly development of the law" that undergirds the doctrine of stare decisis, see Runyon v. McCrary, 427 U.S. 160, 190-191, 96 S.Ct. 2586, 2604-2605, 49 L.Ed.2d 415 (1976) (STEVENS, J., concurring), therefore counsels adherence to settled precedent.

In sum, although in our cases subsequent to 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 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 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 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, [FN10] 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. See Prudential Insurance Co. v. Benjamin, 328 U.S. 408, 66 S.Ct. 1142, 90 L.Ed. 1342 (1946). Indeed, in recent years Congress has considered legislation that would "overrule" the Bellas Hess rule. [FN11] Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in 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.

FN10. Many States have enacted use taxes. See App. 3 to Brief for Direct Marketing Association as Amicus Curiae. An overruling of Bellas Hess might raise thorny questions concerning the retroactive application of those taxes and might trigger substantial unanticipated liability for mail-order houses. The precise allocation of such burdens is better resolved by Congress rather than this Court.


Indeed, even if we were convinced that 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.' Commonwealth Edison Co. v. Montana, 453 U.S., at 637, 101 S.Ct., at 2964, (WHITE, J., concurring). In this situation, it *319 may be that "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government." Id., at 638, 101 S.Ct., at 2964.

The judgment of the Supreme Court of North Dakota is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

*321 Justice WHITE, concurring in part and dissenting in part.

Today the Court repudiates that aspect of our decision in National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), which restricts, under the Due Process Clause of the Fourteenth Amendment, the power of the States to impose use tax collection responsibilities **1917 on out-*322 of-state mail-order businesses that do not have a "physical presence" in the State. The Court stops short, however, of giving Bellas Hess the complete burial it justly deserves. In my view, the Court should also overrule that part of Bellas Hess which justifies its holding under the Commerce Clause. I, therefore, respectfully dissent from Part IV.

In Part IV of its opinion, the majority goes to some lengths to justify the Bellas Hess physical-presence requirement under our Commerce Clause jurisprudence. I am unpersuaded by its interpretation of our cases. In Bellas Hess, the majority placed great weight on the interstate quality of the mail-order sales, stating that "it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." Id., at 759, 87 S.Ct., at 1392. As the majority correctly observes, the idea of prohibiting States from taxing "exclusively interstate" transactions had been an important part of our jurisprudence for many decades, ranging intermittently from such cases as Case of State Freight Tax, 15 Wall. 232, 279, 21 L.Ed. 146 (1873), through Freeman v. Hewit, 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), and Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 573 (1951). But though it recognizes that Bellas Hess was decided amidst an upheaval in our Commerce Clause jurisprudence, in which we began to hold that "a State, with proper drafting, may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause," Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 285, 97 S.Ct. 1076, 1082, 51 L.Ed.2d 326 (1977), the majority draws entirely the wrong conclusion from this period of ferment.
The Court attempts to paint Bellas Hess in a different hue from Freeman and Spector because the former "did not rely" on labeling taxes that had "direct" and "indirect" effects on interstate commerce. See ante, at 1912. Thus, the Court concludes, Bellas Hess "did not automatically fall with Freeman *323 and its progeny" in our decision in Complete Auto. See ante, at 11. I am unpersuaded by this attempt to distinguish Bellas Hess from Freeman and Spector, both of which were repudiated by this Court. See Complete Auto, supra, at 288-289, and n. 15, 97 S.Ct., at 1084, and n. 15. What we disavowed in Complete Auto was not just the "formal distinction between 'direct' and 'indirect' taxes on interstate commerce," ante, at 1912, but also the whole notion underlying the Bellas Hess physical-presence rule--that "interstate commerce is immune from state taxation," Complete Auto, supra, at 288, 97 S.Ct., at 1083.

The Court compounds its misreading by attempting to show that Bellas Hess "is not inconsistent with Complete Auto and our recent cases." Ante, at 1912. This will be news to commentators, who have rightly criticized Bellas Hess. [FN1] Indeed, the majority displays no small amount of audacity in claiming that our decision in National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 559, 97 S.Ct. 1386, 1391, 51 L.Ed.2d 631 (1977), which was rendered several weeks after Complete Auto, reaffirmed the continuing vitality of Bellas Hess. See ante, at 1912.

Our decision in that case did just the opposite. National Geographic held that the National Geographic Society was liable for use tax collection responsibilities in California. **1918 The Society conducted an out-of-state mail-order business similar to the one at issue here and in Bellas Hess, and in addition, maintained two small offices in California that solicited advertisements for National Geographic Magazine. The Society argued that its physical presence in California was unrelated to its mail-order sales, and thus that the Bellas *324 Hess rule compelled us to hold that the tax collection responsibilities could not be imposed. We expressly rejected that view, holding that the "requisite nexus for requiring an out-of-state seller [the Society] to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate

some definite link, some minimum connection, between (the State and) the person ... it seeks to tax." 430 U.S., at 561, 97 S.Ct., at 1393 (citation omitted).

By decoupling any notion of a transactional nexus from the inquiry, the National Geographic Court in fact repudiated the free trade rationale of the Bellas Hess majority. Instead, the National Geographic Court relied on a due process-type minimum contacts analysis that examined whether a link existed between the seller and the State wholly apart from the seller's in-state transaction that was being taxed. Citations to Bellas Hess notwithstanding, see 430 U.S., at 559, 97 S.Ct., at 1391, it is clear that rather than adopting the rationale of Bellas Hess, the National Geographic Court was instead politely brushing it aside. Even were I to agree that the free trade rationale embodied in Bellas Hess' rule against taxes of purely interstate sales was required by our cases prior to 1967, therefore, I see no basis in the majority's opening premise that this substantive underpinning of Bellas Hess has not since been disavowed by our cases.

[FN2]

FN2. Similarly, I am unconvinced by the majority's reliance on subsequent decisions that have cited Bellas Hess. See ante, at 1912. In D. H. Holmes Co. v. McNamara, 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988), for example, we distinguished Bellas Hess on the basis of the company's "significant economic presence in Louisiana, its many connections with the State, and the direct benefits it receives from Louisiana in conducting its business." We then went on to note that the situation presented was much more analogous to that in National Geographic Society v. California Bd. of Equalization, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). See 486 U.S., at 33-34, 108 S.Ct., at 1624-1625. In Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626, 101 S.Ct. 2946, 2958, 69 L.Ed.2d 884 (1981), the Court cited Bellas Hess not to revalidate the physical-presence requirement, but rather to establish that a "nexus" must exist to justify imposition of a state tax. And finally, in Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 437, 100 S.Ct. 1223, 1231, 63 L.Ed.2d 510 (1980), the Court cited Bellas Hess for the due process requirements necessary to sustain a tax. In my view, these citations hardly signal the continuing support of Bellas Hess that the majority seems to find persuasive.

*325 II

The Court next launches into an uncharted and treacherous foray into differentiating between the "nexus" requirements under the Due Process and Commerce Clauses. As the Court explains: "Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated
by different constitutional concerns and policies."

Ante, at 1913. The due process nexus, which the Court properly holds is met in this case, see ante, at Part III, "concerns the fundamental fairness of governmental activity." Ante, at 1913. The Commerce Clause nexus requirement, on the other hand, is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." Ibid.

Citing Complete Auto, the Court then explains that the Commerce Clause nexus requirement is not "like due process 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." Ante, at 1913. This is very curious, because parts two and three **1919 of the Complete Auto test, which require fair apportionment and nondiscrimination in order that interstate commerce not be unduly burdened, now appear to become the animating features of the nexus requirement, which is the first prong of the Complete Auto inquiry. The Court freely acknowledges that there is no authority for this novel interpretation of our cases and that we have never before found, as we do in this case, sufficient contacts for due process purposes but an insufficient nexus under the Commerce Clause. See ante, at 1913-1914, and n. 6.

The majority's attempt to disavow language in our opinions acknowledging the presence of due process requirements *326 in the Complete Auto test is also unpersuasive. See ante, at 1913-1914, n. 7 (citing Trinova Corp. v. Michigan Dept. of Treasury, 498 U.S. 358, 373, 111 S.Ct. 818, 828, 112 L.Ed.2d 884 (1991)). Instead of explaining the doctrinal origins of the Commerce Clause nexus requirement, the majority breezily announces the rule and moves on to other matters. See ante, at 1913-1914. In my view, before resting on the assertion that the Constitution mandates inquiry into two readily distinct "nexus" requirements, it would seem prudent to discern the origins of the "nexus" requirement in order better to understand whether the Court's concern traditionally has been with the fairness of a State's tax or some other value.

The cases from which the Complete Auto Court derived the nexus requirement in its four-part test convince me that the issue of "nexus" is really a due process fairness inquiry. In explaining the sources of the four-part inquiry in Complete Auto, the Court relied heavily on Justice Rutledge's separate concurring opinion in Freeman v. Hewit, 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946), the case whose majority opinion the Complete Auto Court was in the process of comprehensively disavowing. Instead of the formalistic inquiry into whether the State was taxing interstate commerce, the Complete Auto Court adopted the more functionalist approach of Justice Rutledge in Freeman. See Complete Auto, 430 U.S., at 280-281, 97 S.Ct., at 1079-1080. In conducting his inquiry, Justice Rutledge used language that by now should be familiar, arguing that a tax was unconstitutional if the activity lacked a
sufficient connection to the State to give "jurisdiction to tax," Freeman, supra, at 271, 67 S.Ct., at 286; or if the tax discriminated against interstate commerce; or if the activity was subjected to multiple tax burdens. 329 U.S., at 276-277, 67 S.Ct., at 289-290. Justice Rutledge later refined these principles in Memphis Natural Gas Co. v. Stone, 335 U.S. 80, 68 S.Ct. 1475, 92 L.Ed. 1832 (1948), in which he described the principles that the Complete Auto Court would later substantially adopt: "[i]t is enough for me to sustain the tax imposed in this case that it is one clearly within the state's power to lay insofar as any limitation of due process or 'jurisdiction to tax' in that sense is concerned; it is nondiscriminatory ...; [it] is duly apportioned ...; and cannot be repeated by any other state." 335 U.S., at 96-97, 68 S.Ct., at 1483-1484 (concurring opinion) (footnotes omitted).

By the time the Court decided Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959), Justice Rutledge was no longer on the Court, but his view of the nexus requirement as grounded in the Due Process Clause was decisively adopted. In rejecting challenges to a state tax based on the Due Process and Commerce Clauses, the Court stated: "[T]he taxes imposed are levied only on that portion of the taxpayer's net income which arises from its activities within the taxing State. These activities form a sufficient 'nexus between such a tax and transactions within a state for which the tax is an exaction.' " Id., at 464, 79 S.Ct., at 366 (citation omitted). The Court went on to observe that "[i]t strains reality to say, in terms of our decisions, that each of the corporations here was not sufficiently involved in local events to forge 'some definite link, some minimum connection' sufficient to satisfy due process requirements." **1920 Id., at 464-465, 79 S.Ct., at 366 (quoting Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-345, 74 S.Ct. 535, 538-539, 98 L.Ed. 744 (1954)). When the Court announced its four-part synthesis in Complete Auto, the nexus requirement was definitely traceable to concerns grounded in the Due Process Clause, and not the Commerce Clause, as the Court's discussion of the doctrinal antecedents for its rule made clear. See Complete Auto, supra, at 281-282, 285, 97 S.Ct., at 1080-1081, 1082. For the Court now to assert that our Commerce Clause jurisprudence supports a separate notion of nexus is without precedent or explanation.

Even were there to be such an independent requirement under the Commerce Clause, there is no relationship between the physical-presence/nexus rule the Court retains and Commerce Clause considerations that allegedly justify it. Perhaps long ago a seller's "physical presence" was a sufficient part of a trade to condition imposition of a tax on such presence. But in today's economy, physical presence frequently has very little to do with a transaction a State might seek to tax. Wire transfers of money involving billions of dollars occur every day; purchasers place orders with sellers by fax, phone, and computer linkup; sellers
ship goods by air, road, and sea through sundry delivery services without leaving their place of business. It is certainly true that the days of the door-to-door salesperson are not gone. Nevertheless, an out-of-state direct marketer derives numerous commercial benefits from the State in which it does business. These advantages include laws establishing sound local banking institutions to support credit transactions; courts to ensure collection of the purchase price from the seller's customers; means of waste disposal from garbage generated by mail-order solicitations; and creation and enforcement of consumer protection laws, which protect buyers and sellers alike, the former by ensuring that they will have a ready means of protecting against fraud, and the latter by creating a climate of consumer confidence that inures to the benefit of reputable dealers in mail-order transactions.

To create, for the first time, a nexus requirement under the Commerce Clause independent of that established for due process purposes is one thing; to attempt to justify an anachronistic notion of physical presence in economic terms is quite another.

III

The illogic of retaining the physical-presence requirement in these circumstances is palpable. Under the majority's analysis, and our decision in National Geographic, an out-of-state seller with one salesperson in a State would be subject to use tax collection burdens on its entire mail-order sales even if those sales were unrelated to the salesperson's solicitation efforts. By contrast, an out-of-state seller in a neighboring State could be the dominant business in the putative taxing State, creating the greatest infrastructure burdens and undercutting the State's home companies by its comparative price advantage in selling products free of use taxes, and yet not have to collect such taxes if it lacks a physical presence in the taxing State. The majority clings to the physical-presence rule not because of any logical relation to fairness or any economic rationale related to principles underlying the Commerce Clause, but simply out of the supposed convenience of having a bright-line rule. I am less impressed by the convenience of such adherence than the unfairness it produces. Here, convenience should give way. Cf. Complete Auto, supra, at 289, n. 15, 97 S.Ct., at 1084 n. 15 ("We believe, however, that administrative convenience ... is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way'").

Also very questionable is the rationality of perpetuating a rule that creates an interstate tax shelter for one form of business--mail-order sellers--but no countervailing advantage for its competitors. If the Commerce Clause was intended to put businesses on an even playing field, the majority's rule is hardly a way to achieve that goal. Indeed, arguably even under the majority's explanation for its "Commerce Clause nexus" requirement, the unfairness of its rule on retailers other than direct marketers should be taken into account. See ante, at 1913 (stating that the Commerce
Clause nexus requirement addresses the "structural concerns about the effects of state regulation on the national economy"). I would think that protectionist rules favoring a $180- billion-a-year industry might come within the scope of such "structural concerns." See Brief for State of New Jersey as Amicus Curiae 4.

IV

The Court attempts to justify what it rightly acknowledges is an "artificial" rule in several ways. See ante, at 1914. First, it asserts that the Bellas Hess principle "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." Ante, at 1915. It is very doubtful, however, that the Court's opinion can achieve its aims. Certainly our cases now demonstrate two "bright-line" rules for mail-order sellers to follow: Under the physical-presence requirement reaffirmed here, they will not be subjected to use tax collection if they have no physical presence in the taxing State; under the National Geographic rule, mail-order sellers will be subject to use tax collection if they have some presence in the taxing State even if that activity has no relation to the transaction being taxed. See National Geographic, 430 U.S., at 560-562, 97 S.Ct., at 1392-1393. Between these narrow lines lies the issue of what constitutes the requisite "physical presence" to justify imposition of use tax collection responsibilities.

Instead of confronting this question head on, the majority offers only a cursory analysis of whether Quill's physical presence in North Dakota was sufficient to justify its use tax collection burdens, despite briefing on this point by the State. [FN3] See Brief for Respondent 45-47. North Dakota contends that even should the Court reaffirm the Bellas Hess rule, Quill's physical presence in North Dakota was sufficient to justify application of its use tax collection law. Quill concedes it owns software sent to its North Dakota customers, but suggests that such property is insufficient to justify a finding of nexus. In my view, the question of Quill's actual physical presence is sufficiently close to cast doubt on the majority's confidence that it is propounding a truly "bright-line" rule. Reasonable minds surely can, and will, differ over what showing is required to make out a "physical presence" adequate to justify imposing responsibilities for use tax collection. And given the estimated loss in revenue to States of more than $3.2 billion this year alone, see Brief for Respondent 9, it is a sure bet that the vagaries of "physical presence" will be tested to their fullest in our courts.

FN3. Instead of remanding for consideration of whether Quill's ownership of software constitutes sufficient physical presence under its new Commerce Clause nexus requirement, the majority concludes as a matter of law that it does not. See ante, at 1914, n. 8. In so doing, the majority rebuffs North Dakota's challenge without setting out any
clear standard for what meets the Commerce Clause physical-presence nexus standard and without affording the State an opportunity on remand to attempt to develop facts or otherwise to argue that Quill's presence is constitutionally sufficient.

The majority next explains that its "bright-line" rule encourages "settled expectations" and business investment. Ante, at 1914-1915. Though legal certainty promotes business confidence, the mail-order business has grown exponentially despite the long line of our post-Bellas Hess precedents that signaled the demise of the physical-presence requirement. Moreover, the Court's seeming but inadequate justification of encouraging settled expectations in fact connotes a substantive economic decision to favor out-of-state direct marketers to the detriment of other retailers. By justifying the Bellas Hess rule in terms of "the mail-order industry's dramatic growth over the last quarter century," ante, at 1915, the Court is effectively imposing its own economic preferences in deciding this case. The Court's invitation to Congress to legislate in this area signals that its preferences are not immutable, but its approach is different from past instances in which we have deferred to state legislatures when they enacted tax obligations on the States' shares of interstate commerce. See, e.g., Goldberg v. Sweet, 488 U.S. 252, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981).

Finally, the Court accords far greater weight to stare decisis than was given to that principle in Complete Auto itself. As that case demonstrates, we have not been averse to overruling our precedents under the Commerce Clause when they have become anachronistic in light of later decisions. See Complete Auto, 430 U.S., at 288-289, 97 S.Ct., at 1083-1084. One typically invoked rationale for stare decisis--an unwillingness to upset settled expectations--is particularly weak in this case. It is unreasonable for companies such as Quill to invoke a "settled expectation" in conducting affairs without being taxed. Neither Quill nor any of its amici point to any investment decisions or reliance interests that suggest any unfairness in overturning Bellas Hess. And the costs of compliance with the rule, in light of today's modern computer and software technology, appear to be nominal. See Brief for Respondent 40; Brief for State of New Jersey as Amicus Curiae 18. To the extent Quill developed any reliance on the old rule, I would submit that its reliance was unreasonable because of its failure to comply with the law as enacted by the North Dakota State Legislature. Instead of rewarding companies for ignoring the studied judgments of duly elected officials, we should insist that the appropriate way to challenge a tax as unconstitutional is to pay it (or in this case collect it and remit it or place it in escrow) and then sue for declaratory judgment and refund. [FN4] Quill's refusal to comply with a state tax statute prior to its being held unconstitutional hardly merits a
determination that its reliance interests were reasonable.


The Court hints, but does not state directly, that a basis for its invocation of stare decisis is a fear that overturning Bellas Hess will lead to the imposition of retroactive liability. Ante, at 1916, and n. 10. See James B. Beam Distilling Co. v. Georgia, 501 U.S. 529, 111 S.Ct. 2439, 115 L.Ed.2d 481 (1991). As I thought in that case, such fears are groundless because no one can "sensibly insist on automatic retroactivity for any and all judicial decisions in the federal system." Id., at 546, 111 S.Ct., at 2449 (WHITE, J., concurring in judgment). Since we specifically limited the question on which certiorari was granted in order not to consider the potential retroactive effects of overruling Bellas Hess, I believe we should leave that issue for another day. If indeed fears about retroactivity are driving the Court's decision in this case, we would be better served, in my view, to address those concerns directly rather than permit them to infect our formulation of the applicable substantive rule.

Although Congress can and should address itself to this area of law, we should not adhere to a decision, however right it was at the time, by reason of later cases and economic reality can no longer be rationally justified. The Commerce Clause aspect of Bellas Hess, along with its due process holding, should be overruled.

**1923 *319** Justice SCALIA, with whom Justice KENNEDY and Justice THOMAS join, concurring in part and concurring in the judgment.

National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), held that the Due Process and Commerce Clauses of the Constitution prohibit a State from imposing the duty of use-tax collection and payment upon a seller whose only connection with the State is through common carrier or the United States mail. I agree with the Court that the Due Process Clause holding of Bellas Hess should be overruled. Even before Bellas Hess, we had held, correctly I think, that state regulatory jurisdiction could be asserted on the basis of contacts with the State through the United States mail. See Travelers Health Assn. v. Virginia ex rel. State Corp. Comm'n, 339 U.S. 643, 646-650, 70 S.Ct. 927, 928- 931, 94 L.Ed. 1154 (1950) (blue sky laws). It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax. As an original matter, it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected

I also agree that the Commerce Clause holding of Bellas Hess should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of stare decisis. American Trucking Assns., Inc. v. Smith, 496 U.S. 167, 204, 110 S.Ct. 2323, 2345, 110 L.Ed.2d 148 (1990) (SCALIA, J., concurring in judgment). Congress has the final say over regulation of interstate commerce, and it can change the rule of Bellas Hess by simply saying so. We have long recognized that the doctrine of stare decisis has "special force" where "Congress remains free to alter what we have done." Patterson v. McLean Credit Union, 491 U.S. 164, 172-173, 109 S.Ct. 2363, 2370, 105 L.Ed.2d 132 (1989). See also Hilton v. South Carolina Public Railways Comm'n, 502 U.S. 197, 202, 112 S.Ct. 560, 564, 116 L.Ed.2d 560 (1991); Illinois Brick Co. v. Illinois, 431 U.S. 720, 736, 97 S.Ct. 2061, 2069, 52 L.Ed.2d 707 (1977). Moreover, the demands of the doctrine are "at their acme ... where reliance interests are involved." Payne v. Tennessee, 501 U.S. 808, 828, 111 S.Ct. 2597, 2610, 115 L.Ed.2d 720 (1991). As the Court notes, "the Bellas Hess rule has engendered substantial reliance and has become part of the basic framework of a sizable industry." Ante, at 1916.

I do not share Justice WHITE's view that we may disregard these reliance interests because it has become unreasonable to rely upon Bellas Hess. Post, at 1922. Even assuming for the sake of argument (I do not consider the point) that later decisions in related areas are inconsistent with the principles upon which Bellas Hess rested, we have never acknowledged that, but have instead carefully distinguished the case on its facts. See, e.g., D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33, 108 S.Ct. 1619, 1624, 100 L.Ed.2d 21 (1988); National Geographic Society, supra, 430 U.S., at 559, 97 S.Ct., at 1391. It seems to me important that we retain our ability--and, what comes to the **1924 same thing, that *321 we maintain public confidence in our ability--sometimes to adopt new principles for the resolution of new issues without abandoning clear holdings of the past that those principles contradict. We
seemed to be doing that in this area. Having affirmatively suggested that the "physical presence" rule could be reconciled with our new jurisprudence, we ought not visit economic hardship upon those who took us at our word. We have recently told lower courts that "[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484, 109 S.Ct. 1917, 1921, 104 L.Ed.2d 526 (1989). It is strangely incompatible with this to demand that private parties anticipate our overrulings. It is my view, in short, that reliance upon a square, unabandoned holding of the Supreme Court is always justifiable reliance (though reliance alone may not always carry the day). Finally, the "physical presence" rule established in Bellas Hess is not "unworkable," Patterson, supra 491 U.S., at 173, 109 S.Ct., at 2370, to the contrary, whatever else may be the substantive pros and cons of the rule, the "bright-line" regime that it establishes, see ante, at 1914-1915, is unqualifiedly in its favor. Justice WHITE's concern that reaffirmance of Bellas Hess will lead to a flurry of litigation over the meaning of "physical presence," see post, at 1921, seems to me contradicted by 25 years of experience under the decision.

For these reasons, I concur in the judgment of the Court and join Parts I, II, and III of its opinion.
Supreme Court of the United States
OKLAHOMA TAX COMMISSION, Petitioner, v. JEFFERSON LINES, INC.

No. 93-1677.

Argued Nov. 28, 1994.

Oklahoma Tax Commission sought payment of unpaid sales tax on gross price of interstate bus tickets sold by taxpayer in Oklahoma prior to filing of taxpayer's Chapter 11 petition. The United States Bankruptcy Court for the District of Minnesota, Dennis D. O'Brien, Chief Judge, determined that tax violated commerce clause, and Oklahoma Tax Commission appealed. The District Court, Donald D. Alsop, Senior District Judge, affirmed, and Oklahoma Tax Commission took further appeal. The Court of Appeals for the Eighth Circuit, 15 F.3d 90, affirmed, and Oklahoma Tax Commission petitioned for writ of certiorari. The Supreme Court, Justice Souter, held that: (1) Oklahoma's sales tax on full price of ticket for bus travel from Oklahoma to another state was sufficiently apportioned to satisfy dormant commerce clause; tax was both internally consistent, in that if every state were to impose identical tax no sale would be subject to more than one state's tax, and externally consistent, in that if every state were to impose identical tax no sale would be subject to more than one state's tax, and externally consistent, known as dormant commerce clause, prohibiting certain state taxation even when Congress has failed to legislate on subject. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[1] Commerce

State tax does not violate dormant commerce clause when tax is applied to activity with substantial nexus with taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by state. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[2] Commerce

Sale of ticket in Oklahoma for bus travel from Oklahoma to another state had sufficient nexus to Oklahoma to be treated as local transaction subject to Oklahoma sales tax, under dormant commerce clause. U.S.C.A. Const. Art. 1, § 8, cl. 3: 68 Okl.St.Ann. § 1354, subd. 1(C).

[3] Commerce

Oklahoma's sales tax on full price of ticket for bus travel from Oklahoma to another state did not violate dormant commerce clause.

[4] Commerce

Oklahoma's sales tax on full price of ticket for bus travel from Oklahoma to another state was sufficiently apportioned to satisfy dormant commerce clause; tax was both internally consistent, in that if every state were to impose identical tax no sale would be subject to more than one state's tax, and externally consistent,
because sale and partial delivery could not be duplicated as taxable event in any other state, and there was no possibility of successive taxation so closely related to transaction as to indicate potential unfairness of Oklahoma's tax on full amount of sale. **U.S.C.A. Const. Art. 1, § 8, cl. 3; 68 Okl.St.Ann. § 1354, subd. 1(C).**

[5] Commerce $\text{\foreignlanguage{en}{\textit{\$62.80}}}$
83k62.80 Most Cited Cases
For purposes of apportionment analysis under dormant commerce clause, tax is "internally consistent" when imposition of tax identical to one in question by every other state would add no burden to interstate commerce that intrastate commerce would not also bear; test asks nothing about degree of economic reality reflected by tax, but simply looks to structure of tax at issue to see whether its identical application by every state would place interstate commerce at disadvantage as compared with commerce intrastate. **U.S.C.A. Const. Art. 1, § 8, cl. 3.**

[6] Commerce $\text{\foreignlanguage{en}{\textit{\$62.80}}}$
83k62.80 Most Cited Cases
For purposes of apportionment analysis under dormant commerce clause, determination of external consistency of tax looks not to logical consequences of cloning of tax by other states, but to economic justification for state's claim upon value taxed, to discover whether state's tax reaches beyond that portion of value that is fairly attributable to economic activity within taxing state; threat of real multiple taxation, though not by literally identical statute, may indicate state's impermissible reaching. **U.S.C.A. Const. Art. 1, § 8, cl. 3.**

[7] Commerce $\text{\foreignlanguage{en}{\textit{\$74.5(1)}}}$
83k74.5(1) Most Cited Cases
For purposes of determining whether sales tax is properly apportioned under dormant commerce clause, sale of goods is most readily viewed as discrete event facilitated by laws and amenities in place of sale, and transaction itself does not readily reveal extent to which completed or anticipated interstate activity affects value on which buyer is taxed, with result that taxation of sales based on gross charge, without any division of tax base among states, will consistently be upheld, even where parties to sales contract specifically contemplate interstate movement of goods either immediately before or after transfer of ownership. **U.S.C.A. Const. Art. 1, § 8, cl. 3.**

[8] Commerce $\text{\foreignlanguage{en}{\textit{\$62.80}}}$
83k62.80 Most Cited Cases
Commerce clause does not forbid actual assessment of succession of taxes by different states on different events as same tangible object flows along. **U.S.C.A. Const. Art. 1, § 8, cl. 3.**

[9] Commerce $\text{\foreignlanguage{en}{\textit{\$74.5(1)}}}$
83k74.5(1) Most Cited Cases
For purposes of determining whether sales tax is properly apportioned under dormant commerce clause, sale of services can ordinarily be treated as local state event just as readily as sale of tangible goods can be located within state of delivery, and it need not be treated in same manner as tax on gross receipts from sales of services, which must be apportioned to reflect location of various interstate activities by which it was earned. **U.S.C.A. Const. Art. 1, § 8, cl. 3.**

[10] Commerce $\text{\foreignlanguage{en}{\textit{\$74.5(2)}}}$
83k74.5(2) Most Cited Cases
Fact that Oklahoma could feasibly apportion its sales tax on tickets for bus travel from Oklahoma to other states on basis of mileage did not establish that sales tax was not properly apportioned under dormant commerce clause. **U.S.C.A. Const. Art. 1, § 8, cl. 3; 68 Okl.St.Ann. § 1354, subd. 1(C).**

[11] Commerce $\text{\foreignlanguage{en}{\textit{\$74.5(2)}}}$
Oklahoma's sales tax on full price of ticket for bus travel from Oklahoma to another state did not discriminate against interstate commerce, in violation of dormant commerce clause, even if dividing Oklahoma sales taxes by in-state miles to be traveled produced an average higher figure when interstate trips were sold than when sale was of wholly domestic journey; as with tax on sale of tangible goods, potential for interstate movement after sale had no bearing on reason for sales tax. U.S.C.A. Const. Art. 1, § 8, cl. 3; 68 Okl.St.Ann. § 1354, subd. 1(C).

Dormant commerce clause bars taxing state from discriminating against foreign enterprises competing with local businesses, and from discriminating against commercial activity occurring outside taxing state. U.S.C.A. Const. Art. 1, § 8, cl. 3.


Demand of commerce clause that fair relation exist between tax and benefits conferred upon taxpayer by state does not require detailed accounting of services provided to taxpayer on account of activity being taxed, nor, indeed, is state limited to offsetting public costs created by tax activity; if event is taxable, proceeds from tax may ordinarily be used for purposes unrelated to taxable event, and interstate commerce may thus be made to pay its fair share of state expenses and contribute to cost of providing all governmental services, including those services from which it arguably receives no direct benefit. U.S.C.A. Const. Art. 1, § 8, cl. 3.

Respondent Jefferson Lines, Inc., a common carrier, did not collect or remit to Oklahoma the state sales tax on bus tickets sold in Oklahoma for interstate travel originating there, although it did so for tickets sold for intrastate travel. After Jefferson filed for bankruptcy, petitioner, Oklahoma Tax Commission, filed proof of claims for the uncollected taxes, but the Bankruptcy Court found that the tax was inconsistent with the Commerce Clause in that it imposed an undue burden on interstate commerce and presented a danger of multiple taxation. The District Court affirmed. The Court of Appeals also affirmed.
holding that the tax was not fairly apportioned. Rejecting the Commission's position that a bus ticket sale is a wholly local transaction justifying a State's sales tax on the ticket's full value, the court reasoned that such a tax is indistinguishable from New York's unapportioned tax on an interstate bus line's gross receipts struck down by this Court in *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 68 S.Ct. 1260, 92 L.Ed. 1633.

*Held:* Oklahoma's tax on the sale of transportation services is consistent with the Commerce Clause. Pp. 1335-1346.

(a) Under *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326, Oklahoma's tax is valid if it is applied to an activity with a substantial nexus with the State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. The activity here clearly has a nexus with Oklahoma, the State where the ticket is purchased and the service originates. Pp. 1335-1338.

(b) The purpose of the second prong of *Complete Auto*'s test is to ensure that each State taxes only its fair share of an interstate transaction. A properly apportioned tax must be both internally and externally consistent. Internal consistency looks to whether a tax's identical application by every State would place interstate commerce at a disadvantage as compared with intrastate commerce. There is no failure of such consistency in this case, for if every State were to impose a tax identical to Oklahoma's--i.e., a tax on ticket sales within the State for travel originating there--no sale would be subject to more than one State's tax. External consistency, on the other hand, looks to the economic justification for the State's claim upon the value taxed, to discover whether the tax reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State. P. 1338.

(c) Where taxation of income from interstate business is in issue, apportionment disputes have often focused on slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable income. When examining the taxation of a sale of goods, however, the sale is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which interstate activity affects the value on which a buyer is taxed. Thus, taxation of sales has been consistently approved without any division of the tax base among different States and has been found properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future. Therefore, an internally consistent, conventional sales tax has long been held to be externally consistent as well. Pp. 1338-1340.

**1334** (d) A sale of services can ordinarily be treated as a local state event just as readily as a sale of tangible goods can be located solely within the State of delivery. Sales of services with performance wholly in the taxing State justify that State's taxation of the transaction's entire gross receipts in the hands of the seller. Even where interstate activity contributes to the value of the service performed, sales with performance in the taxing State justify that State's taxation of the seller's entire gross receipts. See, e.g., *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 58 S.Ct. 546, 82 L.Ed. 823. In this case, although the service is performed only partially within the taxing State, the buyer is no more subject to double taxation on the sale of services than the buyer of goods would be. The taxable event here comprises agreement, payment, and delivery of some of the services in the taxing State. No
other State can claim to be the site of the same combination, and these combined events are commonly understood to suffice for a sale. *Central Greyhound*, *supra*, distinguished. Pp. 1340-1341.

(e) Jefferson offers no convincing reasons to reconsider whether this internally consistent tax on sales of services could fail the external consistency test for lack of further apportionment. It has raised no specter of successive taxation so closely related to the transaction as to indicate potential unfairness of Oklahoma's tax on the sale's full amount. Nor is the fact that Oklahoma could feasibly apportion its tax on the basis of mileage, as New York was required to do in *Central Greyhound*, *supra*, a sufficient reason to conclude that the tax exceeds Oklahoma's fair share. Pp. 1341-1344.

(f) The tax also meets the remaining two prongs of *Complete Auto’s* test. No argument has been made that Oklahoma discriminates against out-of-state enterprises, and there is no merit in the argument that the tax discriminates against interstate activity, *American Trucking Assns., Inc. v. Scheiner*, 483 U.S. 266, 107 S.Ct. 2829, 97 L.Ed.2d 226, distinguished. The tax is also fairly related to the taxpayer's presence or activities in the State. It falls on a sale that takes place wholly inside Oklahoma and is measured by the value of the service purchased. Pp. 1344-1346.

15 F.3d 90 (CA 8 1994), reversed and remanded.


Stanley P. Johnston, Oklahoma City, OK, for petitioner.

*Steven D. DeRuyter*, Minneapolis, MN, for respondent.

Justice *Souter* delivered the opinion of the Court.

This case raises the question whether Oklahoma's sales tax on the full price of a ticket for bus travel from Oklahoma to another State is consistent with the Commerce Clause, *U.S. Const.*, Art. I, § 8, cl. 3. We hold that it is.

I

Oklahoma taxes sales in the State of certain goods and services, including transportation for hire. *Okla.Stat.*, Tit. 68, § 1354(1)(C) (Supp.1988). [FN1] The buyers of the taxable *178* goods and services pay the taxes, which must be collected and remitted to the State by sellers. § 1361.

**1335** Respondent Jefferson Lines, Inc., is a Minnesota corporation that provided bus services as a common carrier in Oklahoma from

[FN1] At the time relevant to the taxes at issue here, § 1354 provided as follows: "There is hereby levied upon all sales ... an excise tax of four percent (4%) of the gross receipts or gross proceeds of each sale of the following ... (C) Transportation for hire to persons by common carriers, including railroads both steam and electric, motor transportation companies, taxicab companies, pullman car companies, airlines, and other means of transportation for hire." As a result of recent amendments, the statute presently provides for a 4 1/2 percent tax rate.
1988 to 1990. Jefferson did not collect or remit the sales taxes for tickets it had sold in Oklahoma for bus travel from Oklahoma to other States, although it did collect and remit the taxes for all tickets it had sold in Oklahoma for travel that originated and terminated within that State.

After Jefferson filed for bankruptcy protection on October 27, 1989, petitioner, Oklahoma Tax Commission, filed proof of claims in Bankruptcy Court for the uncollected taxes for tickets for interstate travel sold by Jefferson. Jefferson cited the Commerce Clause in objecting to the claims, and argued that the tax imposes an undue burden on interstate commerce by permitting Oklahoma to collect a percentage of the full purchase price of all tickets for interstate bus travel, even though some of that value derives from bus travel through other States. The tax also presents the danger of multiple taxation, Jefferson claimed, because any other State through which a bus travels while providing the services sold in Oklahoma will be able to impose taxes of their own upon Jefferson or its passengers for use of the roads.

The Bankruptcy Court agreed with Jefferson, the District Court affirmed, and so did the United States Court of Appeals for the Eighth Circuit. In re Jefferson Lines, Inc., 15 F.3d 90 (1994). The Court of Appeals held that Oklahoma's tax was not fairly apportioned, as required under the established test for the constitutionality of a state tax on interstate commerce. See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326 (1977). The Court of Appeals understood its holding to be compelled by our decision in Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 68 S.Ct. 1260, 92 L.Ed. 1633 (1948), which held unconstitutional an unapportioned state tax on the gross receipts of a company that sold tickets for interstate bus travel. The Court of Appeals rejected the Commission's position that the sale of a bus ticket is a wholly local transaction justifying a sales tax on the ticket's full value in the State where it is sold, reasoning that such a tax is indistinguishable from the unapportioned tax on gross receipts from interstate travel struck down in Central Greyhound, 15 F.3d, at 92-93. We granted certiorari, 512 U.S. 1204, 114 S.Ct. 2672, 129 L.Ed.2d 808 (1994), and now reverse.

FN2. The parties have stipulated that the dispute concerns only those taxes for Jefferson's in-state sales of tickets for travel starting in Oklahoma and ending in another State. App. 5; Tr. of Oral Arg. 3-4. The Commission does not seek to recover any taxes for tickets sold in Oklahoma for travel wholly outside of the State or for travel on routes originating in other States and terminating in Oklahoma. Accordingly, the validity of such taxes is not before us.

FN3. We follow standard usage, under which gross receipts taxes are on the gross receipts from sales payable by the seller, in contrast to sales taxes, which are also levied on the gross receipts from sales but are payable by the buyer (although they are collected by the seller and remitted to the taxing entity). P. Hartman, Federal Limitations on State and Local Taxation § § 8:1, 10:1 (1981).

II

[1] Despite the express grant to Congress of the power to "regulate Commerce ... among the several States," U.S. Const., Art. I, § 8, cl. 3, we have consistently held this language to contain a further, negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has
failed to legislate on the subject. Quill Corp. v. North Dakota, 504 U.S. 298, 309, 112 S.Ct. 1904, 1911, 119 L.Ed.2d 91 (1992); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959); H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534-535, 69 S.Ct. 657, 663-664, 93 L.Ed. 865 (1949); cf. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 209, 6 L.Ed. 23 (1824) (Marshall, C.J.) (dictum). We have understood this construction to serve the Commerce Clause's purpose of preventing a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear. The provision thus 'reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.' " Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 7, 106 S.Ct. 2369, 2372-2373, 91 L.Ed.2d 1 (1986), quoting Hughes v. Oklahoma, 441 U.S. 322, 325-326, 99 S.Ct. 1727, 1730-1731, 60 L.Ed.2d 250 (1979); see also The Federalist Nos. 42 (J. Madison), 7 (A. Hamilton), 11 (A. Hamilton).

The command has been stated more easily than its object has been attained, however, and the Court's understanding of the dormant Commerce Clause has taken some turns. In its early stages, see 1 J. Hellerstein & W. Hellerstein, State Taxation ¶¶ 4.05-4.08 (2d ed. 1993) (hereinafter Hellerstein & Hellerstein); Hartman, supra n. 3, § 2:9-2:16, the Court held the view that interstate commerce was wholly immune from state taxation "in any form," Leloup v. Port of Mobile, 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888), "even though the same amount of tax should be laid on [intrastate] commerce," Robbins v. Shelby County Taxing Dist., 120 U.S. 489, 497, 7 S.Ct. 592, 596, 30 L.Ed. 694 (1887); see also Cooley v. Board of Wardens of Port of Philadelphia ex rel. Soc. for Relief of Distressed Pilots, 53 U.S. (12 How.) 299, 13 L.Ed. 996 (1852); Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 6 L.Ed. 678 (1827). This position gave way in time to a less uncompromising but formal approach, according to which, for example, the Court would invalidate a state tax levied on gross receipts from interstate commerce, New Jersey Bell Telephone Co. v. State Bd. of Taxes and Assessments of N.J., 280 U.S. 338, 50 S.Ct. 111, 74 L.Ed. 463 (1930); Meyer v. Wells, Fargo & Co., 223 U.S. 298, 32 S.Ct. 218, 56 L.Ed. 445 (1912), or upon the "freight carried" in interstate commerce, *181 Case of the State Freight Tax, 82 U.S. (15 Wall.) 232, 278, 21 L.Ed. 146 (1873), but would allow a tax merely measured by gross receipts from interstate commerce as long as the tax was formally imposed upon franchises, Maine v. Grand Trunk R. Co., 142 U.S. 217, 12 S.Ct. 121, 35 L.Ed. 994 (1891), or "in lieu of all taxes upon [the taxpayer's] property," United States Express Co. v. Minnesota, 223 U.S. 335, 346, 32 S.Ct. 211, 215, 56 L.Ed. 459 (1912). See generally Lockhart, Gross Receipts Taxes on Interstate Transportation and Communication, 57 Harv.L.Rev. 40, 43-66 (1943) (hereinafter Lockhart). Dissenting from this formal approach in 1927, Justice Stone remarked that it was "too mechanical, too uncertain in its application, and too remote from actualities, to be of value." Di Santo v. Pennsylvania, 273 U.S. 34, 44, 47 S.Ct. 267, 71 L.Ed. 524 (1927) (dissenting opinion).

FN4. The Court had indeed temporarily adhered to an additional distinction between taxes upon interstate commerce such as that struck down in the Case of

In 1938, the old formalism began to give way with Justice Stone's opinion in *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 58 S.Ct. 254, 82 L.Ed. 823, which examined New Mexico's franchise tax, measured by gross receipts, as applied to receipts from out-of-state advertisers in a journal produced by taxpayers in New Mexico but circulated both inside and outside the State. Although the assessment could have been sustained solely on prior precedent, see *id.*, at 258, 58 S.Ct., at 549-550; *Lockhart*, at 66, and n. 122, Justice Stone added a dash of the pragmatism that, with a brief interlude, has since become our aspiration in this quarter of the law. The Court had no trouble rejecting the claim that the "mere formation of the contract between persons in different states" insulated the receipts from taxation, *Western Live Stock*, 303 U.S., at 253, 58 S.Ct., at 547, and it saw the business of "preparing, printing and publishing magazine advertising [as] peculiarly local" and therefore subject to taxation by the State within which the business operated. *Id.*, at 258, 58 S.Ct., at 550. The more "vexed question," however, was one that today we would call a question of apportionment: whether the interstate circulation of the journal barred taxation of receipts from advertisements enhanced in value by the journal's wide dissemination. *Id.*, at 254, 58 S.Ct., at 548.

After rebuffing any such challenge on the ground that the burden on interstate commerce was "too remote and too attenuated" in the light of analogous taxation of railroad property, *id.*, at 259, 58 S.Ct., at 550, Justice Stone provided an "added reason" for sustaining the tax:

"So far as the value contributed to appellants' New Mexico business by circulation of the magazine interstate is taxed, it cannot again be taxed elsewhere any more than the value of railroad property taxed locally. The tax is not one which in form or substance can be repeated by other states in such manner as to lay an added burden on the interstate distribution of the magazine." *Id.*, at 260, 58 S.Ct., at 550-551.

The Court explained that "[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." *Id.*, at 254, 58 S.Ct., at 548. Soon after *Western Live Stock*, the Court expressly rested the invalidation of an unapportioned gross receipts tax on the ground that it violated the prohibition against multiple taxation:

"The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by States in which the goods are sold as those in which they are manufactured." *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311, 58 S.Ct. 913, 916, 82 L.Ed. 1365 (1938).

*See also* *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 438-439, 59 S.Ct. 325, 327-328, 83 L.Ed. 272 (1939).

Stock's multiple taxation rule in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959), and we categorically abandoned the latter-day formalism when *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), overruled Spector and Freeman. In *Complete Auto*, a business engaged in transporting cars manufactured outside the taxing State to dealers within it challenged a franchise tax assessed equally on all gross income derived from transportation for hire within the State. The taxpayer's challenge resting solely on the fact that the State had taxed the privilege of engaging in an interstate commercial activity was turned back, and in sustaining the tax, we explicitly returned to our prior decisions that "considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 U.S., at 279, 97 S.Ct., at 1079.


**1338** *184* III

A

[3] It has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State. *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 60 S.Ct. 388, 84 L.Ed. 565 (1940) (upholding tax on sale of coal shipped into taxing State by seller). So, too, in addressing the interstate provision of services, we recently held that a State in which an interstate telephone call originates or terminates has the requisite Commerce Clause nexus to tax a customer's purchase of that call as long as the call is billed or charged to a service address, or paid by an addressee, within the taxing State. *Goldberg, supra*, 488 U.S., at 263, 109 S.Ct., at 590. Oklahoma's tax falls comfortably within these rules. Oklahoma is where the ticket is purchased, and the service originates there. These facts are enough for concluding that "[t]here is 'nexus' aplenty here." See *D.H. Holmes, supra*, 486 U.S., at 33, 108 S.Ct., at 1624. Indeed, the taxpayer does not deny Oklahoma's substantial nexus to the in-state portion of the bus service, but rather argues that nexus to the State is insufficient as to the portion of travel outside its borders. This point, however, goes to the second prong of *Complete Auto*, to which we turn.

B

[4] The difficult question in this case is whether the tax is properly apportioned within the meaning of the second prong of *Complete Auto*'s test, "the central purpose [of which] is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg, supra*, 488 U.S., at 260-261, 109 S.Ct., at 588. This principle of fair share is the lineal descendant of *Western Live Stock*'s prohibition of multiple taxation, which is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which *185* one State exceeded its fair share would be taxed again by a State properly laying
For over a decade now, we have assessed any threat of malapportionment by asking whether the tax is "internally consistent" and, if so, whether it is "externally consistent" as well. See Goldberg, supra, at 261, 109 S.Ct., at 589; Container Corp., supra, 463 U.S., at 169, 103 S.Ct., at 2942. Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax. See Gwin, White & Prince, 305 U.S., at 439, 59 S.Ct., at 327-328. There is no failure of it in this case, however. If every State were to impose a tax identical to Oklahoma's, that is, a tax on ticket sales within the State for travel originating there, no sale would be subject to more than one State's tax.

External consistency, on the other hand, looks not to the logical consequences of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State. See Goldberg, supra, 488 U.S., at 262, 109 S.Ct., at 589; Container Corp., supra, 463 U.S., at 169-170, 103 S.Ct., at 2942-2943. Here, the threat of real multiple taxation (though not by literally identical statutes) may indicate a State's impermissible overreaching. It is to this less tidy world of real taxation that we turn now, and at length.

The very term "apportionment" tends to conjure up allocation by percentages, and where taxation of income from interstate business is in issue, apportionment disputes have often centered around specific formulas for slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value. In Moorman Mfg. Co. v. Bair, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197 (1978), for example, we considered whether Iowa could measure an interstate corporation's taxable income by attributing income to business within the State "'in that proportion which the gross sales made within the state bear to the total gross sales.'" Id., at 270, 98 S.Ct., at 2342-2343. We held that it could. In Container Corp., we decided whether California could constitutionally compute taxable income assignable to a multijurisdictional enterprise's in-state activity by apportioning its combined business income according to a formula "based, in equal parts, on the proportion of [such] business' total payroll, property, and sales which are located in the taxing State." 463 U.S., at 170, 103 S.Ct., at 2943. Again, we held that it could. Finally, in Central Greyhound, we held that New York's taxation of an interstate bus line's gross receipts was constitutionally limited to that portion reflecting miles traveled within the taxing jurisdiction. 334 U.S., at 663, 68 S.Ct., at 1266.

In reviewing sales taxes for fair share, however, we have had to set a different course. A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated...
interstate activity affects the value on which a buyer is taxed. We have therefore consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future. See, e.g., *McGoldrick v. Berwind-White Coal Mining Co.*, supra.

**187** Such has been the rule even when the parties to a sales contract specifically contemplated interstate movement of the goods either immediately before, or after, the transfer of ownership. See, e.g., *Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 106 S.Ct. 2369, 91 L.Ed.2d 1 (1986) (upholding sales tax on airplane fuel); *State Tax Comm'n of Utah v. Pacific States Cast Iron Pipe Co.*, 372 U.S. 605, 83 S.Ct. 925, 10 L.Ed.2d 8 (1963) (*per curiam*) (upholding tax on sale that contemplated purchaser's interstate shipment of goods immediately after sale). The sale, we held, was "an activity which ... is subject to the state taxing power" so long as taxation did not "discriminat[e]" against or "obstruc[t]" interstate commerce, *Berwind-White*, 309 U.S., at 58, 60 S.Ct., at 398, and we found a sufficient safeguard against the risk of impermissible multiple taxation of a sale in the fact that it was consummated in only one State. As we put it in *Berwind-White*, a necessary condition for imposing the tax was the occurrence of "a local activity, delivery of goods within the State upon their purchase for consumption." *Ibid.* So conceived, a sales tax on coal, for example, could not be repeated by other States, for the same coal was not imagined ever to be delivered in two States at once. Conversely, we held that a sales tax could not validly be imposed if the purchaser already had obtained title to the goods as they were shipped from outside the taxing State into the taxing State by common carrier. *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 64 S.Ct. 1023, 88 L.Ed. 1304 (1944). The out-of-state seller in that case "was through selling" outside the taxing State. *Id.*, at 330, 64 S.Ct., at 1025. In other words, the very conception of the common sales tax on goods, operating on the transfer of ownership and possession at a particular time and place, insulated the buyer from any threat of further taxation of the transaction.

[8] In deriving this rule covering taxation to a buyer on sales of goods we were not, of course, oblivious to the possibility of successive taxation of related events up and down the stream of commerce, and our cases are implicit with the understanding that the Commerce Clause does not forbid the **188** actual assessment of a succession of taxes by different States on distinct events as the **1340** same tangible object flows along. Thus, it is a truism that a sales tax to the buyer does not preclude a tax to the seller upon the income earned from a sale, and there is no constitutional trouble inherent in the imposition of a sales tax in the State of delivery to the customer, even though the State of origin of the thing sold may have assessed a property or severance tax on it. See *Berwind-White*, 309 U.S., at 53, 60 S.Ct., at 396; cf. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981) (upholding severance tax on coal mined within the taxing State). In light of this settled treatment of taxes on sales of goods and other successive taxes related through the stream of commerce, it is fair to say that because the taxable event of the consummated sale of goods has been found to be properly treated as unique, an internally consistent, conventional sales tax has long been held to be externally consistent as well.

[9] A sale of services can ordinarily be treated as a local state event just as readily as a sale of tangible goods can be located solely within the
State of delivery. Cf. Goldberg v. Sweet, 488 U.S. 252, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989). Although our decisional law on sales of services is less developed than on sales of goods, one category of cases dealing with taxation of gross sales receipts in the hands of a seller of services supports the view that the taxable event is wholly local. Thus we have held that the entire gross receipts derived from sales of services to be performed wholly in one State are taxable by that State, notwithstanding that the contract for performance of the services has been entered into across state lines with customers who reside outside the taxing State. Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 58 S.Ct. 546, 82 L.Ed. 823 (1938).

So, too, as we have already noted, even where interstate circulation contributes to the value of magazine advertising purchased by the customer, we have held that the Commerce Clause does not preclude a tax on its full value by the State *189 of publication. Id., at 254, 258-259, 58 S.Ct., at 548, 549-550. And where the services are performed upon tangible items retrieved from and delivered to out-of-state customers, the business performing the services may be taxed on the full gross receipts from the services, because they were performed wholly within the taxing State. Department of Treasury of Ind. v. Ingram-Richardson Mfg. Co. of Ind., 313 U.S. 252, 61 S.Ct. 866, 85 L.Ed. 1313 (1941). Interstate activity may be essential to a substantial portion of the value of the services in the first case and essential to performance of the services in the second, but sales with at least partial performance in the taxing State justify that State's taxation of the transaction's entire gross receipts in the hands of the seller. On the analogy sometimes drawn between sales and gross receipts taxes, see International Harvester Co. v. Department of Treasury, 322 U.S. 340, 347-348, 64 S.Ct. 1019, 1022-1023, 88 L.Ed. 1313 (1944); but see Norton Co. v. Department of Revenue of Ill., 340 U.S. 534, 537, 71 S.Ct. 377, 380, 95 L.Ed. 517 (1951), there would be no reason to suppose that a different apportionment would be feasible or required when the tax falls not on the seller but on the buyer.

Cases on gross receipts from sales of services include one falling into quite a different category, however, and it is on this decision that the taxpayer relies for an analogy said to control the resolution of the case before us. In 1948, the Court decided Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 68 S.Ct. 1260, 92 L.Ed. 1633, striking down New York's gross receipts tax on transportation services imposed without further apportionment on the total receipts from New York sales of bus services, almost half of which were actually provided by carriage through neighboring New Jersey and Pennsylvania. The Court held the statute fatally flawed by the failure to apportion taxable receipts in the same proportions that miles traveled through the various States bore to the total. The similarity of Central Greyhound to this case is, of course, striking, and on the assumption that the economic significance of a gross receipts tax is indistinguishable from a tax on sales the Court of Appeals held that a similar mileage *190 apportionment is required here, see 15 F.3d, at 92-93, as the taxpayer now argues.

**1341 We, however, think that Central Greyhound provides the wrong analogy for answering the sales tax apportionment question here. To be sure, the two cases involve the identical services, and apportionment by mileage per State is equally feasible in each. But the two diverge crucially in the identity of the taxpayers and the consequent opportunities that are understood to exist for multiple taxation of the same taxpayer. Central Greyhound did not rest simply on the mathematical and administrative feasibility of a mileage apportionment, but on the Court's express understanding that the seller-taxpayer was
exposed to taxation by New Jersey and Pennsylvania on portions of the same receipts that New York was taxing in their entirety. The Court thus understood the gross receipts tax to be simply a variety of tax on income, which was required to be apportioned to reflect the location of the various interstate activities by which it was earned. This understanding is presumably the reason that the *Central Greyhound* Court said nothing about the arguably local character of the levy on the sales transaction. [FN5] Instead, the Court heeded *Berwind-White*'s warning about "[p]rivilege taxes requiring a percentage of the gross receipts from interstate transportation," which "if sustained, could be imposed wherever the interstate activity occurs...." 309 U.S., at 45-46, n. 2, 60 S.Ct., at 391, n. 2.

FN5. Although New York's tax reached the gross receipts only from ticket sales within New York State, 334 U.S., at 664, 666, 68 S.Ct., at 1266-1267, 1267-1268 (Murphy, J., dissenting), the majority makes no mention of this fact.

Here, in contrast, the tax falls on the buyer of the services, who is no more subject to double taxation on the sale of these services than the buyer of goods would be. The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State; no other State can claim to be the site of the same combination. The economic activity represented by the receipt of the ticket for "consumption" in the form of commencement and partial provision of the *191* transportation thus closely resembles *Berwind-White*’s "delivery of goods within the State upon their purchase for consumption," *id.*, at 58, 60 S.Ct., at 398, especially given that full "consumption" or "use" of the purchased goods within the taxing State has never been a condition for taxing a sale of those goods. Although the taxpayer seeks to discount these resemblances by arguing that sale does not occur until delivery is made, nothing in our case law supports the view that when delivery is made by services provided over time and through space a separate sale occurs at each moment of delivery, or when each State's segment of transportation State by State is complete. The analysis should not lose touch with the common understanding of a sale, see *Goldberg*, 488 U.S., at 262, 109 S.Ct., at 589; the combined events of payment for a ticket and its delivery for present commencement of a trip are commonly understood to suffice for a sale.

In sum, the sales taxation here is not open to the double taxation analysis on which *Central Greyhound* turned, and that decision does not control. Before we classify the Oklahoma tax with standard taxes on sales of goods, and with the taxes on less complicated sales of services, however, two questions may helpfully be considered.

3

Although the sale with partial delivery cannot be duplicated as a taxable event in any other State, and multiple taxation under an identical tax is thus precluded, is there a possibility of successive taxation so closely related to the transaction as to indicate potential unfairness of Oklahoma's tax on the full amount of sale? And if the answer to that question is no, is the very possibility of apportioning by mileage a sufficient reason to conclude that the tax exceeds the fair share of the State of sale?

a

The taxpayer argues that anything but a *Central Greyhound* mileage apportionment by State will expose it to the *192* same threat of multiple taxation assumed to exist in that case: further taxation, that is, of some portion of the value already taxed, though not under a statute in every respect identical to Oklahoma's. But the claim does not hold up. The taxpayer has failed
to raise any specter of successive taxes that might require us to reconsider whether an internally consistent tax on sales of services could fail the external consistency test for lack of further apportionment (a result that no sales tax has ever suffered under our cases).

If, for example, in the face of Oklahoma's sales tax, Texas were to levy a sustainable, apportioned gross receipts tax on the Texas portion of travel from Oklahoma City to Dallas, interstate travel would not be exposed to multiple taxation in any sense different from coal for which the producer may be taxed first at point of severance by Montana and the customer may later be taxed upon its purchase in New York. The multiple taxation placed upon interstate commerce by such a confluence of taxes is not a structural evil that flows from either tax individually, but it is rather the "accidental incident of interstate commerce being subject to two different taxing jurisdictions." Lockhart 75; See Moorman Mfg. Co., 437 U.S., at 277, 98 S.Ct., at 2346-2347.

**FN6.** Any additional gross receipts tax imposed upon the interstate bus line would, of course, itself have to respect well-understood constitutional strictures. Thus, for example, Texas could not tax the bus company on the full value of the bus service from Oklahoma City to Dallas when the ticket is sold in Oklahoma, because that tax would, among other things, be internally inconsistent. And if Texas were to impose a tax upon the bus company measured by the portion of gross receipts reflecting in-state travel, it would have to impose taxes on intrastate and interstate journeys alike. In the event Texas chose to limit the burden of successive taxes attributable to the same transaction by combining an apportioned gross receipts tax with a credit for sales taxes paid to Texas, for example, it would have to give equal treatment to service into Texas purchased subject to a sales tax in another State, which it could do by granting a credit for sales taxes paid to any State. See, e.g., Henneford v. Silas Mason Co., 300 U.S. 577, 583-584, 57 S.Ct. 527-528, 81 L.Ed. 814 (1937) (upholding use tax which provided credit for sales taxes paid to any State); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 70, 83 S.Ct. 1201, 1204, 10 L.Ed.2d 202 (1963) ("[E]qual treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state"); Maryland v. Louisiana, 451 U.S. 725, 759, 101 S.Ct. 2114, 2135, 68 L.Ed.2d 576 (1981) (striking down Louisiana's "first use" tax on imported gas because "the pattern of credits and exemptions allowed under the ... statute undeniably violates this principle of equality"); Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 240-248, 107 S.Ct. 2810, 2816-2820, 97 L.Ed.2d 199 (1987) (striking down Washington's gross receipts wholesaling tax exempting in-state, but not out-of-state, manufacturers); see also Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 331-332, 97 S.Ct. 599, 607-608, 50 L.Ed.2d 514 (1977).

Although we have not held that a State imposing an apportioned gross receipts tax that grants a credit for sales taxes paid in state must also extend such a credit to sales taxes paid out of state, see, e.g., Halliburton, supra, 373 U.S., at 77, 83 S.Ct., at 1207-1208 (Brennan, J., concurring); Silas Mason, supra, 300 U.S., at 587, 57 S.Ct., at 529; see also
Williams v. Vermont, 472 U.S. 14, 21-22, 105 S.Ct. 2465, 2470-2471, 86 L.Ed.2d 11 (1985), we have noted that equality of treatment of interstate and intrastate activity has been the common theme among the paired (or "compensating") tax schemes that have passed constitutional muster, see, e.g., Boston Stock Exchange, supra, 429 U.S., at 331-332, 97 S.Ct., at 607-608. We have indeed never upheld a tax in the face of a substantiated charge that it provided credits for the taxpayer's payment of in-state taxes but failed to extend such credit to payment of equivalent out-of-state taxes. To the contrary, in upholding tax schemes providing credits for taxes paid in-state and occasioned by the same transaction, we have often pointed to the concomitant credit provisions for taxes paid out of state and occasioned by the same transaction, we have often pointed to the concomitant credit provisions for taxes paid out of state as supporting our conclusion that a particular tax passed muster because it treated out-of-state and in-state taxpayers alike. See, e.g., Itel Containers Int'l Corp. v. Huddleston, 507 U.S. 60, 74, 113 S.Ct. 1095, 1104, 122 L.Ed.2d 421 (1993); D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31, 108 S.Ct. 1619, 1623-1624, 100 L.Ed.2d 21 (1988) ("The ... taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States"); General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335, 64 S.Ct. 1028, 88 L.Ed. 1309 (1944); Silas Mason, supra, 300 U.S., at 584, 57 S.Ct., at 527-528. A general requirement of equal treatment is thus amply clear from our precedent. We express no opinion on the need for equal treatment when a credit is allowed for payment of in- or out-of-state taxes by a third party. See Darnell v. Indiana, 226 U.S. 390, 33 S.Ct. 120, 57 L.Ed. 267 (1912).

*193 Nor has the taxpayer made out a case that Oklahoma's sales tax exposes any buyer of a ticket in Oklahoma for travel into another State to multiple taxation from taxes imposed upon passengers by other States of passage. Since a use tax, or some equivalent on the consumption of services, is generally levied to compensate the taxing State for its *194 incapacity to reach the corresponding sale, it is commonly paired with a sales tax, see, e.g., D.H. Holmes, 486 U.S., at 31, 108 S.Ct., at 1623-1624; Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 331-332, 97 S.Ct. 599, 607-608, 50 L.Ed.2d 514 (1977); Henneford v. Silas Mason Co., 300 U.S. 577, 57 S.Ct. 524, 81 L.Ed. 814 (1937), being applicable only when no sales tax has been paid or subject to a credit for any such tax paid. Since any use tax would have to comply with Commerce Clause requirements, the tax scheme could not apply differently to goods and services purchased out of state from those purchased domestically. Presumably, then, it would not apply when another State's sales tax had previously been paid, or would apply subject to credit for such payment. In either event, the Oklahoma ticket purchaser would be free from multiple taxation. True, it is not Oklahoma that has offered to provide a credit for related taxes paid elsewhere, but in taxing sales Oklahoma may rely upon use-taxing States to do so. This is merely a practical consequence of the structure of use taxes as generally based upon the primacy of taxes on sales, in that use of goods is taxed only to the extent that their prior sale has escaped taxation. Indeed the District of Columbia and 44 of the 45 States that impose sales and use taxes permit such a credit or exemption for similar taxes paid to other States. See 2 Hellerstein & Hellerstein ¶ 18.08, p. 18-48; 1 All States Tax Guide ¶ 256 (1994). As one
state court summarized the provisions in force:

"These credit provisions create a national system under which the first state of purchase or use imposes the tax. Thereafter, no other state taxes the transaction unless there has been no prior tax imposed ... or if the tax rate of the prior taxing state is less, in which case the subsequent taxing state imposes a tax measured only by the differential rate."  


*195 The case of threatened multiple taxation where a sales tax is followed by a use tax is thus distinguishable from the case of simultaneous sales taxes considered in Goldberg, where we were reassured to some degree by the provision of a credit in the disputed tax itself for similar taxes placed upon the taxpayer by other States. See Goldberg, 488 U.S., at 264, 109 S.Ct., at 590-591 ("To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the [t]ax [a]ct operates to avoid actual multiple taxation"). In that case, unlike the sales and use schemes posited for the sake of argument here, each of the competing sales taxes would presumably have laid an equal claim on the taxpayer's purse.

b

[10] Finally, Jefferson points to the fact that in this case, unlike the telephone communication tax at issue in Goldberg, Oklahoma could feasibly apportion its sales tax on the basis of mileage as we required New York's gross receipts tax to do in Central Greyhound. Although Goldberg indeed noted that "[a]n apportionment formula based on mileage or some other geographic division of individual telephone calls would produce insurmountable administrative and technological barriers," 488 U.S., at 264-265, 109 S.Ct., at 590, and although we agree that no comparable barriers exist here, we nonetheless reject the idea that a particular apportionment formula must be used simply because it would be possible to use it. We have never required that any particular apportionment formula or method be used, and when a State has chosen one, an objecting taxpayer has the burden to demonstrate by "clear and cogent evidence," that "the income attributed to the State is in fact out of all appropriate proportions to the business transacted ... in that State, or has led to a grossly distorted result."  Container Corp., 463 U.S., at 170, 103 S.Ct., at 2942, quoting Moorman Mfg. Co., 437 U.S., at 274, 98 S.Ct., at 2345 (internal quotation marks omitted; citations omitted). That is too much for Jefferson *196 to bear in this case. It fails to show that Oklahoma's tax on the sale of transportation imputes economic activity to the State of sale in any way substantially different from that imputed by the garden-variety sales tax, which we have perennially sustained, even though levied on goods that have traveled in interstate commerce to the **1344 point of sale or that will move across state lines thereafter. See, e.g., Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 106 S.Ct. 2369, 91 L.Ed.2d 1 (1986); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 60 S.Ct. 388, 84 L.Ed. 565 (1940); State Tax Comm'n of Utah v. Pacific States Cast Iron Pipe Co., 372 U.S. 605, 83 S.Ct. 925, 10 L.Ed.2d 8 (1963); see also Western Live Stock, 303 U.S., at 259, 58 S.Ct., at 550 (upholding tax where measure of the tax "include[s] the augmentation attributable to the [interstate] commerce in which [the object of the tax] is employed"); Goldberg, 488 U.S., at 262, 109 S.Ct., at 589 (upholding tax upon the purchase of an interstate telephone call which had "many of the characteristics of a sales tax ... [e]ven though such a retail purchase is not a purely local event since it triggers simultaneous activity in several States"). Nor does Oklahoma's tax raise any greater threat of multiple taxation than those sales taxes that have passed muster time and again. There is thus no reason to leave the line of longstanding precedent and lose the
simplicity of our general rule sustaining sales taxes measured by full value, simply to carve out an exception for the subcategory of sales of interstate transportation services. We accordingly conclude that Oklahoma's tax on ticket sales for travel originating in Oklahoma is externally consistent, as reaching only the activity taking place within the taxing State, that is, the sale of the service. Cf. id., at 261-262, 109 S.Ct., at 588-589; Container Corp., supra, 463 U.S., at 169-170, 103 S.Ct., at 2942-2943.

FN7. Justice BREYER would reject review of the tax under general sales tax principles in favor of an analogy between sales and gross receipts taxes which, in the dissent's view, are without "practical difference," post, at 1348. Although his dissenting opinion rightly counsels against the adoption of purely formal distinctions, economic equivalence alone has similarly not been (and should not be) the touchstone of Commerce Clause jurisprudence. Our decisions cannot be reconciled with the view that two taxes must inevitably be equated for purposes of constitutional analysis by virtue of the fact that both will ultimately be "pass[ed] ... along to the customer" or calculated in a similar fashion, ibid. Indeed, were that to be the case, we could not, for example, dismiss successive taxation of the extraction, sale, and income from the sale of coal as consistent with the Commerce Clause's prohibition against multiple taxation. Justice BREYER's opinion illuminates the difference between his view and our own in its suggestion, post, at 1349, that our disagreement turns on differing assessments of the force of competing analogies. His analogy to Central Greyhound derives strength from characterizing the tax as falling on "interstate travel," post, at 1349, or "transportation," post, at 1347. Our analogy to prior cases on taxing sales of goods and services derives force from identifying the taxpayer in categorizing the tax and from the value of a uniform rule governing taxation on the occasion of what is generally understood as a sales transaction. The significance of the taxpayer's identity is, indeed, central to the Court's longstanding recognition of structural differences that permit successive taxation as an incident of multiple taxing jurisdictions. The decision today is only the latest example of such a recognition and brings us as close to simplicity as the conceptual distinction between sales and income taxation is likely to allow.

*197 C

[11] We now turn to the remaining two portions of Complete Auto's test, which require that the tax must "not discriminate against interstate commerce," and must be "fairly related to the services provided by the State." 430 U.S., at 279, 97 S.Ct., at 1079. Oklahoma's tax meets these demands.

[12] A State may not "impose a tax which discriminates against interstate commerce ... by providing a direct commercial advantage to local business." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S., at 458, 79 S.Ct., at 362; see also American Trucking Assns., Inc. v. Scheiner, 483 U.S. 266, 269, 107 S.Ct. 2829, 2832-2833, 97 L.Ed.2d 226 (1987). Thus, States are barred from discriminating against foreign enterprises competing with local businesses, see, e.g., id., at 286, 107 S.Ct., at 2841-2842, and from discriminating against commercial activity occurring outside the taxing State, see, e.g., Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 97 S.Ct. 599, 50
L.Ed.2d 514 (1977). No argument has been made that Oklahoma discriminates against out-of-state enterprises, and there is no merit in the argument that the tax discriminates against interstate activity.

The argument proffered by Jefferson and amicus Greyhound Lines is largely a rewriting of the apportionment challenge rejected above, and our response needs no reiteration here. See Brief for Respondent 40; Brief for Greyhound Lines, Inc., as Amicus Curiae 20-27. Jefferson takes the additional position, however, that Oklahoma discriminates against out-of-state travel by taxing a ticket "at the full 4% rate" regardless of whether the ticket relates to "a route entirely within Oklahoma" or to travel "only 10 percent within Oklahoma." Brief for Respondent 40. In making the same point, amicus Greyhound invokes our decision in Scheiner, which struck down Pennsylvania's flat tax on all trucks traveling in and through the State as "plainly discriminatory." 483 U.S., at 286, 107 S.Ct., at 2840. But that case is not on point.

In Scheiner, we held that a flat tax on trucks for the privilege of using Pennsylvania's roads discriminated against interstate travel, by imposing a cost per mile upon out-of-state trucks far exceeding the cost per mile borne by local trucks that generally traveled more miles on Pennsylvania roads. Ibid. The tax here differs from the one in Scheiner, however, by being imposed not upon the use of the State's roads, but upon "the freedom of purchase." McLeod v. J.E. Dilworth Co., 322 U.S., at 330, 64 S.Ct., at 1025. However complementary the goals of sales and use taxes may be, the taxable event for one is the sale of the service, not the buyer's enjoyment or the privilege of using Oklahoma's roads. Since Oklahoma facilitates purchases of the services equally for intrastate and interstate travelers, all buyers pay tax at the same rate on the value of their purchases. See D.H. Holmes, 486 U.S., at 32, 108 S.Ct., at 1624; cf. Scheiner, supra, 483 U.S., at 291, 107 S.Ct., at 2844 ("[T]he amount of Pennsylvania's ... taxes owed by a trucker does not vary directly ... with some ... proxy for value obtained from the State"). Thus, even if dividing Oklahoma sales taxes by in-state miles to be traveled produces on average a higher figure when interstate trips are sold than when the sale is of a wholly domestic journey, there is no discrimination against interstate travel; miles traveled within the State simply are not a relevant proxy for the benefit conferred upon the parties to a sales transaction. As with a tax on the sale of tangible goods, the potential for interstate movement after the sale has no bearing on the reason for the sales tax. See, e.g., Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 106 S.Ct. 2369, 91 L.Ed.2d 1 (1986) (upholding sales tax on airplane fuel); cf. Commonwealth Edison Co., 453 U.S., at 617-619, 101 S.Ct., at 2953-2954 (same for severance tax). Only Oklahoma can tax a sale of transportation to begin in that State, and it imposes the same duty on equally valued purchases regardless of whether the purchase prompts interstate or only intrastate movement. There is no discrimination against interstate commerce.

D

[13][14] Finally, the Commerce Clause demands a fair relation between a tax and the benefits conferred upon the taxpayer by the State. See Goldberg, 488 U.S., at 266-267, 109 S.Ct., at 591-592; D.H. Holmes, supra, 486 U.S., at 32-34, 108 S.Ct., at 1624-1625; Commonwealth Edison, supra, 453 U.S., at 621-629, 101 S.Ct., at 2955-2960. The taxpayer argues that the tax fails this final prong because the buyer's only benefits from the taxing State occur during the portion of the journey that takes place in Oklahoma. The taxpayer misunderstands the import of this last requirement.
The fair relation prong of *Complete Auto* requires no detailed accounting of the services provided to the taxpayer on account of the activity being taxed, nor, indeed, is a State limited to offsetting the public costs created by the taxed activity. If the event is taxable, the proceeds from the tax may ordinarily be used for purposes unrelated to the taxable event. Interstate commerce may thus be made to pay its fair share of state expenses and "contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct "benefit."{\textsuperscript{15}} *Goldberg, supra*, 488 U.S., at 267, 109 S.Ct., at 592, **1346** quoting *Commonwealth Edison, supra*, 453 U.S., at 627, n. 16, 101 S.Ct., at 2958, n. 16 (emphasis in original). The bus terminal may not catch fire during the sale, and no robbery there may be foiled while the buyer is getting his ticket, but police and fire protection, along with the usual and usually forgotten advantages conferred by the State's maintenance of a civilized society, are justifications enough for the imposition of a tax. See *Goldberg, supra*, at 267, 109 S.Ct., at 592, *Complete Auto* 's fourth criterion asks only that the measure of the tax be reasonably related to the taxpayer's presence or activities in the State. See *Commonwealth Edison, supra*, 453 U.S., at 626, 629, 101 S.Ct., at 2958, 2959-2960. What we have already said shows that demand to be satisfied here. The tax falls on the sale that takes place wholly inside Oklahoma and is measured by the value of the service purchased.

IV

Oklahoma's tax on the sale of transportation services does not contravene the Commerce Clause. The judgment of the Court of Appeals is reversed, accordingly, and the case is remanded for further proceedings consistent with this opinion.

*It is so ordered.*

I agree with the Court's conclusion that Oklahoma's sales tax does not facially discriminate against interstate commerce. See *ante*, at 1345. That seems to me the most we can demand to certify compliance with the "negative Commerce Clause"--which is "negative" not only because it negates state regulation of commerce, but also because it does not appear in the Constitution. See *Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dept. of Treasury*, 490 U.S. 66, 80, 109 S.Ct. 1617, 1625-1626, 104 L.Ed.2d 58 (1989) (SCALIA, J., concurring in judgment); *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 254, 259-265, 107 S.Ct. 2810, 2823-2824, 2826-2829, 97 L.Ed.2d 199 (1987) (SCALIA, J., concurring in part and dissenting in part).

I would not apply the remainder of the eminently unhelpful, so-called "four-part test" of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326 (1977). Under the real Commerce Clause ("The Congress shall have Power ... To regulate Commerce ... among the several States," U.S. Const., Art. I, § 8), it is for Congress to make the judgment that interstate commerce must be immunized from certain sorts of nondiscriminatory state action--a judgment that may embrace (as ours ought not) such imponderables as how much "value [is] fairly attributable to economic activity within the taxing State," and what constitutes "fair relation between a tax and the benefits conferred upon the taxpayer by the State." *Ante*, at 1338, 1345 (emphases added). See *Tyler Pipe, supra*, 483 U.S., at 259, 107 S.Ct., at 2826. I look forward to the day when *Complete Auto* will take its rightful place in Part II of the Court's opinion, among the other useless and discarded tools of

Justice SCALIA, with whom Justice THOMAS joins, concurring in the judgment.
our negative Commerce Clause jurisprudence.

Justice BREYER, with whom Justice O'CONNOR joins, dissenting.

Despite the Court's lucid and thorough discussion of the relevant law, I am unable to join its conclusion for one simple reason. Like the judges of the Court of Appeals, I believe the tax at issue here and the tax that this Court held unconstitutional in *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 68 S.Ct. 1260, 92 L.Ed. 1633 (1948), are, for all relevant purposes, identical. Both cases involve taxes imposed upon interstate bus transportation. In neither case did the State apportion the tax to avoid taxing that portion of the interstate activity performed in other States. And, I find no other distinguishing features. Hence, I would hold that the tax before us violates the Constitution for the reasons this Court set forth in *Central Greyhound*.

*202* Central Greyhound considered a tax imposed by the State of New York on utilities doing business in New York--a tax called "emergency tax on the furnishing of utility services." *Id., at 664, 68 S.Ct., at 1266* **1347** (Murphy, J., dissenting) (quoting New York Tax Law § 186-a). That tax was equal to "two per centum of "gross income," defined to include "receipts received ... by reason of any sale ... made" in New York. *334 U.S., at 664, 68 S.Ct., at 1266-1267*. The New York taxing authorities had applied the tax to gross receipts from sales (in New York) of bus transportation between New York City and cities in upstate New York over routes that cut across New Jersey and Pennsylvania. *Id., at 654, 68 S.Ct., at 1261-1262*. The out-of-state portion of the trips accounted for just over 40 percent of total mileage. *Id., at 660, 68 S.Ct., at 1264-1265*.

Justice Frankfurter wrote for the Central Greyhound Court that "it is interstate commerce which the State is seeking to reach," *id., at 661, 68 S.Ct., at 1265*; that the "real question [is] whether what the State is exacting is a constitutionally fair demand ... for that aspect of the interstate commerce to which the State bears a special relation," *ibid.;* and that by "its very nature an unapportioned gross receipts tax makes interstate transportation bear more than 'a fair share of the cost of the local government whose protection it enjoys,'" *id., at 663, 68 S.Ct., at 1266* (quoting Freeman v. Hewit, 329 U.S. 249, 253, 67 S.Ct. 274, 277, 91 L.Ed. 265 (1946)). The Court noted:

"[I]f New Jersey and Pennsylvania could claim their right to make appropriately apportioned claims against that substantial part of the business of appellant to which they afford protection, we do not see how on principle and in precedent such a claim could be denied. This being so, to allow New York to impose a tax on the gross receipts for the entire mileage--on the 57.47% within New York as well as the 42.53% without--would subject interstate commerce to the unfair burden of being taxed as to portions of its revenue by States which give protection *203* to those portions, as well as to a State which does not." *334 U.S., at 662, 68 S.Ct., at 1265*.

The Court essentially held that the tax lacked what it would later describe as "external consistency." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169, 103 S.Ct. 2933, 2942, 77 L.Ed.2d 545 (1983). That is to say, the New York law violated the Commerce Clause because it tried to tax significantly more than "that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg v. Sweet*, 488 U.S. 252, 262, 109 S.Ct. 582, 589, 102 L.Ed.2d 607 (1989).

The tax before us bears an uncanny resemblance to the New York tax. The Oklahoma statute (as applied to
courts have recognized that the "taxable event" to which the Oklahoma tax attaches is not the interstate transportation of passengers but the sale of a bus ticket (combined, perhaps, with transportation to the state line). See ante, at 1341 ("The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State."). Thus, the majority suggests that a tax on transportation (as opposed to the sale of a bus ticket) by a different State might be "successive," ante, at 1342, but is not "double

**1348** The majority sees a number of reasons why the result here should be different from that in Central Greyhound, but I do not think any is persuasive. First, the majority points out that the New York law required a seller, the bus company, to pay the tax, whereas the Oklahoma law says that the "tax ... shall be paid by the consumer or user to the vendor." Okla. Stat., Tit. 68, § 1361(A) (Supp.1988). This difference leads the majority to characterize the former as a "gross receipts" tax and the latter as a constitutionally distinguishable "sales tax." This difference, however, seems more a formal, than a practical difference. The Oklahoma law makes the bus company ("the vendor") and "each principal officer ... personally liable" for the tax, whether or not they collect it from the customer. Ibid. Oklahoma (as far as I can tell) has never tried to collect the tax directly from a customer. And, in any event, the statute tells the customer to pay the tax, not to the State, but "to the vendor." Ibid. The upshot is that, as a practical matter, in respect to both taxes, the State will calculate the tax bill by multiplying the rate times gross receipts from sales; the bus company will pay the tax bill; and, the company will pass the tax along to the customer.

Second, the majority believes that this case presents a significantly smaller likelihood than did Central Greyhound that the out-of-state portions of a bus trip will be taxed both "by States which give protection to those portions, as well as [by] ... a State which does not." Central Greyhound, 334 U.S., at 662, 68 S.Ct., at 1265-1266. There is at least a hint in the Court's opinion that this is so because the "taxable event" to which the Oklahoma tax attaches is not the interstate transportation of passengers but the sale of a bus ticket (combined, perhaps, with transportation to the state line). See ante, at 1341 ("The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State."). Thus, the majority suggests that a tax on transportation (as opposed to the sale of a bus ticket) by a different State might be "successive," ante, at 1342, but is not "double
taxation" in a constitutionally relevant way, ante, at 1341; see ante, at 1341 ("[N]o other State can claim to be the site of the same combination"). I concede that Oklahoma could have a tax of the kind envisioned, namely, one that would tax the bus company for the privilege of selling tickets. But, whether or not such a tax would pass constitutional muster should depend upon its practical effects. To suggest that the tax here is constitutional simply because it lends itself to recharacterizing the taxable event as a "sale" is to ignore economic reality. Because the sales tax is framed as a percentage of the ticket price, it seems clear that the activity Oklahoma intends to tax is the transportation of passengers—not some other kind of conduct (like selling tickets).

In any event, the majority itself does not seem to believe that Oklahoma is taxing something other than bus transportation; it seems to acknowledge the risk of multiple taxation. The Court creates an ingenious set of constitutionally based taxing rules in footnote 6--designed to show that any other State that imposes, say, a gross receipts tax on its share of bus ticket sales would likely have to grant a credit for the Oklahoma sales tax (unless it forced its own citizens to pay both a sales tax and a gross receipts tax). But, one might have said the same in Central Greyhound. Instead of enforcing its apportionment requirement, the Court could have simply said that once one State, like New York, imposes a gross receipts tax on "receipts received ... by reason of any sale ... made" in that State, any other State, trying to tax the gross receipts of its share of bus ticket sales, might have *206 to give some kind of credit. The difficulties with this approach lie in its complexity and our own inability to foresee all the ways in which other States might effectively tax their own portion of the journey now (also) taxed by Oklahoma. Under the Court's footnote rules, is not a traveler who buys a ticket in Oklahoma still threatened with a duplicative tax by a State that does not impose a sales tax on transportation (and thus, would not have to offer a credit for the sales tax paid in Oklahoma)? Even if that were not so, the constitutional problem would remain, namely, that Oklahoma is imposing an unapportioned tax on the portion of travel outside the State, just as did New York.

**1349 Finally, the majority finds support in Goldberg v. Sweet, 488 U.S. 252, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989), a case in which this Court permitted Illinois to tax interstate telephone calls that originated, or terminated, in that State. However, the Goldberg Court was careful to distinguish "cases [dealing] with the movement of large physical objects over identifiable routes, where it was practicable to keep track of the distance actually traveled within the taxing State," id., at 264, 109 S.Ct., at 590-591, and listed Central Greyhound as one of those cases, 488 U.S., at 264, 109 S.Ct., at 590-591. Telephone service, the Goldberg Court said, differed from movement of the kind at issue in Central Greyhound, in that, at least arguably, the service itself is consumed wholly within one State, or possibly two--those in which the call is charged to a service address or paid by an addressee. 488 U.S., at 264, 109 S.Ct., at 589-590. Regardless of whether telephones and buses are more alike than different, the Goldberg Court did not purport to modify Central Greyhound, nor does the majority. In any event, the Goldberg Court said, the tax at issue credited taxpayers for similar taxes assessed by other States. 488 U.S., at 264, 109 S.Ct., at 590-591.

Ultimately, I may differ with the majority simply because I assess differently the comparative force of two competing analogies. The majority finds determinative this Court's case law concerning sales taxes applied to the sale of goods, *207 which cases, for example, permit one State to impose a severance tax and
another a sales tax on the same physical item (say, coal). In my view, however, the analogy to sales taxes is not as strong as the analogy to the tax at issue in *Central Greyhound*. After all, the tax before us is not a tax imposed upon a product that was made in a different State or was consumed in a different State or is made up of ingredients that come from a different State or has itself moved in interstate commerce. Rather, it is a tax imposed upon interstate travel itself—the very essence of interstate commerce. And, it is a fairly obvious effort to tax more than "that portion" of the "interstate activity[s]" revenue "which reasonably reflects the in-state component." *Goldberg v. Sweet*, *supra*, at 262, 109 S.Ct., at 589. I would reaffirm the *Central Greyhound* principle, even if doing so requires different treatment for the inherently interstate service of interstate transportation, and denies the possibility of having a single, formal constitutional rule for all self-described "sales taxes." The Court of Appeals wrote that this "is a classic instance of an unapportioned tax" upon interstate commerce. *In re Jefferson Lines, Inc.*, 15 F.3d 90, 93 (CA8 1994). In my view, that is right. I respectfully dissent.
Sales Tax School II

BREAKOUT SESSION

2 Problems

Constitutional Issues 1, 2
CONSTITUTIONAL ISSUES

PROBLEM 1

The State of Oz taxes the sale of tangible personal property within the state, including property that will be put to its intended purpose in another state. Oz also taxes the use of such property when it is not sold in Oz but is used in Oz. Oz statutes define "use" as the exercise of any right or power over tangible personal property incident to the ownership thereof, but DOR regulations state that the tax is imposed only on "first use," defined as the use for which the property was designed, constructed, or intended. Oz allows a credit for a sales tax lawfully imposed and paid in another state, but not for use tax paid elsewhere. Oz DOR believes that taxing only the "intended" use is more logical than taxing "any right or power" as its statute prescribes. It also maintains that because there can only be one "first use," a credit for use tax paid elsewhere is unnecessary.

The State of Neverland also has a use tax, and defines “use” as the exercise of any right or power over tangible personal property incident to the ownership thereof. This is the same as the Oz statutory definition, but Neverland administers it literally. The Neverland tax is applied to tangible personal property which is brought into the state, even when the item is not utilized there for its intended purpose.

Over the Rainbow, Inc. "(Rainbow") purchased pipe from a foreign supplier and had it delivered to Neverland for inspection, cleaning, and coating. Rainbow paid use tax to Neverland, measured by the cost price of the pipe, in accordance with Neverland law. The pipe was then shipped to Oz where it was installed and used in Rainbow's business. Oz has assessed tax on the "first use," measured by the cost of the pipe, and denied credit for use tax paid to Neverland. Rainbow is upset at having to pay two use taxes with respect to the same property.

What issues are raised by the Oz assessment? Assume that the Neverland use tax was properly paid and there are no constitutional or other legal defects in the Neverland use tax. Also, do not be concerned with the external consistency test.
CONSTITUTIONAL ISSUES
PROBLEM 2

Aching Thumb Co. ("Aching") manufactures hammers and anvils in the State of Pain, where it also has a warehouse and is registered for sales/use tax. Aching has sales contracts with distributors, including Anvils to Drop, Inc. ("Anvils") located in the State of Revenge. Anvils lack nexus in Pain and is not registered for sales/use tax there.

Classic Toon Network (CTN), located in the State of Pain, needed anvils for a feature cartoon it was filming. CTN ordered one gross of rubber anvils from Anvils over the Internet and paid using a credit card. Anvils received the order and immediately faxed a purchase order for the anvils to Aching. Aching agreed to ship the anvils directly to CTN from its Pain warehouse. Aching promptly filled the order and shipped it via common carrier. The same day, it sent Anvils an invoice, payable on receipt.

The Pain Tax Code provides that “all retail sales are subject to the sales tax.” Sales for resale are not retail sales and are not generally taxed if a valid resale certificate is extended. However, Pain also has a statute that provides as follows:

“When tangible personal property is delivered by an owner or former owner thereof, or by a factor or agent of that owner, former owner, or factor to a consumer or to a person for re-delivery to a consumer, pursuant to a retail sale made by a retailer not engaged in business in this state, the person making the delivery shall be deemed the retailer of that property. He or she shall include the retail selling price of the property in his or her gross receipts or sales price.”

Under Pain’s law there would be no Pain tax were the locations of the parties reversed, that is, if the retailer were located in Pain but the manufacturer and ultimate consumer were not. Pain does not honor resale certificates furnished to sellers by purchasers who are not registered in Pain.

Arnie the Auditor, a former Toon actor who had too many anvils dropped on his head, audited CTN and noticed that CTN received the shipment from Aching’s Pain warehouse. Feeling lucky, he began an audit of Aching and confirmed that it paid no tax on the transaction and did not have a valid resale certificate from Anvils. He issued an assessment against Aching.

Discuss the issues.