

Substantive and Enforcement Jurisdiction In a Post-Wayfair World

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In this article, the authors examine the *Wayfair* case through the lens of substantive and enforcement jurisdiction and focus on the question whether there is a constitutionally required relationship between the nexus of the person that the state seeks to enlist as the tax collector and the underlying activity that the state is taxing.

I. Introduction

A few years ago,¹ one of us suggested that it might be helpful to distinguish between substantive jurisdiction and enforcement jurisdiction in analyzing jurisdiction-to-tax

¹Time flies when you're having fun.

issues.² Substantive jurisdiction relates to the power of a state³ to tax the subject matter of an exaction. Substantive jurisdiction to tax includes such questions as whether a state has the power to impose a tax on the income that a nonresident earns from sources in the state, or to impose a tax on goods or services purchased outside but consumed within a state.

Enforcement jurisdiction relates to the power of a state to compel collection of the tax over which it has substantive tax jurisdiction. Enforcement jurisdiction includes such questions as whether a state has power to enforce the collection of a tax on income earned by a nonresident from sources in the state, or whether a state has power to enforce the collection of a tax on goods or services purchased by an in-state consumer from a remote vendor.⁴ We believe that analysis of the jurisdiction-to-tax issues spawned by the U.S. Supreme Court's decision in *South Dakota v. Wayfair Inc.*⁵ may be facilitated by examining

²Walter Hellerstein, "Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective," 38 *Ga. L. Rev.* 1 (2003). See also Walter Hellerstein, "Jurisdiction to Impose and Enforce Income and Consumption Taxes: Towards a Unified Conception of Tax Nexus," in *Value Added Tax and Direct Taxation: Similarities and Differences* 545 (2009).

³Although this article focuses on subnational states, the general principles regarding substantive and enforcement jurisdiction, and the relationship between them, are relevant to national states as well. See sources cited in note 2 *supra*.

⁴The discussion in the text relates to the legal power to enforce the tax, but there are practical issues as well. A state may have the power to enforce a consumption tax against individual consumers, and therefore technically have enforcement jurisdiction, but may lack an effective enforcement mechanism if it has no power to require a remote vendor to collect the tax. In that case, the absence of enforcement jurisdiction over the out-of-state vendor will effectively deprive the state of the ability to collect a consumption tax regarding the goods or services sold by that vendor to local consumers, even if the local consumers have a legal obligation to remit the tax. This, of course, reflects the state of affairs regarding remote vendors selling to local consumers under the state retail sales tax.

⁵138 S. Ct. 2080 (2018).

them in light of the distinction between substantive jurisdiction and enforcement jurisdiction.

II. Substantive Jurisdiction and *Wayfair*

There was no issue of substantive jurisdiction to tax in *Wayfair*, nor could there have been. The case involved the application of South Dakota's sales and use tax to sales by online retailers of home goods, furniture, clothing, jewelry, and consumer electronics to consumers in South Dakota.⁶ With a tax designed in principle to reach "final consumption"⁷ and, in *Wayfair*, applied to quintessential examples of such consumption, South Dakota indisputably had substantive jurisdiction to tax the sales at issue.

A state has substantive jurisdiction to tax consumption where it occurs. This virtually axiomatic proposition is reflected in the OECD's statement of the overarching consumption tax principle that "rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place."⁸ It is likewise reflected in existing consumption tax rules in many states — at least regarding goods — which are typically taxed at destination where consumption is presumed to occur.⁹ As the U.S. Supreme Court declared in sustaining an Iowa use tax, which it characterized as "a nondiscriminatory excise on all personal property consumed in Iowa":

The property is enjoyed by an Iowa resident partly because the opportunity is given by Iowa to enjoy property no matter whence acquired. The exaction is made against the ultimate consumer — the Iowa resident who is paying taxes to sustain his own state government.¹⁰

⁶ *Id.* at 2088-2089.

⁷ In principle, the retail sales tax is a levy on consumer expenditures — that is, it applies only to final sales for personal use and consumption. See Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, para. 12.01 (3d ed. 2018 rev.). In fact, the American retail sales tax deviates substantially from this norm. *Id.*

⁸ OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* 5 (2001). See also OECD, *International VAT/GST Guidelines* 15-17 (2017) (elaborating on destination principle and its widespread adoption for applying consumption taxes to cross-border trade).

⁹ Hellerstein, Hellerstein, and Swain, *supra* note 7, at para. 18.02[1].

¹⁰ *General Trading Co. v. State Tax Commission*, 322 U.S. 335, 338 (1944).

For these reasons, there was simply no issue regarding substantive jurisdiction to tax the sales at issue in *Wayfair*. As the Court noted, "all concede that taxing the sales in question here is lawful."¹¹ The Court reiterated the point later in the opinion, observing that "all agree that South Dakota has the authority to tax these transactions."¹² In short, *Wayfair* had nothing to do with a state's substantive jurisdiction to impose a sales or use tax, a conclusion that followed inexorably from the destination principle.¹³

III. Enforcement Jurisdiction and *Wayfair*

A. *Wayfair's* Enforcement Jurisdiction Analysis

The only question in *Wayfair* was whether South Dakota had enforcement jurisdiction over sellers without physical presence in the state to require them to collect a tax over which South Dakota had undisputed and indisputable substantive jurisdiction. The Court's answer to that question was not complicated, at least as a matter of constitutional principle. There was no due process objection to such enforcement jurisdiction¹⁴ because, as the Court observed in *Wayfair*, it is settled law that "a business need not have a physical presence in a State to satisfy the demands of due process."¹⁵ Indeed, as the Court further noted, "*Quill* itself," the leading case before *Wayfair* on sales tax enforcement jurisdiction over a remote seller, "recognized that '[t]he requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State.'"¹⁶

As for the commerce clause objection to the existence of enforcement jurisdiction over

¹¹ *Wayfair*, 138 S. Ct. at 2087.

¹² *Id.* at 2092.

¹³ Indeed, the Court also recognized the destination principle. ("Generally speaking, a sale is attributable to its destination." *Id.* (citation and internal quotations omitted).)

¹⁴ Or at least not one worth raising, a conclusion reinforced by the fact that respondents, who were represented by skilled and experienced counsel, did not raise one. See Brief for Respondents, *South Dakota v. Wayfair Inc.*, No. 17-494. The respondents' only reference to due process in their brief was the following: "In addition, the Court has on more than one occasion cited with approval *Quill's* ruling that the Commerce Clause establishes limitations on state taxing power that differ from the basic requirements of due process." *Id.* at 42.

¹⁵ *Wayfair*, 138 S. Ct. at 2093 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)).

¹⁶ *Id.* (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992)).

sellers without physical presence in the state, the Court found that “[t]he reasons given in *Quill* for rejecting the physical presence rule for due process purposes apply as well to the question whether physical presence is a requisite for an out-of-state seller’s liability to remit sales taxes. Physical presence is not necessary to create a substantial nexus.”¹⁷ After examining the rule as applied to the contemporary digital economy, and noting that *Quill* had characterized the rule as “artificial at its edges,”¹⁸ the Court declared that it is now “all the more evident that the physical presence rule is artificial in its entirety.”¹⁹

The Court further observed:

Between targeted advertising and instant access to most consumers via any internet-enabled device, “a business may be present in a State in a meaningful way without” that presence “being physical in the traditional sense of the term.” A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores. Yet the continuous and pervasive virtual presence of retailers today is, under *Quill*, simply irrelevant. This Court should not maintain a rule that ignores these substantial virtual connections to the State.²⁰

Once it had repudiated the physical presence rule, it remained only for the Court to apply its commerce clause nexus test — which “simply asks whether the tax applies to an activity with a substantial nexus with the state”²¹ — to the tax collection obligations

imposed by South Dakota statute.²² Quoting an earlier decision, the Court found that “such a nexus is established when the taxpayer [or collector] “avails itself of the substantial privilege of carrying on business” in that jurisdiction.”²³ The decision followed easily:

Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State. The Act applies only to sellers that deliver more than \$100,000 of goods or services into South Dakota or engage in 200 or more separate transactions . . . on an annual basis. This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota. And respondents are large, national companies that undoubtedly maintain an extensive virtual presence. Thus, the substantial nexus requirement . . . is satisfied in this case.²⁴

B. Enforcement Jurisdiction Analysis After *Wayfair*

The constitutional nexus standard for requiring remote vendors to comply with states’ sales and use tax collection obligations after *Wayfair* is therefore whether the vendor has purposefully “availed itself” of the “privilege” or “benefit” of carrying on business in the state’s economic market. In *Wayfair*, the Court articulated the commerce clause nexus standard for imposing such obligations on remote vendors as whether the taxpayer or tax collector “avails itself of the substantial privilege of carrying on

²² One must read the Court’s quotation of *Complete Auto*’s generic statement of the commerce clause nexus requirement in context, namely, whether there was enforcement jurisdiction over the tax collector — a point made clear by the next sentence and by the entire thrust of the Court’s opinion — and not whether the underlying tax applied to an activity over which the state had substantive jurisdiction, which it indisputably did. See Part II *supra*. Thus, in the context of legislation like South Dakota’s, titled “An Act to Provide for Collection of Sales Taxes From Certain Remote Sellers,” the *Complete Auto* nexus standard, properly understood, “simply asks whether the tax [collection obligation] applies to an activity with a substantial nexus with the state.” *Complete Auto*, 430 U.S. at 279 (bracketed words supplied), just as the Court modified its quotation of the language of *Polar Tankers Inc. v. City of Valdez*, 557 U.S. 1 (2009) (quoted at text accompanying note 23 *infra*).

²³ *Wayfair*, 138 S. Ct. at 2099 (quoting *Polar Tankers*, 557 U.S. at 11 (brackets in original) (emphasis supplied)).

²⁴ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 2095 (citation and internal quotation marks omitted).

¹⁹ *Id.*

²⁰ *Id.* (citation omitted).

²¹ *Id.* at 2099 (quoting *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

business” in the state.²⁵ This standard is substantially the same as the due process clause nexus standard the Court had earlier articulated in *Quill* (and reaffirmed in *Wayfair*) — namely, whether the “foreign corporation purposefully avails itself of the benefits of an economic market in the . . . State.”²⁶ As the Court observed in *Wayfair*, these questions may be answered by reference to the taxpayer’s or tax collector’s “economic and virtual contacts” with the state.

One does not need to be a tax professional to recognize that these standards provide little concrete guidance to remote sellers, state tax administrators, and state tax advisers as to the nature and level of “economic and virtual contacts” that will satisfy constitutional nexus norms for enforcing sales and use tax collection obligations regarding remote sellers. The only thing we know for sure about these norms as of this writing is that sellers that deliver “more than \$100,000 of goods or services” into a state or “engage in 200 or more separate transactions” in a state on an annual basis have economic and virtual contacts with the state that are “clearly sufficient” to satisfy constitutional nexus standards. If the dollar value or number of a remote seller’s transactions with purchasers in a state fall below the thresholds approved by the Court in *Wayfair*, the constitutional nexus question will have to be resolved by a fact-sensitive inquiry into the question whether the remote seller’s economic and virtual contacts with the state amount to “purposeful availment” by the remote seller of the “privilege” or “benefit” of carrying on business in the state’s economic market. It is also worth keeping in mind that the Court indicated in *Wayfair* that “other aspects of the Court’s Commerce Clause doctrine,”²⁷ apart from the nexus requirement (for example, discrimination against interstate commerce) might prevent a state from enforcing a use tax obligation against a remote seller with constitutional nexus with the state.

IV. The Relationship Between Substantive Jurisdiction and Enforcement Jurisdiction in a Post-Wayfair World

If there were nothing more to the post-*Wayfair* jurisdictional analysis than what we offered above, even when viewed through the lens of substantive and enforcement jurisdiction, one might fairly inquire why we bothered to clutter up the pages of *State Tax Notes* with yet another article about constitutional nexus in the wake of *Wayfair* if the governing constitutional principles (as distinguished from their practical consequences) are so simple and, we assume, relatively uncontroversial. The answer, at least in our view, is that there is a constitutional issue lurking beneath the surface of the Court’s opinion in *Wayfair* that warrants additional attention because it may well emerge as a controversial question in the post-*Wayfair* environment. That issue is whether there is a constitutionally required relationship between the nexus of the person that the state seeks to enlist as the tax collector (enforcement jurisdiction) and the underlying activity that the state is taxing (substantive jurisdiction) for a state to compel the putative tax collector to collect the tax in question.

A. National Geographic Society

The leading case addressing the question whether there is a constitutionally required relationship between substantive jurisdiction and enforcement jurisdiction, *National Geographic Society Inc. v. State Board of Equalization*,²⁸ answered the question in the negative. In that case, National Geographic, a District of Columbia corporation, made substantial mail-order sales of maps, atlases, globes, and books to California residents who responded to its magazine and direct mail solicitations. National Geographic also maintained two California offices, which solicited advertising for its magazine, but it conducted no activities relating to its mail-order business there. California assessed a use tax against National Geographic on its mail-order sales to California customers. The Court characterized the “question presented” as “whether the Society’s activities in California provided sufficient nexus between the

²⁵ See text accompanying note 23 *supra*.

²⁶ *Quill*, 504 U.S. at 307.

²⁷ *Wayfair*, 138 S. Ct. at 2098.

²⁸ 430 U.S. 551 (1977).

out-of-state seller . . . and the State as required by the Due Process Clause . . . and the Commerce Clause to support imposition upon the Society of a use tax collection duty.”²⁹

The Court first determined that National Geographic’s two offices in California, and its activities there, provided California with enforcement jurisdiction over National Geographic — that is, they “adequately establish a relationship or ‘nexus’ between the Society and the State”³⁰ that permitted the state to impose a use tax collection obligation on National Geographic.

The Court then turned to the question of the constitutional requirements, if any, governing the relationship between California’s enforcement jurisdiction over National Geographic and its substantive jurisdiction over the tax that it was compelling National Geographic to collect. National Geographic contended that the in-state advertising offices played no role in furthering its mail-order sales to California customers and that therefore it could not be required to collect use taxes on those sales, because, in effect, there was no enforcement jurisdiction in California directly related to such sales.³¹ As the Court put it, “[t]he Society argues in other words that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the activity within the State.”³² The Court tersely replied: “We disagree.”³³ It explained that “[h]owever fatal to a direct tax a ‘showing that particular transactions are dissociated from the local business . . .,’ such dissociation does not bar the imposition of the use tax collection duty.”³⁴ Rather, the Court continued, “the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller 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.’”³⁵

National Geographic’s refusal to recognize a constitutionally required relationship between the nexus of the person on whom the state is imposing tax collection obligations and the underlying activity that the state is subjecting to tax raises numerous questions. On the one hand, there is surely something to be said for the Court’s position that a state should be able to demand compliance with use tax collection requirements from those sellers whose contacts with the state establish the requisite nexus for subjecting them to those requirements, whether or not the “activity . . . sought to be taxed” (the use of goods within the state) is directly related to the seller’s nexus-creating contact (owning in-state advertising offices). On the other hand, suppose, as the seller in *National Geographic* suggested, that its only nexus-creating activity was the ownership of a parking lot. Would it still be required to collect use taxes on its mail-order sales on the ground that the parking lot gave rise to enforcement jurisdiction regardless of the relationship of its sales to the parking lot? The short answer that the Court gave to this question — that the statute applied to National Geographic only because it maintained offices in the state, which rendered it a “retailer engaged in business in this State” under the statute — was not entirely satisfactory.³⁶ Suppose the offices had been for the parking lot operation rather than for magazine advertising? At some point, the nexus-creating activity becomes so attenuated from the mail-order sales that as a practical matter — if not as a legal matter — imposition of the tax collection obligation regarding the sales may become problematic.

Although these issues have been given relatively little attention in the 40 years since

²⁹ *Id.* at 554.

³⁰ *Id.* at 556.

³¹ National Geographic argued that the case was controlled by *National Bellas Hess Inc. v. Department of Revenue*, 386 U.S. 753 (1967), the precursor of *Quill*, which held that a state could not impose a use tax collection obligation on an out-of-state mail-order vendor with no physical presence in the state.

³² *National Geographic*, 430 U.S. at 560.

³³ *Id.*

³⁴ *Id.* (citation omitted).

³⁵ *Id.* at 561 (citation omitted, emphasis and brackets in original).

Although the consumer is the taxpayer under state use taxes, the vendor becomes a person liable for any tax that it is required to collect, whether or not it collects the tax. *Id.* at 533 (quoting the California statutes).

³⁶ *Id.* at 556 n.5 (quoting the statute).

National Geographic was decided,³⁷ we believe that they are likely to be the focus of additional scrutiny in a post-*Wayfair* world, and we offer some preliminary thoughts on how these issues might be approached.

B. *Wayfair* on the Requirement of a Relationship Between Substantive Jurisdiction and Enforcement Jurisdiction

Before one considers possible approaches to the relationship between substantive jurisdiction and enforcement jurisdiction in a post-*Wayfair* world, it is critical to recognize that *Wayfair* explicitly reiterated *National Geographic*'s rejection of any relational requirement between substantive and enforcement jurisdiction. Because of the importance of the Court's position to any post-*Wayfair* analysis of this issue, we set out its relevant observations in full:

Consider, for example, two businesses that sell furniture online. The first stocks a few items of inventory in a small warehouse in North Sioux City, South Dakota. The second uses a major warehouse just across the border in South Sioux City, Nebraska, and maintains a sophisticated website with a virtual showroom accessible in every State, including South Dakota. By reason of its physical presence, the first business must collect and remit a tax on all of its sales to customers from South Dakota, *even those sales that have nothing to do with the warehouse*. See *National Geographic*, 430 U.S., at 561.³⁸

It may also be worth noting that the *Wayfair* Court had no need to provide any direct guidance on the required relationship, if any, between substantive jurisdiction and enforcement jurisdiction as applied to the facts in *Wayfair* because there was, and could have been, no question about the existence of such a relationship. In *Wayfair* there could not have been a more direct relationship between substantive jurisdiction, "the activity . . . sought to be taxed" — namely, the use of goods in the state — and

enforcement jurisdiction, the nexus-creating "activity within the State," because enforcement jurisdiction was linked to delivery of, or transactions involving, the *very* goods³⁹ that gave rise to substantive jurisdiction (the taxable use).

Moreover, there is a broader observation that may be made about the relationship between substantive and enforcement jurisdiction that is reflected in the *Wayfair* case (at least if one views enforcement jurisdiction through a post-*Wayfair* lens). Thus, if we put on our post-*Wayfair* virtual reality goggles, we would see that few, if any, of the cases involving enforcement jurisdiction — including *Bellas Hess*, *Quill*, and *National Geographic* itself — raised serious questions of a disconnect between substantive jurisdiction and enforcement jurisdiction. For example, if South Dakota's tax collection regime had been in effect in California in 1964, *National Geographic*'s sales into the state clearly would have exceeded the statute's thresholds (adjusted to reflect 2018 dollar values⁴⁰), and enforcement jurisdiction over *National Geographic* would have been perfectly aligned with substantive jurisdiction over the use tax on the maps, atlases, globes, and books it sold to California consumers.

Consequently, in the post-*Wayfair* world, the lack of a relationship between substantive jurisdiction and enforcement jurisdiction is unlikely to arise, as it has in the past, in the context of a state's reliance on a nexus-creating physical presence that is arguably unrelated to substantial sales by a remote seller to in-state consumers, because those sales will establish the requisite constitutional nexus and, in light of states' widespread adoption of economic nexus statutes like South Dakota's,⁴¹ the requisite statutory nexus as well. Instead, we would expect the relationship issue would arise in situations analogous to those described in the next section.

³⁹ Assuming that the threshold of delivery of more than \$100,000 in annual value or of 200 or more annual transactions was exceeded.

⁴⁰ "During the period from April 1, 1964, to September 30, 1964, the Society made sales of maps, atlases, globes and books to California residents in the sum of \$85,596.48 through mail orders." *National Geographic Society v. State Board of Equalization*, 547 P.2d 458, 460 (Cal. 1976), *aff'd*, 430 U.S. 551 (1977).

⁴¹ See, e.g., Wayne D. Roberts, "Wayfair: The Far-Reaching Effects of Killing Quill," *State Tax Notes*, Sept. 3, 2018, p. 985.

³⁷ But see Jeffrey Friedman, "Consumption Tax Nexus: The Connection With the Transaction to Be Taxed," 38 *Ga. L. Rev.* 119 (2003).

³⁸ *Wayfair*, 138 S. Ct. at 2094 (emphasis supplied).

C. Hypothetical Cases

Two examples may help illustrate the type of case that could give rise to issues as to the relational requirement, if any, between substantive and enforcement jurisdiction in the post-*Wayfair* environment. First, assume that a large corporation (LC) has two distinct businesses conducted by the same legal entity. Based in North Carolina, LC sells skateboards over its website and operates a coal mine in West Virginia. Because of low skateboard demand in West Virginia, LC sells just a handful of skateboards to West Virginia customers annually. Absent a relational requirement, LC would have to collect and remit sales and use tax in West Virginia even though its substantial connection to the state is unrelated to the skateboard sales. In such a case, there would be a disjunction between substantive jurisdiction (jurisdiction to tax the sale or use of skateboards) and enforcement jurisdiction (jurisdiction to impose a tax collection obligation on the coal mine operator).

If we put aside potential constitutional requirements for the moment and focus on practical concerns, it is far from clear that the disjunction in this example creates serious problems. LC avails itself of benefits from West Virginia such as roads and public services, even if those benefits accrue, at least directly, to the coal mining line of business. LC presumably is already filing various tax returns in West Virginia, and may even be registered for sales and use tax purposes. Requiring LC to file one more return in the state does not appear overly burdensome, particularly given the benefit to the state, which may not otherwise have an adequate enforcement mechanism regarding the skateboard sales. Moreover, LC could easily avoid the problems associated with its skateboard sales into West Virginia by creating a separate legal entity for each of its lines of business, effectively depriving West Virginia of enforcement jurisdiction over its skateboard operation.

A more compelling example of potential problems raised by the lack of a relationship between substantive jurisdiction and enforcement jurisdiction would be presented by a small corporation (SC) that has only a single

line of business. Based in Brooklyn, New York, SC sells high-end leather jackets via its website and generates revenue that exceeds expectations. SC's sole shareholder distrusts established financial markets, so she decides to purchase five acres of undeveloped land in rural South Dakota with SC's excess cash. SC sells only a few leather jackets to South Dakota customers and does not satisfy South Dakota's economic nexus standards for triggering an enforcement obligation regarding those sales. Absent a relational requirement, SC may have to collect and remit sales tax in South Dakota even though its nexus-creating activity in South Dakota is unrelated to its leather jacket sales.

As in the example involving LC, there is a disjunction between substantive jurisdiction (jurisdiction to tax the leather jacket sales) and enforcement jurisdiction (jurisdiction to impose a collection obligation on the entity based on owning land in the state). Although SC avails itself of benefits provided by South Dakota such as roads and public services, those benefits are minor given the passive nature of the undeveloped land and are effectively paid for, in large part, through property taxes. SC has not filed any statewide tax returns in South Dakota. Requiring SC to register, collect, and remit sales and use tax is arguably excessively burdensome. Assume further that SC's primary competitor is a large corporation that sells \$99,000 worth of leather jackets into South Dakota annually. Because the competitor invests its excess cash in the stock market instead of undeveloped rural land, it would not have a collection and remittance obligation in South Dakota under the state's nexus thresholds. In contrast to the West Virginia hypothetical, the South Dakota hypothetical presents a stronger case for a relational requirement between substantive and enforcement jurisdiction, at least from a practical perspective.

D. Post-*Wayfair* Constitutional Analysis: *Pike* Balancing

Although *National Geographic's* rejection of a general constitutional principle requiring a relationship between substantive jurisdiction and enforcement jurisdiction plainly remains good

law after *Wayfair*,⁴² the Court in *Wayfair* did allude to a constitutional mechanism for requiring such a relationship, at least in some circumstances — namely, the commerce clause “balancing framework” of *Pike v. Bruce Church Inc.*⁴³ We explore these issues, along with other issues raised by the *Pike* balancing framework, below.

V. The *Pike* Balancing Framework and Enforcement Jurisdiction in a Post-*Wayfair* World

A. The *Pike* Balancing Test

After repudiating *Quill*'s physical presence test of commerce clause nexus in *Wayfair*, the Court declared:

Finally, other aspects of the Court's Commerce Clause doctrine can protect against any undue burden on interstate commerce, taking into consideration the small businesses, startups, or others who engage in commerce across state lines. For example, the United States argues that tax-collection requirements should be analyzed under the balancing framework of *Pike v. Bruce Church, Inc.*⁴⁴

In *Pike*, the Court articulated the following “balancing framework” for adjudicating commerce clause issues:

Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on

the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.⁴⁵

The ensuing discussion explores how the *Pike* balancing test may be applied in the wake of *Wayfair* to remote sellers' efforts to resist states' enforcement of sales and use tax collection obligations, including efforts to require that enforcement jurisdiction be aligned with substantive jurisdiction in fact scenarios analogous to those described above.⁴⁶

B. Applying the *Pike* Balancing Test in Light of *Wayfair*

It may be difficult for large, sophisticated remote sellers to avoid a sales and use tax collection obligation under the *Pike* balancing test. The Court has recognized that imposing such obligations on sellers is a “familiar and sanctioned device,”⁴⁷ and that the “sole burden imposed upon the out-of-state seller . . . is the administrative one of collecting [the tax],”⁴⁸ unless, of course, the seller fails or refuses to comply with its collection obligations.⁴⁹ States may also assert that the remote sellers can facilitate compliance with their collection obligations by engaging one of the many firms that offer multistate tax compliance services.⁵⁰ Regarding the benefit to the state, the *Wayfair* Court recognized at length the substantial benefit that remote seller sales and use tax collection provided to the state, particularly in the absence of alternative effective enforcement mechanisms.

Smaller remote sellers may have a stronger argument under the *Pike* balancing test. As suggested by the second example set forth above,⁵¹ requiring a small remote seller, even one with physical presence in the state, to collect and

⁴⁵ *Pike*, 397 U.S. at 142 (citation omitted).

⁴⁶ See Part IV.C. *supra*.

⁴⁷ *General Trading Co. v. State Tax Commission*, 322 U.S. 335, 338 (1944).

⁴⁸ *National Geographic*, 430 U.S. at 558.

⁴⁹ *Id.*

⁵⁰ See, e.g., the website of the Streamlined Sales Tax Governing Board, which lists many certified service providers that provide tax compliance services.

⁵¹ See Part IV.C. *supra*.

⁴² See Part IV.B. *supra*.

⁴³ 397 U.S. 137 (1970).

⁴⁴ *Wayfair*, 138 S. Ct. at 2098-2099.

remit use tax can be quite burdensome. The benefit to the state, at least if one considers each small remote seller in isolation, is minimal because of the nominal use tax revenue attributable to the small remote seller. It may be inappropriate, however, to view each remote seller in isolation when analyzing the benefits a state achieves from a tax collection regime under the *Pike* standard, which requires that courts determine whether “the burden imposed on . . . [interstate] commerce is clearly excessive in relation to the putative local benefits.”⁵²

Regardless of the size and financial wherewithal of a remote seller, there are several factors that generally strengthen the undue burden argument, many of which were recognized in *Wayfair*. Retroactive application of an economic nexus standard is particularly problematic because the remote seller’s burden may effectively shift from an administrative collection obligation to an actual payment obligation. If the remote seller is not in a position to collect sales and use tax from its customers for past transactions — a task that can be daunting from both a practical and client relationship perspective — the remote seller may be subjected to a substantial tax payment obligation even though the burden of the tax is designed to be passed on to the final consumer. Most states have prudently avoided the retroactive application of their economic presence remote seller collection statutes,⁵³ heeding the implicit warning in *Wayfair*,⁵⁴ although states have not been shy about retroactive application of their tax statutes in other contexts.⁵⁵

The strongest factor supporting an undue burden argument is the complexity and cost of tax compliance. *Wayfair* analyzed and approved a tax regime at the low end of the spectrum in terms of compliance burdens. South Dakota had

uniformity as a result of its adoption of the Streamlined Sales and Use Tax Agreement, and the state administered local sales and use taxes (and even promised free compliance software for remote sellers). At the other end of the spectrum, one would find states that have not adopted the SSUTA, lack uniformity with other states, and allow each locality to administer sales and use taxes. Free or low-cost tax compliance software or assistance may fail to alleviate the substantial compliance burden faced by remote sellers in such states. The burden is exacerbated when a remote seller must deal with many states on the high end of the compliance burden spectrum. Indeed, the *Wayfair* Court signaled that such a regime is potentially open to an undue burden challenge.

A remote seller may also be able to advance or bolster an undue burden argument under a *Pike* balancing analysis by focusing on the principal theme of this article — to wit, the relationship (or lack thereof) between substantive and enforcement jurisdiction. To be sure, as observed above, if a state has an economic presence threshold based on sales into the state, and a remote seller exceeds that threshold, the same activity will generally form the basis for both substantive and enforcement jurisdiction, negating any relationship argument.⁵⁶ Nevertheless, there may be circumstances in which an isolated sale exceeding the threshold would generate statutory collection responsibility for other unrelated sales, thereby arguably imposing an undue burden regarding such unrelated sales under a *Pike* balancing analysis.

A more compelling case for a *Pike* balancing attack based on the lack of a relationship between substantive and enforcement jurisdiction would be one in which a state asserts nexus (and enforcement jurisdiction) based on a remote seller’s physical contacts with the state when those contacts are unrelated to the remote seller’s sales into the state (and substantive jurisdiction) and those sales fall below constitutional and statutory nexus thresholds.⁵⁷ It goes — or at least should go — without saying that physical presence remains a

⁵² *Pike*, 397 U.S. at 142.

⁵³ See Roberts, *supra* note 41.

⁵⁴ After noting in *Wayfair* that “the question remains whether some other principle” aside from nexus might “invalidate” the South Dakota statute, the Court observed that “South Dakota’s tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce,” including that “the Act ensures that no obligation to remit the sales tax may be applied retroactively.” *Wayfair*, 138 S. Ct. at 2099.

⁵⁵ See Hellerstein, Hellerstein, and Swain, *supra* note 7, at para. 4.17[1][a][ii].

⁵⁶ See Part IV.B. *supra*.

⁵⁷ See Part IV.C. *supra*.

significant factor in post-*Wayfair* commerce clause nexus analysis. If the remote seller's physical presence is the primary basis for enforcement jurisdiction, it is arguably an undue burden, at least in some circumstances, to impose a tax collection obligation regarding sales over which the state has substantive jurisdiction when those sales are unrelated to that physical presence and enforcement jurisdiction. Indeed, the taxpayer's hypothetical suggestion in *National Geographic* of the ownership of a parking lot in a state unrelated to its remote sales presents such a case.⁵⁸ We also described such cases in our hypothetical examples of cases raising questions of the requirement of a relationship between substantive jurisdiction and enforcement jurisdiction.

C. The Limits of *Pike* Balancing

Despite the *Wayfair* Court's tantalizing suggestion that *Pike* could potentially protect remote sellers from overreaching sales and use tax collection obligations, *Pike* is unlikely to be the panacea that some have envisaged. Few courts have applied the *Pike* balancing test to analyze state tax laws, but it has been used frequently to analyze other types of state laws. The bad news for remote sellers is that courts rarely strike down *any* state law using the *Pike* balancing test. The last time the U.S. Supreme Court struck down a state law based on a *Pike* analysis was more than 35 years ago,⁵⁹ and not because of lack of opportunity. The Court has more recently addressed and rejected the *Pike* balancing arguments on numerous occasions.⁶⁰ Indeed, it has been argued that the Court has implicitly repudiated a *Pike* balancing analysis in dormant commerce clause cases, based on both the results and language of the Court's decisions that considered *Pike* balancing arguments.⁶¹

The trend is consistent with the case law in federal courts of appeal, which seldom strike down a state law based on a *Pike* balancing analysis, apart from cases involving discrimination against interstate commerce that would have been invalidated wholly apart from *Pike* balancing.⁶² Although most state tax laws are challenged in state courts because of the restrictions on federal jurisdiction over state tax controversies under the federal Tax Injunction Act,⁶³ under the "home cooking" doctrine state courts are even less likely than federal courts to strike down their own state's tax regime, particularly when using a fact-based comparative analysis.⁶⁴

The reason that so few courts strike down state laws under the *Pike* balancing test is the inherent problematic nature of applying the test in a judicial setting.⁶⁵ In its most recent case fully addressing *Pike* — which arose in the state tax context — the Court explained why balancing tests, such as the test articulated in *Pike*, are problematic. The Court recognized that "weighing or quantifying [burdens] for a cost-benefit analysis would be a very subtle exercise."⁶⁶ In the context of analyzing a state tax regime, the Court explained that it would have to examine too many "what if" questions, many of which required speculative and attenuated hypotheses.⁶⁷ The Court identified the broader problem expressly — namely, that courts are often not the proper venue for heavily fact-based balancing tests:

What is most significant about these cost-benefit questions is not even the difficulty of answering them or the inevitable uncertainty of the predictions that might be made in trying to come up with

⁵⁸ See Part IV.A. *supra*. This assumes, of course, that the remote sales do not independently exceed constitutional and statutory nexus thresholds.

⁵⁹ See *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

⁶⁰ See, e.g., *Department of Revenue of Kentucky v. Davis*, 553 U.S. 328, (2008); *United Haulers Association Inc. v. Oneida-Herkimer Solid Waste Management Authority*, 550 U.S. 330 (2007); and *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, 489 U.S. 493 (1989) (finding a state regulation addressing interstate natural gas did not violate the commerce clause after performing a *Pike* balancing analysis).

⁶¹ Brannon P. Denning, "Reconstructing the Dormant Commerce Clause Doctrine," 50 *Wm. & Mary L. Rev.* 417, 493-494 (2008).

⁶² See, e.g., *Colon Health Centers of America LLC v. Hazel*, 813 F.3d 145 (4th Cir. 2016) (upholding a state law after performing a *Pike* balancing analysis); and *Yamaha Motor Corp. U.S.A. v. Jim's Motorcycle Inc.*, 401 F.3d 560 (4th Cir. 2005) (striking down a state statute using a *Pike* balancing analysis, but relying heavily on discrimination).

⁶³ 28 U.S.C. section 1341.

⁶⁴ This is a doctrine well known to state tax practitioners and is the reason they generally support federal legislation allowing state tax challenges to be brought in federal court.

⁶⁵ *Davis*, 553 U.S. at 353-356; Denning, *supra* note 61, at 493-494.

⁶⁶ *Id.* at 354.

⁶⁷ *Id.*

answers, but the unsuitability of the judicial process and judicial forums for making whatever predictions and reaching whatever answers are possible at all.⁶⁸

The Court followed its generalized statement by declaring that balancing tests, such as *Pike*'s, are even less appropriate in tax cases:

[C]ourts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. The complexities of factual economic proof always present a certain potential for error, and courts have little familiarity with the process of evaluating the relative economic burden of taxes.⁶⁹

The Court's suggested solution, which may ring hollow with tax practitioners, is that the legislature — particularly at the federal level — is best equipped to make these determinations and act accordingly.⁷⁰ With that said, the Court's composition has changed significantly over the past 10 years and is continuing to change, and the *Wayfair* Court's suggestion that *Pike* could potentially create an avenue for relief for remote sellers may well find a more hospitable audience than it has in the past.

VI. Due Process 'Relational' Issues

We would be remiss if we did not at least mention the possibility that due process restraints on state personal jurisdiction over nonresident defendants regarding claims that are unrelated to the defendants' activities in the state arguably provide a basis for recognizing a relational

requirement between substantive and enforcement jurisdiction in the state tax context. Despite the Court's explicit rejection of such a requirement in *National Geographic*, which involved both commerce clause and due process clause objections to the state's assertion of enforcement jurisdiction arguably unrelated to substantive jurisdiction,⁷¹ and its reaffirmation of that principle in *Wayfair* (citing *National Geographic*⁷²), the Court has applied what may be regarded as an analogous distinction between general and specific jurisdiction in the personal jurisdiction context.⁷³

The Court explained the distinction in *Bristol-Myers Squibb Co. v. Superior Court*:⁷⁴

Since our seminal decision in *International Shoe*, our decisions have recognized two types of personal jurisdiction: "general" (sometimes called "all-purpose") jurisdiction and "specific" (sometimes called "case-linked") jurisdiction. "For an individual, the paradigm forum for the exercise of general jurisdiction is the individual's domicile; for a corporation, it is an equivalent place, one in which the corporation is fairly regarded as at home." A court with general jurisdiction may hear *any* claim against that defendant, even if all the incidents underlying the claim occurred in a different State. But "only a limited set of affiliations with a forum will

⁷¹ See Part IV.A. *supra*.

⁷² See Part IV.B. *supra*.

⁷³ See, e.g., *Bristol-Myers Squibb Co. v. Superior Court of California, San Francisco County*, 137 S. Ct. 1773 (2017); *Daimler AG v. Bauman*, 571 U.S. 117 (2014); and *Goodyear Dunlop Tires Operations SA v. Brown*, 564 U.S. 915 (2011). Some recent Supreme Court due process decisions addressed whether there was *any* basis for asserting jurisdiction over nonresident defendants. *Walden v. Fiore*, 571 U.S. 277 (2014) (due process clause bars state from asserting personal jurisdiction over nonresident defendant when the defendant never "traveled to, conducted activities within, contacted anyone in, or sent anything or anyone to" the state); *J. McIntyre Mach. Ltd. v. Nicastro*, 564 U.S. 873 (2011) (due process clause bars state from asserting personal jurisdiction over foreign manufacturer regarding personal injury claims arising from use of its machine in state when manufacturer had no presence in the state and neither marketed products in nor shipped products to the state). These cases do not implicate the question whether the due process distinction between general and specific in the personal jurisdiction context informs the analysis of whether there is a required due process relationship between substantive and enforcement jurisdiction in the state tax context — the issue we are addressing here.

⁷⁴ 137 S. Ct. 1773 (2017).

⁶⁸ *Id.* at 355. Denning observes:

Balancing forces courts, on limited information, to second-guess legislative judgments as to things that are not readily reducible to a common metric. If courts balance aggressively, they will overdeter legislatures passing nondiscriminatory laws for the benefit of their citizens, which undermines federalism. Balancing calls into question courts' institutional competence (given their limited capacity for fact-finding), raises institutional concerns by creating friction between them and popularly elected legislatures, and increases litigation costs to parties through the use of an unpredictable and unstable standard.

Denning, *supra* note 61, at 494.

⁶⁹ *Davis*, 553 U.S. at 355-356 (quoting *Fulton Corp. v. Faulkner*, 516 U.S. 325, 342 (1996), quoting *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 589-590 (1983)).

⁷⁰ See *Davis*, 553 U.S. at 356.

render a defendant amenable to” general jurisdiction in that State.

Specific jurisdiction is very different. In order for a state court to exercise specific jurisdiction, “the *suit*” must “aris[e] out of or relat[e] to the defendant’s contacts with the *forum*.” In other words, there must be “an affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State and is therefore subject to the State’s regulation.” For this reason, “specific jurisdiction is confined to adjudication of issues deriving from, or connected with, the very controversy that establishes jurisdiction.”⁷⁵

Moreover, when there is no general jurisdiction over a defendant, “specific jurisdiction is lacking regardless of the extent of the defendant’s unconnected activities in the State.”⁷⁶

The Court’s recent cases illustrate the application of these general principles in the personal jurisdiction context. In *Bristol-Myers Squibb*, plaintiffs sued the pharmaceutical company in California, alleging that the company’s drug damaged their health. The plaintiffs were not California residents and did not allege that they obtained the drug from a California source. Bristol-Myers engaged in business in California, but did not develop, manufacture, label, package, or create a marketing strategy or work on the regulatory approval for the drug in California.⁷⁷ After observing that “all the conduct giving rise to the nonresidents’ claims occurred [outside California],”⁷⁸ the Court concluded that because there was no “connection between the forum and the specific claims at issue,” California lacked jurisdiction under the due process clause to adjudicate these claims.⁷⁹

In *Daimler AG v. Bauman*,⁸⁰ residents of Argentina filed suit against a German parent corporation in California alleging human rights violations by the parent’s Argentine subsidiary in Argentina. The Court held that under the due process clause California did not have personal jurisdiction over the German parent corporation when the California activities of the parent’s U.S. subsidiary bore no relationship to the underlying alleged human rights violations.

In *Goodyear Dunlop Tires Operations SA v. Brown*,⁸¹ North Carolina residents filed suit against three foreign subsidiaries of a U.S. parent corporation for personal injuries that occurred in France. The Court held that the due process clause barred North Carolina from asserting personal jurisdiction over the foreign subsidiaries because the personal injury claims were unrelated to any of the subsidiaries’ activities in North Carolina.

In substance, then, the argument would be that in the absence of general jurisdiction over a remote seller, a state may not impose tax enforcement obligations regarding any sales that are not related to the seller’s specific jurisdiction in the state. Whatever may be the strength of this argument in the abstract, one must be cautious about translating due process restraints on state personal jurisdiction over nonresident defendants into due process restraints on state jurisdiction to enforce tax obligations for many reasons. First, these controversies are inherently fact specific. It is by no means clear that courts would conclude, based on cases like *Bristol-Myers*, *Daimler*, and *Goodyear*, that there is no connection between the forum state and a remote seller’s sales into the state, even if those sales, considered alone, are insufficient to create due process nexus. Second, it is by no means clear that the Court’s concept of “general jurisdiction” in the context of personal jurisdiction — the corporation’s “home”⁸² — is one that courts would find appropriate for confining a state’s enforcement jurisdiction regarding transactions that cannot be traced to the corporation’s in-state activities. Third, and at the risk of repeating ourselves on this important

⁷⁵ *Id.* at 1779-1780 (citations omitted, emphasis in original).

⁷⁶ *Id.* at 1781.

⁷⁷ *Id.* at 1775, 1778.

⁷⁸ *Id.* at 1782.

⁷⁹ *Id.* at 1781.

⁸⁰ 571 U.S. 117 (2014).

⁸¹ 564 U.S. 915 (2014).

⁸² *Bristol-Myers Squibb*, 137 S. Ct. at 1780.

point, the Court's explicit refusal up to now to embrace the argument in the state tax context suggests that the argument would, at a minimum, involve some heavy lifting.⁸³ Although the Court in *Wayfair* found reasons for rejecting *stare decisis*, four of the nine justices regarded *stare decisis* as controlling, and we believe that reports of its death⁸⁴ may be premature.

VII. Conclusion

In the wake of *Wayfair*'s expansion of enforcement jurisdiction for remote sellers, there will likely be renewed calls for the recognition of a relational requirement between substantive and enforcement jurisdiction, whether in the context of *Pike* balancing challenges or by analogy to due process personal jurisdiction "relational" requirements. This position is certainly understandable from a practical perspective, particularly for small remote sellers. At the end of the day, however, we are skeptical about the long-term success of relational requirement arguments and would be cautious about taking such cases on a contingency. ■

⁸³ For further discussion of the potential role of recent due process clause jurisprudence in the state tax context generally, *see, e.g.*, Denning, "Due Process and Personal Jurisdiction: Implications for State Taxes," *State Tax Notes*, June 18, 2012, p. 837; Hayes Holderness, "Taking Tax Due Process Seriously: The Give and Take of State Taxation," *20 Fla. Tax Rev.* 371 (2017); and Eric Smith, "Due Process Implications Related to State Notice and Economic Nexus Laws," *70 Tax Lawyer* 833 (2017).

⁸⁴ George Isaacson and David Bertoni, "The Strange Death of *Stare Decisis*," *State Tax Notes*, Sept. 3, 2018, p. 963.

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