Winding Back *Wayfair*: Retaining the Physical Presence Rule for State Income Taxation

In 2018, the U.S. Supreme Court decided South Dakota v. Wayfair, Inc.*, a case abrogating the physical presence rule from* Quill Corp. v. North Dakota. *The physical presence rule barred a state from forcing a retailer to collect sales taxes on the state's behalf if the retailer lacked a physical presence within the state. The decision came after a decades-long effort by the states to reach sales-tax revenue effectively pushed beyond their reach by the physical presence rule. While enabling states to reach a new revenue source, the Court failed to take full account of the reliance interests dependent on the physical presence rule. In particular, the Court did not consider the effect its decision would have on businesses that used the physical presence rule as a shield from state income-tax liability. Thus, the Court erred in abrogating the physical presence rule without considering the full picture. This Note argues that Congress should pass legislation reinstating the physical presence rule for income-tax purposes to ensure that the* Wayfair *decision will not result in an unanticipated disruption in commerce.*

INTRODUCTION

In September 2018, Amazon became the second company in U.S. history, after Apple, to reach a market capitalization greater than $1 trillion.[1] This valuation reflected the growing market share that online retailers occupy, often at the expense of brick-and-mortar stores.[2] Until

1. David Streitfeld, *Amazon Hits $1,000,000,000,000 in Value, Following Apple*, N.Y. TIMES (Sept. 4, 2018), https://www.nytimes.com/2018/09/04/technology/amazon-stock-price-1-trillion-value.html [https://perma.cc/6J9A-9UNS].

2. Indeed, online retail accounted for an estimated 9.9 percent of retail sales in the fourth quarter of 2018. Press Release, U.S. Dep't of Commerce, Quarterly Retail E-commerce Sales 4th Quarter 2018, at 2 tbl.1 (Mar. 13, 2019), https://census.gov/retail/mrts/www/data/pdf/ec_current.pdf [https://perma.cc/UTJ6-R64J]. At least one source estimates online retail will account for seventeen percent of the market by 2022. Daniel Keyes, *E-commerce Will Make Up 17% of All US Retail Sales by 2022—and One Company Is the Main Reason*, BUS. INSIDER (Aug. 11, 2017, 11:12 AM), http://www.businessinsider.com/e-commerce-retail-sales-2022-amazon-2017-8 [https://perma.cc/Q2LS-K9EL] (summarizing data compiled by Forrester Research).

recently, states struggled to tax the increasingly large portion of retail commerce conducted online because of the 1992 U.S. Supreme Court case *Quill Corp. v. North Dakota*.[3] *Quill* held that a state could not force a retailer that lacked a physical presence in the state—known as a remote retailer—to collect, on the state's behalf, sales taxes[4] from customers.[5] Although consumers are ultimately liable for the sales taxes assessed on their purchases, states depend on retailers to remit the taxes to state treasuries.[6] Due to resource constraints, states cannot, by themselves, realistically track down the tax liability associated with individual consumer purchases.[7] Despite the practical difficulties inherent in a state collecting sales taxes directly from a consumer, *Quill* held the that the Dormant Commerce Clause of the U.S. Constitution prohibits a state from compelling a retailer to collect sales taxes if the retailer lacks a physical presence in the state.[8]

The legal rule espoused in *Quill*, known as the physical presence rule, allowed internet retailers to sell to a national market without facing any tax-collection burdens in states where they lacked a physical presence.[9] With states unable to collect sales taxes on online retail sales, brick-and-mortar retailers were placed at a competitive

3. *See* Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 317–18 (1992) (upholding the physical presence rule under the Dormant Commerce Clause of the U.S. Constitution), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018); *see also* Michael A. Lehmann & Steven Kolias, *Is Justice Kennedy's* Quill *Mightier than the Online Retailer's Sword?*, TAX'N EXEMPTS, Mar./Apr. 2016, at 41, 41 (noting the increasing disparity between state sales-tax-revenue figures and total retail sales created by the combination of *Quill*'s physical presence rule and the rapid rise in e-commerce since 1992).

4. A sales tax involves a state imposing a monetary liability on a consumer's retail purchase at a percentage of the sale price. Shane Padgett Morris, Commentary, *Interstate Commerce and the Future of State Sales and Use Taxes*, 54 ALA. L. REV. 1393, 1395 (2003). A use tax is a tax by a state on property that is purchased outside the state but will be used, stored, or consumed in the state; it is "meant to complement the sales tax by taxing the use of goods inside the state on which no sales tax has been paid." *Id.* at 1396.

5. *Quill*, 504 U.S. at 301.

6. *See, e.g.*, Julie M. Buechler, Note, *Virtual Reality:* Quill*'s "Physical Presence" Requirement Obsolete when Cogitating Use Tax Collection in Cyberspace*, 74 N.D. L. REV. 479, 481–82 (1998) (explaining that a retailer acts as an agent of the state by collecting and remitting sales taxes on the state's behalf but that consumers are ultimately liable for the payment of the tax).

7. *See, e.g.*, Helen Hecht & Lila Disque, DMA v. Brohl—*Is It Time to Stop Fighting the Last War?*, J. MULTISTATE TAX'N & INCENTIVES, July 2016, at 12, 46 (observing that without retailer cooperation, a state must engage in costly audits of thousands of individual taxpayers to obtain the sales-tax revenue to which it is entitled).

8. *See Quill*, 504 U.S. at 314; *infra* Section I.B.3.

9. *See, e.g.*, P. Greg Gulick & Paul M. Jones, Jr., *The Internet's Impact on State Tax Systems: A Proposal to Impose a Use Tax Collection Duty on Remote Vendors*, 33 URB. LAW. 479, 488–90 (2001) (noting that *Quill* removed a state's control over remote retailers even as the internet provided the means for remote retailers to reach consumers across the country).

disadvantage, and states consequently suffered an erosion of their tax revenues.[10]

But now, the conflict is over. In *South Dakota v. Wayfair, Inc.*, states finally convinced the Supreme Court to overturn *Quill* and remove the obstacle that effectively prevented states from collecting online retail sales taxes.[11] The Court pointed to several sound economic[12] and legal[13] reasons that *Quill* was a bad decision. Nonetheless, in *Wayfair* the Justices were considering overturning precedent, a move that required careful consideration of how such a decision might affect the reliance interests of businesses that expanded under the assumption that *Quill* would exist into the future.[14] While a five-member majority of the Court determined that the harmful effects of *Quill* outweighed the need to protect such reliance interests, the Court defined the reliance interests at stake in *Quill* too narrowly. The Court focused only on remote retailers and their sales-tax-collection obligations, but a second, broader reliance interest of businesses that

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10. *See* DONALD BRUCE, WILLIAM F. FOX & LEANN LUNA, STATE AND LOCAL GOVERNMENT SALES TAX REVENUE LOSSES FROM ELECTRONIC COMMERCE 11 tbl.5 (2009), http://cber.utk.edu/ecomm/ecom0409.pdf [https://perma.cc/4X8K-CD3H] (estimating that states would fail to collect approximately $11.4 billion in sales taxes from e-commerce in 2012); ARTHUR B. LAFFER & DONNA ARDUIN, PRO-GROWTH TAX REFORM AND E-FAIRNESS 11 (2013), http://www.efairness.org/files/dr-art-laffer-sudy.pdf [https://perma.cc/Y3FK-53L4] (projecting that states would lose between $27 and $33 billion in 2022 under *Quill*'s physical presence rule). *But see* JEFFREY A. EISENACH & ROBERT E. LITAN, UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK 27 (2010), https://netchoice.org/wp-content/uploads/eisenach-litan-e-commerce-taxes.pdf [https://perma.cc/E39L-JYZ6] (arguing that states would lose only $3 billion in sales taxes for 2012 because of *Quill*).

11. 138 S. Ct. 2080, 2099 (2018) ("[T]he Court concludes that the physical presence rule of *Quill* is unsound and incorrect.").

12. *See id.* at 2094:

> *Quill* puts both local businesses and many interstate businesses with physical presence at a competitive disadvantage relative to remote sellers. Remote sellers can avoid the regulatory burdens of tax collection and can offer *de facto* lower prices caused by the widespread failure of consumers to pay the tax on their own.

13. *See id.* at 2100–01 (Gorsuch, J., concurring):

> My agreement with the Court's discussion of the history of our dormant commerce clause jurisprudence . . . should not be mistaken for agreement with all aspects of the doctrine. The Commerce Clause is found in Article I and authorizes *Congress* to regulate interstate commerce. Meanwhile our dormant commerce cases suggest Article III *courts* may invalidate state laws that offend no congressional statute. Whether and how much of this can be squared with the text of the Commerce Clause, justified by *stare decisis*, or defended as misbranded products of federalism or antidiscrimination imperatives flowing from Article IV's Privileges and Immunities Clause are questions for another day.

14. *See, e.g.*, Randy J. Kozel, *Precedent and Reliance*, 62 EMORY L.J. 1459, 1466 (2013) ("So well established is the relevance of reliance that, even while departing from precedent, the Court has offered reassurance that 'reliance on a judicial opinion [remains] a significant reason to adhere to it.' " (alteration in original) (quoting Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 906 (2007))); *infra* Section II.A.

depended on *Quill* to shield them from state income taxes was ignored.[15] *Quill*'s demise now leaves these businesses without any protection from state income taxes—an exposure that could greatly disrupt commerce.[16] Whatever the merits of the *Wayfair* Court's decision regarding sales-tax collection, this Note argues that the Court should not have overturned *Quill*, because the Court failed to take account of reliance interests associated with protection from state income-tax collection. To correct this problem, Congress should write legislation filling in the gap *Wayfair* created.

This Note proceeds in three parts. First, Part I reviews the doctrinal evolution before the Court's decision in *Wayfair*. Next, Part II analyzes how the Court failed to take full stock of the reliance interests at stake in *Wayfair* and consequently erred in overturning *Quill*. Finally, Part III argues that Congress should correct the Court's misstep through legislation that recreates the physical presence rule for state income taxation.

I. ORIGIN AND RATIONALE OF THE PHYSICAL PRESENCE RULE

This Part reviews the doctrinal basis of the physical presence rule. Section I.A introduces the Dormant Commerce Clause and its limits on state power. Next, Section I.B follows the development of the physical presence rule from its origin in *Bellas Hess* to its demise in *Wayfair*. Section I.C then explains the Court's application of the *Complete Auto* test to various types of state taxes beyond sales taxes. Finally, Section I.D reviews the state court split on whether to extend the physical presence rule to state income taxes.

A. The Dormant Commerce Clause: A Shield Against the State

The Commerce Clause of the U.S. Constitution expressly gives Congress power "[t]o regulate Commerce with foreign Nations, and among the several States."[17] In addition to the express powers, a dormant implication to the Clause, which limits a state's power to regulate commerce, has been recognized by the Supreme Court.[18] If a

15. *See infra* Part II.

16. *See infra* Section II.B.

17. U.S. CONST. art. I, § 8, cl. 3.

18. *E.g.*, S.C. State Highway Dep't v. Barnwell Bros., 303 U.S. 177, 185 (1938) ("The commerce clause by its own force, prohibits discrimination against interstate commerce . . . ."); *see also* Comptroller of the Treasury v. Wynne, 135 S. Ct. 1787, 1794 (2015) (citing Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 207 (1824) (Marshall, C.J.)) (asserting that the Dormant Commerce Clause has "deep roots"). *But see* Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting) (arguing that the Dormant Commerce Clause has no textual basis

state law unduly burdens interstate commerce—commerce between two parties residing in different states—the Dormant Commerce Clause invalidates the regulation.[19]

The Court's analysis of whether a state's law unduly burdens interstate commerce takes a different form if a state seeks to regulate versus tax.[20] If a state seeks to regulate, the Court will analyze the regulation under the *Pike* balancing test.[21] If a state seeks to tax, the Court will analyze the tax under the *Complete Auto* four-part test, which is examined in the next Section.[22] One part of the *Complete Auto* test requires that a taxed activity have a sufficient nexus with the taxing state.[23] As discussed below, before *Wayfair* the nexus requirement and the physical presence rule were one and the same: a taxed entity had a sufficient nexus with a state if and only if the entity had a physical presence in the state.[24]

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in the Constitution); Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 260 (1987) (Scalia, J., concurring in part and dissenting in part) (arguing that according to the clear text of the Constitution, the Commerce Clause gives an affirmative power to Congress and that no negative power necessarily flows to the courts from its language); Amy M. Petragnani, Comment, *The Dormant Commerce Clause: On Its Last Leg*, 57 ALB. L. REV. 1215, 1239 (1994) (arguing that no historical support exists suggesting that the Framers sought to create a dormant commerce power in the Commerce Clause).

19. *See Wynne*, 135 S. Ct. at 1794 (explaining that the Dormant Commerce Clause prohibits states from imposing excessive burdens on interstate commerce without congressional approval); S. Pac. Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761, 769 (1945) ("[The Commerce Clause provides] protection from state legislation inimical to the national commerce, . . . [even] where Congress has not acted . . . .").

20. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES § 5.4.1, at 478–79 (5th ed. 2015) (noting that "the same basic principles apply to state taxation of interstate commerce as to state regulation of commerce" but that "the topic of state taxation of interstate commerce requires separate consideration because the Court, both historically and currently, has formulated distinct tests for evaluating state taxes that burden interstate commerce"). *But see* Samantha K. Graff, *State Taxation of Online Tobacco Sales: Circumventing the Archaic Bright Line Penned by* Quill, 58 FLA. L. REV. 375, 408–09 (2006) (observing that the distinction between regulation and taxation under the Dormant Commerce Clause appears rather nominal in nature).

21. Pike v. Bruce Church, Inc., 397 U.S. 137 (1970). The test states: "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." *Id.* at 142.

22. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

23. *See, e.g.*, Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 364 (1941) (upholding a state's imposition of a tax-collection burden on a retailer for mail orders filled by out-of-state branches because the retailer's in-state branches created a sufficient nexus with the state).

24. *See* Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 309–10 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018). Additionally, the Court's nexus jurisprudence has striking similarities to the Court's personal jurisdiction jurisprudence under the Due Process Clause. The Court has said that the two standards are "closely related." Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 756 (1967), *overruled by Wayfair*, 138 S. Ct. 2080.

B. The Road to Wayfair

1. *Bellas Hess* and the Physical Presence Rule

The disputes in *Quill* and *Wayfair* derived directly from the 1967 decision *National Bellas Hess, Inc. v. Department of Revenue*.[25] In *Bellas Hess*, the Supreme Court held that a retailer lacking physical presence in a state could not be forced to collect and remit sales taxes on behalf of the state.[26] National Bellas Hess was a retailer based in Missouri that mailed catalogs and delivered merchandise via common carrier to customers in Illinois.[27] Bellas Hess had neither tangible property nor employees working or living in Illinois.[28]

Illinois had a sales-tax-collection statute requiring all retailers, regardless of their physical presence in the state, to collect sales taxes from Illinois residents and remit the revenue to the state.[29] The law also required retailers to "keep such records, receipts, invoices and other pertinent books, documents, memoranda and papers as the [state] shall require, in such form as the [state] shall require."[30] Bellas Hess ignored the statute, and Illinois successfully obtained an injunction from the Illinois Supreme Court that required Bellas Hess to collect and remit the sales taxes.[31]

Bellas Hess appealed to the U.S. Supreme Court, which reversed the Illinois Supreme Court.[32] The Court noted that its precedent had always interpreted the Dormant Commerce Clause to require a remote retailer's physical presence in a state before the state could impose its regulations on the retailer.[33] Allowing Illinois to impose tax-collection obligations on Bellas Hess would mean that the company would potentially have to comply with regulations from other states where it made sales but had no physical presence.[34] The myriad of conflicting state rules on recordkeeping and tax rates would "entangle" Bellas

25. *Quill*, 504 U.S. at 301 (remarking on the similar facts of *Bellas Hess* and *Quill*).
26. *Bellas Hess*, 386 U.S. at 759–60.
27. *Id.* at 753–54.
28. *Id.* at 754.
29. *Id.* at 755.
30. *Id.*
31. *Id.* at 754.
32. *Id.* at 760.
33. *Id.* at 758 ("[T]he Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail."); *see also* James L. Kronenberg, *A New Commerce Clause Nexus Requirement: The Analysis of Nexus in* Quill Corp. v. North Dakota, 1994 ANN. SURV. AM. L. 1, 13 (tracing the first articulation of the physical presence rule under the Dormant Commerce Clause to Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941)).
34. *Bellas Hess*, 386 U.S. at 759.

Hess's business in a manner that the Dormant Commerce Clause prohibited.[35]

2. *Complete Auto* and the Substantial Nexus Test

In *Complete Auto Transit, Inc. v. Brady*, decided ten years after *Bellas Hess*, the Court revisited the extent of a state's power to tax a business under the Dormant Commerce Clause.[36] The case involved a car transporter that brought new cars from a railroad junction in Jackson, Mississippi, to car dealerships throughout the rest of the state.[37] At issue was whether the Dormant Commerce Clause allowed a state to impose a gross income tax on the "privilege" of conducting interstate commerce.[38] The Court applied a four-part test whereby a state could tax an entity under the Dormant Commerce Clause only if (1) the entity had a substantial nexus with the taxing state, (2) the tax was fairly apportioned, (3) the tax did not discriminate against interstate commerce, and (4) the tax was fairly related to the services provided by the state.[39] If a tax failed a single part, the tax was unconstitutional. The first part asked if a "substantial nexus" existed between the state and the retailer's activity.[40] If a substantial nexus existed, the Dormant Commerce Clause would allow the state tax, although the tax might still fail under one of the other three parts of the test.[41] As to the first part, which was subsequently at issue in *Quill* and is the focus of this Note, the Court found that a substantial nexus

35. *Id.* at 759–60; *see also* Charles E. McLure, Jr., *Radical Reform of the State Sales and Use Tax: Achieving Simplicity, Economic Neutrality, and Fairness*, 13 HARV. J.L. & TECH. 567, 573 (2000) (discussing the difficulties for a business to comply with fifty state tax and regulatory regimes).

36. 430 U.S. 274, 274–75 (1977).

37. *Id.* at 276.

38. *Id.* at 278.

39. *Id.* at 279. The latter three elements only arise after determining if an entity has a substantial nexus; they are not discussed in this Note, because *Quill* did not reach them. *See* Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 310–11 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

40. The Court in *Complete Auto* substituted "sufficient nexus" for "substantial nexus" on several occasions, implying that no real difference existed between the two words. At one point, the Court listed "sufficient nexus" as the first of the four prongs in its Dormant Commerce Clause test. *Complete Auto*, 430 U.S. at 278. Several paragraphs later, the Court listed "substantial nexus" as the first of four prongs. *Id.* at 279; *see* H. Beau Baez III, *The Rush to the Goblin Market: The Blurring of* Quill*'s Two Nexus Tests*, 29 SEATTLE U. L. REV. 581, 596 (2006) (listing various ways in which the Court has worded the jurisdictional standard under the Dormant Commerce Clause, including substantial nexus, sufficient nexus, Commerce Clause nexus, and nexus aplenty).

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

existed because the company's entire business of transporting cars took place within the state.[42]

By holding that the car transporter's physical presence in Mississippi was sufficient to validate the state's power to tax, *Complete Auto* appeared to incorporate *Bellas Hess*'s physical presence rule into the substantial nexus part of *Complete Auto*'s four-part test.[43] *National Geographic Society v. California Board of Equalization*, decided four weeks after *Complete Auto*, strengthened the hypothesis that substantial nexus meant the same thing as the physical presence rule.[44] In *National Geographic*, the Court held that although National Geographic only maintained two sales offices in the state,[45] those two sales offices nonetheless established a clear physical presence and thus a substantial nexus that justified the state's imposition of a sales-tax-collection duty.[46]

3. *Quill* Upholds the Physical Presence Rule

In 1987, North Dakota decided to test the strength of *Bellas Hess* by requiring all retailers to collect and remit sales taxes on the state's behalf, regardless of retailers' physical presence.[47] Quill Corporation, a mail-order retailer of office supplies, regularly solicited business from North Dakota residents through telephone calls and mail advertisements.[48] Quill possessed no tangible property, such as sales offices or warehouses, within North Dakota,[49] nor did any of its employees live or work within North Dakota's borders.[50] Quill failed to collect and remit sales taxes for North Dakota, so the state sued Quill for the unremitted tax balance.[51]

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42. *Id.* at 277–78 ("Appellant, in its complaint in Chancery Court, did not allege that its activity which Mississippi taxes does not have a sufficient nexus with the State . . . .").

43. *See id.* at 287 ("We note . . . that no claim is made that the activity is not sufficiently connected to the State to justify a tax . . . .").

44. *See* 430 U.S. 551, 554 (1977) ("The question . . . is whether [National Geographic]'s activities at the offices in California provided *sufficient nexus* between [National Geographic] and the State as required by . . . the Commerce Clause to support . . . a use-tax-collection liability . . . ." (emphasis added) (footnote omitted)).

45. *Id.* at 552.

46. *Id.* at 556 ("Our affirmance thus rests upon our conclusion that appellant's maintenance of the two offices in California and activities there adequately establish a relationship or 'nexus' between [National Geographic] and the State . . . .").

47. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 302–03 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

48. *Id.* at 302.

49. *Id.*

50. *Id.*

51. *Id.* at 303.

The North Dakota Supreme Court concluded that *Complete Auto*'s substantial nexus prong had replaced the physical presence rule from *Bellas Hess*.[52] To the state high court, *Complete Auto*'s substantial nexus requirement did not require a business to have a physical presence in a state for the state to regulate the business.[53] The U.S. Supreme Court disagreed and made clear that the substantial nexus part of the four-part *Complete Auto* test requires some physical presence in the state. Justice Stevens remarked, "[A] vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."[54] After determining that *Bellas Hess* and *Complete Auto* controlled, Justice Stevens reasoned that the Court should adhere to stare decisis[55] and follow the rule set down in *Bellas Hess*.[56]

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52. *Id.* at 303–04 ("[The North Dakota Supreme Court] . . . indicated that the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess*.").

53. *See id.*

54. *Id.* at 311.

55. Justice White, who dissented from the Court's Dormant Commerce Clause holding, argued that the majority based its decision almost entirely on stare decisis and undervalued the real-world implications of protecting the growing mail-order industry. *Id.* at 331–32 (White, J., concurring in part and dissenting in part) ("Finally, the Court accords far greater weight to *stare decisis* than was given to that principle in *Complete Auto* itself."); *see also* David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-commerce*, 92 B.U. L. REV. 483, 512 (2012) (observing that *Quill* upheld *Bellas Hess* on stare decisis grounds); Kozel, *supra* note 14, at 1488–89 (arguing that other areas of contemporary constitutional jurisprudence rendered the physical presence rule irrelevant and that the Court made its decision in *Quill* based on stare decisis alone). In fact, the majority's invocation of stare decisis came after it first determined that cases such as *National Geographic* had not overruled *Bellas Hess*. *See Quill*, 504 U.S. at 314. Reliance on stare decisis came as the final logical step in the analytical process, not as the touchstone to the entire decision. *Id.* at 317:

> 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.

Justice Scalia's concurrence, on the other hand, was based entirely on stare decisis. *Id.* at 320 (Scalia, J., concurring in part and concurring in the judgment) ("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*.").

56. *Quill*, 504 U.S. at 317–18. In addition to using the Dormant Commerce Clause, *Bellas Hess* relied on the Due Process Clause in crafting the physical presence rule. Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 756–58 (1967) (explaining the Court's due process jurisprudence and concluding that "[t]he Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail"), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018). While Quill succeeded in convincing the Court to uphold the physical presence rule under the Dormant Commerce Clause, the Court agreed with North Dakota that the physical presence rule could not survive under the Due Process Clause given the Court's jurisprudence subsequent to *Bellas Hess*. *Quill*, 504 U.S. at 308 ("[T]o the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to

4. *Wayfair* Overturns the Physical Presence Rule

Over two decades after North Dakota faced defeat at the hands of the mail-order industry, South Dakota passed a law in direct defiance of the holding in *Quill*, hoping that the resulting litigation would lead to *Quill*'s demise.[57] The legislation required retailers that did not have a physical presence in South Dakota to collect and remit taxes on sales to South Dakota residents.[58] Once the law took effect, South Dakota sued three online retailers, including Wayfair, that lacked a physical presence in South Dakota. The state sought a declaratory judgment from the state court that the law was constitutional.[59] Predictably, the South Dakota Supreme Court held that the newly minted law violated the U.S. Constitution under a straightforward application of *Quill*.[60] In response, South Dakota petitioned for a writ of certiorari, and the U.S. Supreme Court granted the petition.[61]

Ultimately, the state prevailed, convincing five Justices to overturn *Quill*. Writing for the majority, Justice Kennedy unequivocally abolished the physical presence rule and clarified the resulting doctrinal shift:

> In the absence of *Quill* and *Bellas Hess*, the first prong of the *Complete Auto* test simply asks whether the tax applies to an activity with a substantial nexus with the taxing State. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."[62]

Regardless of what the Court meant by the ambiguous word "avail," the Court left no doubt that it meant to end the physical presence rule once and for all.

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collect a use tax, we overrule those holdings as superseded by developments in the law of due process.").

57. State v. Wayfair Inc., 901 N.W.2d 754, 756 (S.D. 2017) ("The Legislature specifically passed the legislation to challenge the Supreme Court's Commerce Clause decisions."), *vacated*, 138 S. Ct. 2080. The South Dakota legislature's stark disregard for Supreme Court precedent arose from Justice Kennedy's invitation for "[t]he legal system [to] find an appropriate case for [the Supreme] Court to reexamine *Quill*." Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring); *see Wayfair*, 901 N.W.2d at 765 (quoting the legislature's findings that Justice Kennedy urged the Court to reconsider *Quill*). Justice Kennedy believed that *Quill*'s holding, combined with the rise of e-commerce, brought economic harm to the states that was far worse than what was anticipated in 1992. *Brohl*, 135 S. Ct. at 1135 (Kennedy, J., concurring).

58. S.D. CODIFIED LAWS § 10-64-2 (2018).

59. *Wayfair*, 901 N.W.2d at 759. South Dakota sued Wayfair, Overstock.com, and Newegg. *Id.* at 756 n.3.

60. *See id.* at 761 ("However persuasive [South Dakota]'s arguments on the merits of revisiting the issue, *Quill* has not been overruled.").

61. South Dakota v. Wayfair, Inc., 138 S. Ct. 735 (2018) (mem.).

62. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) (alterations in original) (citation omitted) (quoting Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009)).

The majority focused almost entirely on the policy merits of abolishing or retaining the physical presence rule. On the one hand, growing state revenue losses due to the physical presence rule demonstrated the need for the rule's demise. In 1992, lost revenues ranged between $694 million and $3 billion per year.[63] In 2018, states stood to lose between $8 and $33 billion.[64] And the rapid growth of internet commerce would continue to make matters worse. In 1992, less than two percent of Americans had access to the internet.[65] The number had grown to eighty-nine percent by 2018.[66] The advent of the "Cyber Age" resulted in internet commerce commanding an 8.9 percent market share in retail sales.[67] In 2000, internet commerce had only a 0.8 percent market share.[68]

The Court also believed that the new adverse consequences for remote retailers were not endemic. The remote retailers argued that complying with heterogeneous rules of thousands of tax jurisdictions could stifle commerce.[69] Justice Kennedy responded, "Eventually, software that is available at a reasonable cost may make it easier for small businesses to cope with these problems."[70] Even better, South Dakota, along with more than twenty other states, had adopted the Streamlined Sales and Use Tax Agreement.[71] The agreement "standardizes taxes to reduce administrative and compliance costs" by "requir[ing] a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules."[72] Justice Kennedy further noted that the agreement provided "sellers access to sales tax administration software paid for by the State" and that those "who choose to use such software are immune from audit liability."[73] In sum, compliance costs posed few problems to industry and could not justify retaining the physical presence rule.

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63. *Id.* at 2097.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*
69. Respondents' Brief at 30, *Wayfair*, 138 S. Ct. 2080 (No. 17-494):

> The State acknowledges that the number of tax jurisdictions continues to grow and does not dispute that they have disparate substantive and administrative requirements. The only response that the State presents to such inordinate complexity is software. In effect, no matter how monstrously complex the states choose to make their sales tax codes, software (or, perhaps, cloud computing) is the "silver bullet" to slay the beast.

70. *Wayfair*, 138 S. Ct. at 2098.
71. *Id.* at 2099–100.
72. *Id.* at 2100.
73. *Id.*

To the majority, the *Quill* Court's error created more than bad policy in the abstract. Rather, *Quill* created a measurable, growing harm from which nearly all the states begged for relief.[74] Given the growing crisis, waiting for Congress no longer seemed like a reasonable option. Justice Kennedy declared, "Courts have acted as the front line of review in this limited sphere; and hence it is important that their principles be accurate and logical, *whether or not* Congress can or will act in response."[75] The majority was in the "real world," and it could not sit idly by.

C. Application of the Complete Auto *Test Beyond Sales-Tax Collection*

While litigation ensued over the physical presence rule and sales-tax collection, other cases addressed the application of *Complete Auto*'s test to other types of assessments beyond sales taxes.[76] For example, in *Mobil Oil Corp. v. Commissioner of Taxes*, decided in 1980, the Court upheld a corporate net income tax leveled by Vermont.[77] The company asserted that Vermont's taxation of income earned outside of the United States violated the Dormant Commerce Clause.[78] The Court decided to analyze the company's claim under the four-part test from *Complete Auto*.[79] Unlike in *Bellas Hess* or *National Geographic*, the company did not dispute that its extensive physical presence created a nexus with the taxing state.[80] Instead, the dispute centered on whether

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74. *Id.* at 2095 ("Forty-one States, two Territories, and the District of Columbia now ask this Court to reject the test formulated in *Quill*.").

75. *Id.* at 2096–97 (emphasis added).

76. *See* Goldberg v. Sweet, 488 U.S. 252, 259–60 (1989) (applying *Complete Auto* to a per-call tax on phone calls); Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 249–51 (1987) (holding that the presence of a single sales representative in a state establishes substantial nexus to tax a company's gross proceeds from wholesaling activity).

77. 445 U.S. 425, 429 (1980). Unlike a sales tax, which involves an assessment on a percentage of a good's sale price, an income tax involves the government taking a percentage of a company's total net income that it earns on its business throughout the year. Julia Kagan, *Income Tax*, INVESTOPEDIA, https://www.investopedia.com/terms/i/incometax.asp (last updated Mar. 23, 2019) [https://perma.cc/M8RS-9M8G].

78. *Id.* at 442 ("[A]ppellant contends that Vermont's tax imposes a burden on interstate and foreign commerce by subjecting appellant's dividend income to a substantial risk of multiple taxation.").

79. *Id.* at 443:

> In an endeavor to establish a consistent and rational method of inquiry, we have examined the practical effect of a challenged tax to determine whether it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."

(quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).

80. *Id.* at 428–29 ("[T]he value of [the company's] property in Vermont was $3,930,100 [in 1970], $6,707,534 [in 1971], and $8,236,792 [in 1972] . . . .").

Vermont's attempt to tax foreign income discriminated against interstate commerce, the third prong of the *Complete Auto* test.[81]

In *Commonwealth Edison Co. v. Montana*, a 1981 case, the Court held that a severance tax, a per-unit tax on the extraction of coal, was valid under *Complete Auto*.[82] Similar to the oil company in *Mobil Oil Corp.*, the coal mining company in *Commonwealth Edison* argued that the Dormant Commerce Clause prohibited the severance tax.[83] Again, the Court relied on the *Complete Auto* test to make its determination.[84] Also, just as in *Mobil Oil Corp.*, the substantial nexus prong of *Complete Auto* was not at issue with Montana's tax because the taxpayer had an undisputed physical presence in the state.[85]

D. State Court Application of the Physical Presence Rule to Income Taxes

Before *Wayfair*, the Court had never directly addressed the scope of *Quill*'s holding. *Quill*, like *Bellas Hess* before it, only involved sales taxes. Following *Quill*, some state courts grappled with whether the physical presence rule applied to other types of assessments, such as incomes taxes.[86] A split quickly emerged among these states, with a majority holding that *Quill* did not extend beyond sales taxes and a minority taking the opposite view.[87] By the time of *Wayfair*, however, most states had not addressed the question.[88]

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81. *Id.* at 443 ("Appellant asserts that Vermont's tax is discriminatory because it subjects interstate business to a burden of duplicative taxation that an intrastate taxpayer would not bear.").

82. 453 U.S. 609, 612 (1981) ("Montana, like many other States, imposes a severance tax on mineral production in the State. In this appeal, we consider whether the tax Montana levies on each ton of coal mined in the State violates the Commerce and Supremacy Clauses of the United States Constitution." (citation omitted)). A severance tax involves the government requiring a company to pay for the physical extraction of a natural resource. Julia Kagan, *Severance Tax*, INVESTOPEDIA, https://www.investopedia.com/terms/s/severance-tax.asp (last updated May 28, 2018) [https://perma.cc/6P86-KCLR]. The government sets the tax rate against a particular weight or volume of the natural resource. For example, a government could require a company to pay $1.50 for every ton of coal extracted by the company from the ground.

83. *Commonwealth Edison*, 453 U.S. at 613.

84. *Id.* at 617 ("We agree with appellants that the Montana tax must be evaluated under *Complete Auto Transit*'s four-part test.").

85. *Id.* ("Appellants do not dispute that the Montana tax satisfies the first two prongs of the *Complete Auto Transit* test.").

86. *See, e.g.*, Crutchfield Corp. v. Testa, 88 N.E.3d 900, 912 (Ohio 2016) (collecting cases that sought to answer whether *Quill* extended beyond sales-tax collection).

87. *Id.* ("[W]e follow our own lead along with that of most state courts that, post-*Quill*, have explicitly rejected the extension of the *Quill* physical-presence standard to taxes on, or measured by, income.").

88. My research did not reveal any post-*Quill* cases addressing state income taxation in the remaining thirty-one states.

1. The Minority Position on State Income Taxes

A minority of courts that had addressed *Quill*'s scope determined that *Quill* extended beyond sales taxes, because they perceived no principled reason or legal authority to limit *Quill*. In *J.C. Penney National Bank v. Johnson*, Tennessee sought to apply a corporate income tax to a credit card company lacking a physical presence in Tennessee.[89] The Tennessee Court of Appeals acknowledged that the controversy in *Quill* involved sales taxes and not income taxes like the case before it.[90] Nonetheless, it found "no basis for concluding that the analysis should be different" for income taxes as opposed to sales taxes.[91] Indeed, the state was "unable to provide any authority as to why the analysis should be different for franchise and excise taxes."[92] Ultimately, the court concluded that it was "not in a position to speculate as to how the Supreme Court might decide future cases," even if "the *Quill* Court expressed some reservations about the vitality of the *Bellas Hess* decision."[93]

In addition to Tennessee courts, Texas courts have repeatedly applied the physical presence rule to income taxes. In *Rylander v. Bandag Licensing Corp.*, a Texas court of appeals invalidated a franchise tax on the fees a subsidiary earned on patents it licensed to its parent corporation.[94] In that case, the court observed, "While the decisions in *Quill Corp.* and *Bellas Hess* involved sales and use taxes, we see no principled distinction when the basic issue remains whether the state can tax the corporation at all under the Commerce Clause."[95] Subsequent Texas appellate decisions followed the *Rylander* court's decision.[96] Similarly, a Pennsylvania appellate court in *Robert L. McNeil, Jr. Trust ex rel. McNeil v. Commonwealth* applied the physical presence rule to limit the imposition of income taxes on a trust that

89. 19 S.W.3d 831, 832–33 (Tenn. Ct. App. 1999).

90. *Id.* at 839.

91. *Id.*

92. *Id.*

93. *Id.* Indeed, the Tennessee court appears to have taken the conservative approach preferred by the Supreme Court. *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 484 (1989) ("If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [the lower court] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.").

94. 18 S.W.3d 296, 298 (Tex. App. 2000).

95. *Id.* at 300.

96. *See* Galland Henning Nopak, Inc. v. Combs, 317 S.W.3d 841, 844 (Tex. App. 2010); INOVA Diagnostics, Inc. v. Strayhorn, 166 S.W.3d 394, 402 (Tex. App. 2005) ("While the tax in question in *Quill* was a use tax, this Court has applied this same bright-line test when determining whether the franchise tax is consistent with the Commerce Clause.").

lacked a physical presence in the state.[97] Connecticut also appears to apply *Quill* beyond sales taxes.[98]

2. The Majority Position on State Income Taxes

The majority position on income taxation and the physical presence rule had comprised fifteen states and held that *Quill* did not extend beyond sales-tax collection.[99] These state courts relied on a single comment from Justice Stevens in *Quill* to justify such a narrow reading. The South Carolina Supreme Court began this trend in *Geoffrey, Inc. v. South Carolina Tax Commission*.[100] South Carolina sought to tax a business's royalty income on certain intangibles, but the business argued that it lacked a physical presence in the state.[101] The court first determined that the business actually did maintain a physical presence in South Carolina due to the trademarks it licensed for use in the state.[102] Then, in dicta in a footnote, the court concluded that even if the defendant had lacked a physical presence, the state would still have the power to tax the defendant's royalty income because

97. 67 A.3d 185, 194 (Pa. Commw. Ct. 2013) ("[W]e agree with the Trusts that they lack the necessary physical presence in Pennsylvania to establish a substantial nexus between the Trusts and Pennsylvania.").

98. In *Chase Manhattan Bank v. Gavin*, the Connecticut Supreme Court examined, among other things, whether the state could tax the income of a trust under the Due Process Clause. 733 A.2d 782, 785–86 (Conn. 1999). The taxpayer argued that *Quill*'s due process holding did not apply, because *Quill* involved a sales tax, not an income tax. *Id.* at 800. The Court responded, "We . . . disagree with the plaintiff's contention that, because *Quill Corp.* involved the collection and payment of a sales tax and the present case involves an income tax, *Quill Corp.* is irrelevant to this case." *Id.* While the Connecticut Supreme Court was not analyzing the Dormant Commerce Clause portion of *Quill*, its rejection that the type of tax was distinguishable from *Quill*'s suggests that Connecticut's understanding was consistent with Tennessee, Texas, and Pennsylvania.

99. These states include Illinois, Indiana, Iowa, Louisiana, Maryland, Massachusetts, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Washington, and West Virginia. Borden Chems. & Plastics, L.P. v. Zehnder, 726 N.E.2d 73 (Ill. App. Ct. 2000); MBNA Am. Bank, N.A. v. Ind. Dep't of State Revenue, 895 N.E.2d 140 (Ind. T.C. 2008); KFC Corp. v. Iowa Dep't of Revenue, 792 N.W.2d 308 (Iowa 2010); Bridges v. Geoffrey, Inc., 984 So. 2d 115 (La. Ct. App. 2008); SYL, Inc. v. Comptroller of the Treasury, No. C-96-0154-01, 1999 WL 322666 (Md. T.C. Apr. 26, 1999); Capital One Bank v. Comm'r of Revenue, 899 N.E.2d 76 (Mass. 2009); Lanco, Inc. v. Dir., Div. of Taxation, 908 A.2d 176 (N.J. 2006) (per curiam); Kmart Props., Inc. v. Taxation & Revenue Dep't, 131 P.3d 27 (N.M. Ct. App. 2001); A & F Trademark, Inc. v. Tolson, 605 S.E.2d 187 (N.C. Ct. App. 2004); Crutchfield Corp. v. Testa, 88 N.E.3d 900 (Ohio 2016); Geoffrey, Inc. v. Okla. Tax Comm'n, 132 P.3d 632 (Okla. Civ. App. 2005); Capital One Auto Fin. Inc. v. Dep't of Revenue, TC 5197, 2016 WL 7429522 (Or. T.C. Dec. 23, 2016); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13 (S.C. 1993); Lamtec Corp. v. Dep't of Revenue, 246 P.3d 788 (Wash. 2011); Tax Comm'r v. MBNA Am. Bank, N.A., 640 S.E.2d 226 (W. Va. 2006).

100. *See* 437 S.E.2d at 18 n.4.

101. *Id.* at 15.

102. *Id.* at 18 ("It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus.").

Quill did not apply beyond sales-taxation cases.[103] The court observed, "The U.S. Supreme Court . . . noted that the physical presence requirement had not been extended to other types of taxes [than sales taxes]."[104] The South Carolina Supreme Court drew this conclusion from the following comment made by Justice Stevens in *Quill*: "Although [the Court] ha[s] 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."[105] Other state courts began to follow the South Carolina Supreme Court's interpretation of *Quill* but went further by upholding state taxation even when the defendant had no physical presence in the state.[106]

II. *WAYFAIR*'S FAILURE TO CONSIDER INCOME TAXES

In light of the above history leading to *Wayfair*, this Part argues that the Court failed to take full account of the reliance interests at stake in *Wayfair* and therefore erred in overturning *Quill*. Section II.A establishes that the Court has upheld contested precedent to honor the reliance on that precedent. Section II.B explains the full extent of the income-tax reliance interest: that of the businesses that relied on the physical presence rule to shield them from state income taxes. Lastly, Section II.C demonstrates how the *Wayfair* Court failed to consider the income-tax reliance interest and consequently should have upheld *Quill*.

A. Stare Decisis and Reliance Interests

The Court has repeatedly emphasized the need to adhere to stare decisis. In *Planned Parenthood of Southeastern Pennsylvania v.*

103. *Id.* at 18 n.4.

104. *Id.*

105. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 314 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

106. *See, e.g.*, KFC Corp. v. Iowa Dep't of Revenue, 792 N.W.2d 308, 321–24 (Iowa 2010) (listing state court cases agreeing with *Geoffrey* that *Quill* only applied to sales taxation); Geoffrey, Inc. v. Comm'r of Revenue, 899 N.E.2d 87, 94–95 (Mass. 2009) (citing to the South Carolina *Geoffrey* opinion and concluding that because the U.S. Supreme Court only discussed the physical presence standard in the context of sales taxes, the Court must have intended to limit *Quill*'s holding to sales taxes); Lanco, Inc. v. Dir., Div. of Taxation, 908 A.2d 176, 177 (N.J. 2006) (per curiam) (finding that the U.S. Supreme Court "carefully limited" its language to sales taxes in order to strictly limit the physical presence standard); Lamtec Corp. v. Dep't of Revenue, 246 P.3d 788, 794 (Wash. 2011) (concluding that the U.S. Supreme Court in *Quill* sought to limit the physical presence standard to sales taxes and citing *Geoffrey* and the same language in *Quill* upon which the *Geoffrey* court relied); Tax Comm'r v. MBNA Am. Bank, N.A., 640 S.E.2d 226, 232 (W. Va. 2006) (concluding that the U.S. Supreme Court expressly limited its holding to sales taxes).

Casey, Justice O'Connor remarked that "respect for precedent" undergirds "the very concept of the rule of law."[107] Accordingly, as Justice Kagan later put it, even if the Court determines that a party makes a "good argument" that the Court "got something wrong," such a determination will not "justify scrapping settled precedent" absent a "special justification."[108] Put another way by Justice Scalia, the Court will typically remain "unresponsive to policy considerations" and will choose to uphold precedent.[109]

Much of the Court's reluctance stems from its concern that overturning precedent would harm the reliance interests of individuals and businesses that took legally significant actions in the past on the assumption that the precedent would exist in the future.[110] The Court has said that stare decisis "exists for the purpose of . . . protecting the expectations of individuals and institutions that have acted in reliance on existing rules."[111] Indeed, the Court has declared that "[c]onsiderations in favor of *stare decisis* are at their acme . . . where reliance interests are involved."[112] More recently, the Court has remarked, "So long as we see a reasonable possibility that parties have structured their business transactions in light of [the Court's precedent], we have one more reason to let it stand."[113]

B. State Income Taxation and the Physical Presence Rule

In addition to the interests of remote retailers that sought to avoid collecting sales taxes in the *Wayfair* opinion, a second, broader reliance interest depended on *Quill*. As described in Part I, before the Court handed down *Wayfair*, state courts had split on whether *Quill*'s physical presence rule applied beyond sales taxes. Majority and minority positions arose on the issue, but most states had never addressed the question.[114] While only a few states subscribed to the minority position, this Note argues that the minority position adopted the correct scope of *Quill*. Given the merits of the minority position

107. 505 U.S. 833, 854 (1992).

108. Kimble v. Marvel Entm't, LLC, 135 S. Ct. 2401, 2409 (2015).

109. Carden v. Arkoma Assocs., 494 U.S. 185, 196 (1990).

110. *See* Kozel, *supra* note 14, at 1465–66 (discussing the reliance interests of "stakeholders whose lives and livelihoods are affected by judicial precedent" and the costs of overturning precedent as falling on "those who have relied reasonably on the rule's continued application" (internal quotation marks omitted) (quoting *Casey*, 505 U.S. at 855)).

111. Walton v. Arizona, 497 U.S. 639, 673 (1990) (Scalia, J., concurring in part and concurring in the judgment), *overruled by* Ring v. Arizona, 536 U.S. 584 (2002).

112. Payne v. Tennessee, 501 U.S. 808, 828 (1991).

113. *Kimble*, 135 S. Ct. at 2407–09.

114. *See supra* notes 86–88 and accompanying text.

coupled with the fact that most states had not spoken on the question, various firms and individuals likely relied on the physical presence rule but were overlooked in the *Wayfair* Court's evaluation of reliance interests. Section II.B.1 establishes the extent of the income-tax reliance interest of those businesses that relied on *Quill* to shield them from state income taxes. Section II.B.2 then illustrates the impact the *Wayfair* decision will have on this reliance interest. Lastly, Section II.B.3 distinguishes the reliance interests on the physical presence rule in avoiding sales-tax collection from those in avoiding income-tax payments.

1. The Reason that *Quill* Applies to State Income Taxation

Contrary to the position of the majority of state courts to consider *Quill*'s scope, *Quill* applied to all types of taxes, not just sales taxes. *Quill*'s fusion of the physical presence rule with *Complete Auto*'s "substantial nexus" standard indicated that the Court intended the physical presence rule to apply to other types of taxes. After reciting *Complete Auto*'s four-part test in *Quill*, Justice Stevens declared, "*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."[115] Thus, *Complete Auto*'s substantial nexus prong and *Bellas Hess*'s physical presence rule became one and the same. Subsequently, other cases involving taxes other than sales taxes endorsed the *Complete Auto* test as the means for analyzing a state tax under the Dormant Commerce Clause.[116] These other cases did not hinge on whether the taxpayer had a substantial nexus with a state only because the taxpayer's physical presence satisfied the "substantial nexus" prong of *Complete Auto*. For example, in *Commonwealth Edison Co. v. Montana*, a severance-tax case, the Court held that the defendant's undisputed physical presence in the state satisfied the substantial nexus prong of *Complete Auto*.[117] The Court also relied on the *Complete Auto* test in *Mobil Oil Corp. v. Commissioner of Taxes*, an income-tax case where the taxpayer again had an undisputed physical

115. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 311 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

116. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 617 (1981) ("We agree with appellants that the Montana tax must be evaluated under *Complete Auto Transit*'s four-part test.").

117. *Id.* ("Appellants do not dispute that the Montana tax satisfies the first two prongs of the *Complete Auto Transit* test. As the Montana Supreme Court noted, 'there can be no argument here that a substantial, in fact, the only nexus of the severance of coal is established in Montana.' " (quoting Commonwealth Edison Co. v. State, 615 P.2d 847, 855 (Mont. 1980))).

presence.[118] Thus, the Court had repeatedly applied the substantial nexus test of *Complete Auto*—the test that evolved into the physical presence rule in *Quill*—beyond the sales-tax realm.

Language in another part of the Court's *Commonwealth Edison* opinion supports the argument that the physical presence rule extends beyond sales taxes. At one point in the opinion, the Court rejected the state's argument that the Dormant Commerce Clause did not apply to severance taxes.[119] The Court responded that "there is no real distinction—in terms of economic effects—between severance taxes and other types of state taxes that have been subjected to Commerce Clause scrutiny."[120] While not focused on the nexus standard of the Dormant Commerce Clause, the comment indicates that the Court did not view the type of tax at issue as a relevant distinction.[121]

The majority position among the states, led by the *Geoffrey* court in South Carolina, held that *Quill* did not apply beyond sales taxes. It based its interpretation on Justice Stevens's comment in *Quill* that "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."[122] Standing alone, the comment could reasonably be interpreted to apply the physical presence rule only to sales-tax situations.

But this comment did not stand alone. Earlier in the opinion, Justice Stevens made a similar comment: "Although [the Court] ha[s] 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."[123] The cases cited for the "review of other types of taxes" in the *Quill* opinion were silent about the physical presence rule because in those

118. *See* Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 443 (1980) (citing to *Complete Auto* and noting that a state cannot tax the net income of a corporation unless the corporation has a substantial nexus with the state).

119. *Commonwealth Edison*, 453 U.S. at 613–14 ("The [Montana] Supreme Court held that the tax is not subject to scrutiny under the Commerce Clause because it is imposed on the severance of coal, which the court characterized as an intrastate activity preceding entry of the coal into interstate commerce." (footnote omitted)).

120. *Id.* at 616.

121. The Court's language in *Commonwealth Edison* echoes an earlier sentiment from the Court when analyzing state taxes under the Due Process Clause. *See* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 443 (1940) ("[T]he descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction.").

122. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 317 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

123. *Id.* at 314.

cases, the taxpayers had a clear physical presence.[124] Put another way, while none of these cases "adopted a similar bright-line, physical-presence requirement," they simply did not need to because the taxpayer's nexus with the state was never at issue. Contrary to the *Geoffrey* court's conclusion, Justice Stevens only meant to observe that the Court's jurisprudence subsequent to *Bellas Hess* offered no guidance one way or the other regarding the continued vitality of the physical presence rule.[125] He did not imply that the Court had limited the physical presence rule to sales taxes by adopting a different nexus standard for other types of taxes.[126]

When compared to each other, the minority position among states that did address *Quill*'s application to income taxes is the better interpretation of *Quill*. As explained above, most states did not, before *Wayfair*, determine whether *Quill* applied to income taxes. No one will know what these states might have held, but given the merits of the minority position, most businesses would have been justified in relying on *Quill* to shield themselves from income taxation.[127] At the very least,

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124. *See* Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 250 (1987) (noting the physical presence of the entity's sales representatives in the state); Standard Pressed Steel Co. v. Wash. Dep't of Revenue, 419 U.S. 560, 562 (1975) (same).

125. *See* Cerro Copper Prods., Inc., No. F. 94-444, 1995 WL 800114, at *3 (Ala. Dep't of Rev. Dec. 11, 1995) ("I disagree that *Quill* affirmatively limited the Commerce Clause physical presence test to only sales and use taxes. Rather, the Supreme Court left open the issue by stating that 'silence does not imply repudiation of the *Bellas Hess* (physical presence) test' concerning other taxes." (quoting *Quill*, 504 U.S. at 314)).

126. *Cf.* Megan A. Stombock, *Economic Nexus and Nonresident Corporate Taxpayers: How Far Will It Go?*, 61 TAX LAW. 1225, 1236 (2008) ("[O]ne could interpret the Supreme Court's language in *Quill* as extending the physical presence requirement to other types of tax or at least reserving the issue in later cases for other types of tax.").

127. Indeed, dissenting opinions from majority-position states highlight the weakness of the majority position's reasoning and make it less attractive to a state court that had not reached the issue at the time of *Wayfair*. *See* Tax Comm'r v. MBNA Am. Bank, N.A., 640 S.E.2d 226, 236 (W. Va. 2006) (Benjamin, J., dissenting):

> In its opinion finding tax liability for an out-of-state corporation with no presence, tangible or intangible, in West Virginia on income realized out-of-state by that corporation from accounts kept out-of-state, the majority, in its opinion, boldly goes where no court has gone before. In doing so, the majority relies not on bedrock constitutional principles or on established legal precedent, but rather on legal commentaries with thinly veiled state-favoring taxing agendas, a strained and inaccurate reading of the United States Supreme Court's decision in [*Quill*] . . . .

(footnote omitted). Lower courts in majority-position states also voiced concern for the majority position:

> [I]t does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant as to justify a different rule for each concerning physical presence as an element of Commerce Clause nexus. Next, the Supreme Court cases decided before *Quill* strongly suggest that physical presence is a necessary element of nexus for income taxation.

Lanco, Inc. v. Dir., Div. of Taxation, 21 N.J. Tax 200, 208 (2003), *rev'd*, 879 A.2d 1234 (N.J. Super. Ct. App. Div. 2005), *aff'd*, 908 A.2d 176 (N.J. 2006); *see also* Kimberley Rice Kaestner 1992 Family

businesses earning income in Tennessee, Texas, Pennsylvania, and possibly Connecticut could rely on *Quill* when seeking to avoid paying state income taxes.

2. The Impact of *Wayfair* on the Income-Tax Reliance Interest

When *Wayfair* overturned *Quill*, it stripped away any protection a remote business or individual might have relied on to avoid income taxes.[128] A quick review of prior Supreme Court precedent on the Dormant Commerce Clause and income taxes demonstrates *Wayfair*'s impact. In *Northwestern States Portland Cement Co. v. Minnesota*, an Iowa manufacturer sought to prevent Minnesota from taxing the net income it earned on sales to Minnesota customers.[129] The manufacturer argued that the Dormant Commerce Clause prohibited states from taxing businesses headquartered outside the state.[130]

The Court first noted the company's undisputed physical presence in Minnesota through several small sales offices.[131] Then, the Court rejected the per se prohibition on net income taxation of a business headquartered in a different state.[132] If the Iowa manufacturer had withdrawn its sales offices from Minnesota, then under *Quill*, Minnesota would not have been able to impose its income tax on the manufacturer. After *Wayfair*, however, the manufacturer's physical retreat from Minnesota would not prevent Minnesota from imposing its income tax.

As the U.S. economy expanded, businesses increasingly relied on legal rules such as the physical presence rule.[133] The decision to eliminate the physical presence rule, whether correct or not, will likely

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Tr. v. N.C. Dep't of Revenue, No. 12 CVS 8740, 2015 WL 1880607, at *10 (N.C. Super. Ct. Apr. 23, 2015) (holding a trust's lack of physical presence protected it from income taxation under *Quill* despite the North Carolina Court of Appeals holding otherwise in A & F Trademark, Inc. v. Tolson, 605 S.E.2d 187 (N.C. Ct. App. 2004)).

128. Sarah Horn et al., *Supreme Court Abandons Physical Presence Standard: An In-Depth Look at* South Dakota v. Wayfair, J. MULTISTATE TAX'N & INCENTIVES, Sept. 2018, at 12, 17 ("Given the Court's conclusion that 'physical presence is not necessary to create substantial nexus,' this decision will impact other state taxes, such as corporate income taxes, which could apply to the income of an entity conducting significant business activities in a state without having a physical presence there.").

129. 358 U.S. 450, 455 (1959).

130. *See id.* at 452.

131. *Id.* at 454.

132. *Id.* at 452 ("[N]et 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 . . . .").

133. *Cf.* Craig J. Langstraat & Emily S. Lemmon, *Economic Nexus: Legislative Presumption or Legitimate Proposition?*, 14 AKRON TAX J. 1, 7–8 (1999) (explaining how a business orders its sales activities around state taxation).

result in a rude awakening as businesses receive payment notices from state departments of revenue throughout the country.[134] Businesses hardest hit by the disappearance of the physical presence rule will be those operating in states without income taxes that sell to customers in states that do have income taxes.[135] Tennessee, though it has a corporate income tax, has no individual income tax. As a result of *Wayfair* eliminating the physical presence rule, numerous Tennessee small business are now likely exposed to other states' individual income taxes.[136] Memphis and Chattanooga, for example, are located on Tennessee's border, adjacent to states that impose an income tax.[137] In all likelihood, many Memphis and Chattanooga businesses sell to customers just over the border, despite the businesses' lack of physical presence in the other states.

Others harmed will include businesses selling to customers in states with a higher income tax rate than where they base their operations. A corporation subject to North Carolina's three percent income tax rate could find itself subject to Pennsylvania's ten percent rate, an increase that could severely harm its return for any sales made in Pennsylvania.[138] Incurring millions in unanticipated income taxes could ruin an investment decision to sell to customers in a particular state based on the belief that the investment would result in little or no income taxation. As Arkansas Governor Asa Hutchinson recently

134. Shirley Sicilian et al., *After* Wayfair*, a Focus on Sourcing*, J. MULTISTATE TAX'N & INCENTIVES, Oct. 2018, at 39, 41 (explaining how states apportion a company's income and noting that the removal of the physical presence rule will permit states to tax apportioned income that *Quill* kept out of reach).

135. Two states, South Dakota and Wyoming, do not assess a corporate income tax or gross receipts tax. Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2018*, TAX FOUND. (Feb. 2018), https://files.taxfoundation.org/20180717150707/Tax-Foundation-FF5711.pdf [https://perma.cc/VV9F-ARY6]. Seven states do not assess personal income taxes: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Maurie Backman, *Here Are the U.S. States with No Income Tax*, MOTLEY FOOL (Nov. 23, 2016, 9:28 AM), https://www.fool.com/retirement/2016/11/23/here-are-the-us-states-with-no-income-tax.aspx [https://perma.cc/Q8D5-677E].

136. New Hampshire and Tennessee only assess taxes on dividend and interest income. Morgan Scarboro, *State Individual Income Tax Rates and Brackets for 2017*, TAX FOUND. 3 (Mar. 2017), https://files.taxfoundation.org/20170727103114/FISCAL-FACT-No.-544-State-Individual-Income-Tax-Rates-and-Brackets-for-2017-PDF-UPDATE.pdf [https://perma.cc/SPQ4-XQ3D].

137. Mississippi has a five percent individual income tax rate, and Georgia has a six percent individual income tax rate. *Id.*

138. Scarboro, *supra* note 135, at 4; *see* Baez, *supra* note 40, at 582 (describing profit margins in various industries ranging from four to eleven percent); Mark J. Perry, *The General Public Thinks the Average Company Makes a 36% Profit Margin, Which Is About 5x Too High, Part II*, AEI (Jan. 15, 2018, 7:13 PM), http://www.aei.org/publication/the-public-thinks-the-average-company-makes-a-36-profit-margin-which-is-about-5x-too-high-part-ii [https://perma.cc/H9FQ-LKQJ] (noting that the average profit margin among seven thousand companies was 7.9 percent in January 2018).

remarked, "The state tax rate is one of the top considerations for a CEO who is looking to expand to another state."[139]

3. Distinguishing Between the Sales-Tax and Income-Tax Reliance Interests

The remote retailers that now face an increased sales-tax-collection burden could also face additional income taxes due to *Wayfair*. That said, the reliance interest on the physical presence rule's protection is broader than just that of remoter retailers that face a sales-tax-collection burden. Only businesses that sell to a final purchaser—a consumer—must collect sales taxes.[140] Typically, retailers alone collect sales taxes; other businesses in the chain of commerce do not sell to a final consumer.[141]

Businesses in the chain of commerce that would not collect sales taxes include suppliers, manufacturers, and wholesalers of a product. Others exempt from the sales-tax-collection duty include service providers whose services are not subject to sales taxes[142]—in most jurisdictions, this includes engineers, business consultants, doctors, lawyers, and accountants.[143] While exempt from a sales-tax-collection burden, these businesses are subject to state *income* taxes. Thus, the reliance interest dependent on the physical presence rule for income-tax purposes likely encompasses a much larger portion of the economy than just remote retailers. Of course, these firms, at least according to the case law, may only include those earning income in Tennessee,

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139. Editorial, *Arkansas Tax Cutters*, WALL ST. J. (Feb. 8, 2019, 7:03 PM), https://www.wsj.com/articles/arkansas-tax-cutters-11549670604 [https://perma.cc/S8SC-ASZN]; *cf.* Ben Casselman, *A $2 Billion Question: Did New York and Virginia Overpay for Amazon?*, N.Y. TIMES (Nov. 13, 2018), https://www.nytimes.com/2018/11/13/business/economy/amazon-hq2-va-long-island-city-incentives.html [https://perma.cc/XK4J-VAES] (describing how New York governor Andrew Cuomo justified New York's tax incentive package to Amazon by referencing the state's relatively high corporate tax rate that made attracting business investment in the state difficult).

140. *Sales Taxes*, TAX FOUND., https://taxfoundation.org/state-tax/sales-taxes (last visited Apr. 3, 2019) [https://perma.cc/9LV3-ZCEK]. North Dakota's sales-tax law illustrates this point. N.D. CENT. CODE § 57-39.2-02.1 (2018) ("[T]here is imposed a tax of five percent upon the gross receipts of retailers from all sales at retail . . . to consumers or users . . . .").

141. N.D. CENT. CODE § 57-40.2-06 ("The tax upon tangible personal property which is sold by a retailer . . . must be collected by the retailer and remitted to the commissioner . . . ."); *see also* Buechler, *supra* note 6, at 481 ("Generally, as in a 'consumer levy' tax jurisdiction, the purchaser pays the tax and the seller, as an agent for the government, collects and remits the tax.").

142. Mark Faggiano, *Sales Tax by State: Sales Tax on Services 101*, TAXJAR (Jan. 15, 2015), https://blog.taxjar.com/sales-tax-services-101/ [https://perma.cc/C8RA-6YL8].

143. *See* Monica Davey, *States Seeking Cash Hope to Expand Taxes to Services*, N.Y. TIMES (Mar. 27, 2010), https://www.nytimes.com/2010/03/28/us/28taxes.html [https://perma.cc/67BE-QFCK]; *Sales Tax on Accounting Services*, AICPA, https://www.aicpa.org/advocacy/tax/statelocal/salestaxonaccountingservices.html (last visited Apr. 3, 2019) [https://perma.cc/MPM8-EBFA].

Texas, Pennsylvania, and Connecticut,[144] but as explained above, the size of the reliance interest is probably far larger.[145]

The cases that did apply the physical presence rule to income taxes—*J.C. Penney*; *Rylander*; and *Robert L. McNeil, Jr. Trust*—give color to the various ways in which *Wayfair* may harm businesses beyond remote retailers.[146] *J.C. Penney* involved a credit card company that extended credit to residents in Tennessee and earned its income from fees and interest.[147] In *Rylander*, the company earned income by licensing a patent, an intangible piece of property.[148] As the name implies, *Robert L. McNeil, Jr. Trust* concerned a trust that earned its income on assets located outside of Pennsylvania.[149] Its only connection to Pennsylvania was that the settlor and beneficiaries of the trust resided in Pennsylvania.[150] None of these would-be taxpayers sold tangible goods, and none of them would face an obligation to collect sales taxes. Under *Wayfair*, financial institutions operating from afar and under a particular tax regime may see an unwelcome increase in the tax rate on their income. Trusts established in Delaware or elsewhere for tax purposes may now be subject to income taxes based on the residence of their beneficiaries.[151]

C. The Wayfair *Court's Mistaken Decision to Overturn Its Precedent*

When deciding to overturn *Quill*, the *Wayfair* Court faced stare decisis head on. While the Court unanimously agreed that *Bellas Hess*'s physical presence rule was incorrect, the Court split over how

144. *See supra* notes 89–98 and accompanying text.

145. *See supra* note 88 and accompanying text.

146. Robert L. McNeil, Jr. Tr. *ex rel.* McNeil v. Commonwealth, 67 A.3d 185 (Pa. Commw. Ct. 2013); J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999); Rylander v. Bandag Licensing Corp., 18 S.W.3d 296 (Tex. App. 2000).

147. 19 S.W.3d at 834 ("The J.C. Penney National Bank charged an annual fee on most Visa and MasterCard credit card accounts, as well as interest and other fees in connection with the account.").

148. 18 S.W.3d at 298 ("During 1992–96, BLC owned three patents that it licensed to Bandag, its parent corporation, under a 1985 agreement executed by Bandag and BLC outside Texas. Under the agreement, Bandag sent royalty payments to BLC's Iowa office . . . .").

149. 67 A.3d at 187–88 ("[T]he Department of Revenue (Department) assessed Pennsylvania Income Tax (PIT) and interest on all of the income of two inter vivos trusts, which are located in, administered in, and governed by the laws of Delaware and which had no Pennsylvania income or assets in 2007.").

150. *Id.* at 188–89 ("All of the Trust's discretionary beneficiaries were residents of Pennsylvania in 2007." (footnote omitted)).

151. Daniel G. Mudd, *I've Got Trust Issues–Are Nonresident Trusts the New Nexus Fight?*, J. MULTISTATE TAX'N & INCENTIVES, Nov./Dec. 2018, at 35, 35 (discussing case law after *Wayfair* and remarking that "[r]ecent state court decisions indicate that nexus issues related to nonresident trusts may be the next area of increasing litigation after taxpayers were generally successful in the past").

overturning *Quill* might harm reliance interests.[152] The dissent voiced concern about overturning precedent in the face of unknown consequences. Writing for the dissent, Chief Justice Roberts observed, "E-commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical-presence rule."[153] An alteration to this backdrop, continued Chief Justice Roberts, could "disrupt the development of such a critical segment of the economy."[154] As such, "[t]he Court should not act on this important question of current economic policy, solely to expiate a mistake it made over 50 years ago."[155]

Like the dissent, the majority also recognized stare decisis and asserted that it should proceed with the "utmost caution" and treat reliance interests as a "legitimate consideration" when deciding whether to overturn its precedent.[156] Still, the majority seemed satisfied with the data that indicated that the benefits of overturning *Quill* outweighed the costs of upsetting reliance interests.[157]

Crucial to the majority's reasoning was an evaluation of the interests that actually relied on *Quill*. To the Court, only remote retailers that could be tasked with collecting sales taxes had a reliance interest in *Quill*'s physical presence rule.[158] The dissent actually agreed with the majority on this point as well.[159] Writing for the majority, Justice Kennedy looked to the reliance interests of only "remote retailers" and focused on the sales taxes these remote retailers would need to collect if the Court overturned *Quill*.[160] The Court never mentioned the reliance interests of those liable for income taxation, and its solutions for lessening the burden of *Wayfair* only pertained to sales-

152. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2101 (2018) (Roberts, C.J., dissenting) ("I agree that *Bellas Hess* was wrongly decided, for many of the reasons given by the Court.").

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* at 2096, 2098 (majority opinion) (quoting Pearson v. Callahan, 555 U.S. 223, 233 (2009)).

157. *Id.* at 2096 (" 'Although we approach the reconsideration of our decisions with the utmost caution, *stare decisis* is not an inexorable command.' Here, *stare decisis* can no longer support the Court's prohibition of a valid exercise of the States' sovereign power." (citation omitted) (quoting *Pearson*, 555 U.S. at 233)).

158. *Cf. id.* at 2087 ("When a consumer purchases goods or services, the consumer's State often imposes a sales tax. This case requires the Court to determine when an out-of-state seller can be required to collect and remit that tax.").

159. *Id.* at 2101 (Roberts, C.J., dissenting) (referring to the reliance interest as belonging to "retailers" that were being forced to "collect taxes on the sale of goods").

160. *Id.* at 2098 (majority opinion).

tax collection.[161] As explained above, however, the Court overlooked a second reliance interest: that of businesses that relied on the physical presence rule to shield them from state income taxes.

The Court's undervaluation of the reliance interest at stake in *Quill* was more than academic. If income taxes were considered, the dissent's fears of upsetting background rules, a concern that nearly prevailed at the Court, would grow much more serious.[162] While the majority in *Wayfair* reasonably relied on information that gave it confidence to correct the sales-tax problem created by *Quill*, it did not have similar information for income taxes. Businesses of all stripes can avoid paying taxes on income earned in a state where they lack a physical presence, but the Court did not consider states' lost revenue from income taxes.[163] The demand by the states, if one even exists, for a correction of the physical presence rule to collect income taxes has not caught the Court's ear.[164] Furthermore, the cost to the economy of suddenly exposing every business that enjoys protection from income taxes because of the physical presence rule has not been studied, although as described above, such a change could prove disastrous to some businesses.[165] In sum, the Court erred when it overturned *Quill*, because it failed to consider the full extent of the reliance interests at stake in the decision.

III. THE NEED FOR A CONGRESSIONAL RESPONSE TO *WAYFAIR*

A. Proposed Legislation

The Court created a chasm in the legal landscape when it removed protection for entities with a reliance interest that the Court did not consider. A great unknown now bears down on commerce, with

161. *Id.* ("[A]s the physical presence rule no longer controls, [sales-tax-collection] systems may well become available in a short period of time, either from private providers or from state taxing agencies themselves.").

162. *Id.* at 2101 (Roberts, C.J., dissenting) ("E-commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical-presence rule. Any alteration to those rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress.").

163. *See supra* notes 63–68 and accompanying text.

164. The states had for years sought to defeat the physical presence rule in order to reach sales taxes. ERIKA K. LUNDER & CAROL A. PETTIT, CONG. RESEARCH SERV., R42629, "AMAZON LAWS" AND TAXATION OF INTERNET SALES: CONSTITUTIONAL ANALYSIS 8–12 (2013), https://www.sos.ms.gov/Policy-Research/Documents/7CRS.pdf [https://perma.cc/3LGE-VXE9] (highlighting, before the Court decided *Wayfair*, legislation in New York and Colorado designed to circumvent *Quill*).

165. *See supra* Section II.B.2.

the states likely to take advantage of the situation.[166] Where the Court erred, Congress can intervene, even if only to return to the status quo on the issue of state income taxation. A statute with the following language would suffice to preserve the status quo for income taxation:

(a) No state or political subdivision thereof shall have the power to impose an income tax on any person if such person owns no real or personal tangible property located within the state and has no employee or agent working in the state.
(b) For purposes of this statute, the term "person" means an individual, corporation, or partnership organized under the laws of any state or foreign jurisdiction.

While the language above should repair the *Wayfair* Court's mistake, two additional points should be considered: (1) whether congressional action in response to *Wayfair* is politically feasible and (2) how to properly tailor such legislation in light of extensive Dormant Commerce Clause precedent. As described in the next two Sections, prior congressional action sheds light on what should take place in response to *Wayfair*.

B. Political Feasibility of a Congressional Response to Wayfair

Anyone supporting the implementation of legislation in response to *Wayfair* will need to take account of the political feasibility of passing such legislation. Assessing the chance of a bill's political success is largely beyond the scope of this Note, but state resistance to such a bill is worthy of brief comment. The states stand as the most likely opponents of a limitation on their taxing power, especially the states in which courts had permitted income taxation before *Wayfair* dissolved

166. *See* Matthew C. Boch, *Way(un)fair? United States Supreme Court Decision Ends State Tax Physical Presence Nexus Test*, ARK. LAW., Summer 2018, at 18, 20:

> *Wayfair*'s impact is not limited to sales and use taxes either. The new nexus principles would seem to bless imposing income or gross receipts taxes on remote businesses as well. While states had asserted economic nexus for income taxes when *Quill* was the rule, expect them to become more aggressive now that *Wayfair* has replaced *Quill*.;

cf. Sylvia Dion, *As States Rush to Adopt Economic Nexus Post*-Wayfair*, Is Congressional Action Needed?*, CPA PRAC. ADVISOR (Sept. 20, 2018), https://www.cpapracticeadvisor.com/news/12428984/as-states-rush-to-adopt-economic-nexus-post-wayfair-is-congressional-action-needed [https://perma.cc/S3QQ-KKA4] (asserting that after *Wayfair*, "more than half of the states in the country have adopted economic nexus"); Kristen Rasmussen, *'Physical Presence' Test Is Gone, but Uncertainty Remains for Companies After* Wayfair *Decision*, CORP. COUNS. (June 25, 2018, 4:42 PM), https://www.law.com/corpcounsel/2018/06/25/062518wayfairinhouse/ [https://perma.cc/3R64-BX32] (observing that the *Wayfair* Court "did not specifically say what amount of sales or activity within the state would satisfy due process and commerce clause concerns" and that state statutes departing from the elements of the statute at issue in *Wayfair* will "likely to be the subject of litigation").

the physical presence rule.[167] History shows, however, that the states typically lose in disputes over taxation and the Dormant Commerce Clause. After the Court handed down *Wayfair*, Professor Brian Galle compiled and analyzed all federal legislation affecting state taxing power passed between 1900 and 2007 to determine if such legislation generally constricted or increased state taxing power.[168] He found that when Congress legislates in the realm of state taxing power, Congress "overwhelmingly reduces the scope of state taxing authority."[169] In only nine instances did Congress increase state taxing power, but in thirty-four instances, Congress reduced state taxing power and instead gave taxpayers relief.[170] Professor Galle posits that limiting state taxing power gives voters a tax break that benefits members of Congress politically, while the states bear the cost of the tax break.[171] Whatever the exact reason for the phenomenon, history demonstrates that Congress tends to prefer limiting state taxing power rather than expanding it, a positive sign for anyone seeking to pass legislation to shield businesses from state income taxation after *Wayfair*.

C. Tailoring the Proposed Legislation

Dormant Commerce Clause jurisprudence, with its multipart tests and extensive history, has quite a bit of precedential baggage.[172] Accordingly, Congress needs to write legislation with language that accomplishes the goal of honoring the income-tax reliance interest without disrupting other aspects of Dormant Commerce Clause doctrine. In particular, judicial terms of art should not enter the statutory language. As described above, the Court has used various forms of the word "nexus" in its Dormant Commerce Clause jurisprudence to refer to a state's power to tax. Terms such as "sufficient nexus," "substantial nexus," or "nexus aplenty" have sprouted up over

167. *See supra* notes 99–106 and accompanying text.

168. Brian Galle, *Kill* Quill*, Keep the Dormant Commerce Clause: History's Lessons on Congressional Control of State Taxation*, 70 STAN. L. REV. ONLINE 158, 162 (2018).

169. *Id.*

170. *Id.* at 162–63.

171. *See id.* at 161–62 ("Congress might conclude that it can use the Commerce power to control the tax base it shares with the States, helping to ensure that members of Congress, and not state officials, can earn rewards for delivering on constituent policy goals.").

172. Indeed, Supreme Court opinions on the Dormant Commerce Clause often require many pages just to review the relevant precedent. *See, e.g.*, Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 179–87 (1995) (summarizing the history of Supreme Court cases reviewing state taxation under the Dormant Commerce Clause as of 1995).

the years.[173] These terms, at least by the time the Court decided *Quill*, had become terms of art and synonymous with the physical presence rule.[174] Indeed, uncertainty over what the Court meant by the term "substantial nexus" in *Complete Auto* seems to have led the North Dakota Supreme Court astray before the U.S. Supreme Court clarified the term's meaning in *Quill*.[175] In *Wayfair*, the Court continued to imbue this term of art with meaning, this time asserting that "substantial nexus" is satisfied when a taxpayer " 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."[176]

To avoid the confusion, the proposed legislation does not use the term "nexus." Rather than saying that a state cannot impose an income tax where the taxpayer lacks a "nexus" with the state, the statute bars taxation when the taxpayer has "no real or personal tangible property located within the state and has no employee or agent working in the state."

Experience with congressional responses to Supreme Court decisions suggests that a statutory description of substantial nexus would more effectively achieve congressional intent. In 1991, Congress amended the 1964 Civil Rights Act in response to several Supreme Court employment discrimination decisions.[177] One persistent question after passage of the 1964 Civil Rights Act was whether a plaintiff could bring a "mixed motive" claim—a claim that an employer's discriminatory intent was *a* cause of an adverse employment action, not *the* cause.[178] The question mattered because there were often multiple reasons, both legitimate and illegitimate, for why an employer took an

173. Baez, *supra* note 40, at 596 (noting that the Court has worded the nexus requirement as requiring substantial nexus, sufficient nexus, requisite nexus, necessary basis, sufficient relation, necessary nexus, adequate nexus, obvious nexus, clear and sufficient nexus, and nexus aplenty).

174. *See, e.g.*, *In re* Appeal of Intercard, Inc., 14 P.3d 1111, 1122 (Kan. 2000) ("In summary, the Commerce Clause requires a taxing state to have substantial nexus with an out-of-state business to impose use tax collection and remittance duties. Substantial nexus requires a finding of physical presence in the taxing state." (citation omitted)).

175. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 303–04 (1992) (explaining that the North Dakota Supreme Court had concluded that *Complete Auto*'s imposition of the "substantial nexus" part of its four-part test indicated that the Dormant Commerce Clause "no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess*"), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

176. *Wayfair*, 138 S. Ct. at 2099 (quoting Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009)).

177. MARIA L. ONTIVEROS ET AL., EMPLOYMENT DISCRIMINATION LAW: CASES AND MATERIALS ON EQUALITY IN THE WORKPLACE 143 (9th ed. 2016).

178. *Id.* at 133 ("A mixed-motive case is one in which the employer relies upon both a legitimate, nondiscriminatory reason and an unlawful, discriminatory reason at the moment it makes an adverse employment decision, and both the legitimate and illegitimate reasons are motivating factors in that decision.").

adverse employment action against an employee.[179] If an employee had to prove that an employer relied on an illegitimate reason alone, an employer that could demonstrate another, legitimate reason could escape liability.[180]

At the risk of oversimplifying, the Court held in *Price Waterhouse v. Hopkins* that an employee could bring a mixed motive claim. But the Court heavily undercut its own holding by requiring that an employee prove a mixed motive claim through "direct evidence."[181] Direct evidence, a term of art developed by the federal courts,[182] usually constituted "smoking gun" evidence such as an employer stating, "I am firing you because you are black."[183] Indirect evidence, by contrast, included circumstantial evidence, such as suspicious timing, offhand racial remarks, or statistical disparity.[184] Naturally, plaintiffs rarely possessed direct evidence.[185] In 1991, as part of a larger overhaul of the 1964 Civil Rights Act, Congress responded to *Price Waterhouse* by codifying the mixed motive claim in the statutory framework.[186] The statute read: "[A]n unlawful employment practice is established when the complaining party *demonstrates* that [a protected classification] was a motivating factor for any [adverse] employment practice, even though other factors also motivated the practice."[187] The statute made no mention of whether "direct" or "indirect" evidence was needed to prevail on a mixed motive claim. The statute just used the word "demonstrate."

In a subsequent case, instead of trying to read its own terminology back into the statute, the Court departed from its terms of art and focused on interpreting the word "demonstrate."[188] With unanimous support, Justice Thomas remarked, "On its face, the statute

179. *Id.*

180. *Id.*

181. 490 U.S. 228, 276 (1989) (O'Connor, J., concurring in the judgment) ("In my view, in order to justify shifting the burden on the issue of causation to the defendant, a disparate treatment plaintiff must show by direct evidence that an illegitimate criterion was a substantial factor in the decision.").

182. *E.g.*, Morgan v. SVT, LLC, 724 F.3d 990, 995 (7th Cir. 2013) ("When a plaintiff is responding to an employer's motion for summary judgment, he (in this case) must initially identify whether he is litigating his case under a 'direct' or an 'indirect' method of proof (or both). . . . The labels have become terms of art.").

183. *E.g.*, Coleman v. Donahoe, 667 F.3d 835, 845 (7th Cir. 2012) (referring to direct evidence as "smoking gun" evidence).

184. *See, e.g.*, *id.* at 851–52 (illustrating a plaintiff's use of circumstantial evidence to raise an inference of discrimination).

185. *E.g.*, *id.* at 845 ("Of course, 'smoking gun' evidence of discriminatory intent is hard to come by.").

186. ONTIVEROS ET AL., *supra* note 177, at 143.

187. 42 U.S.C. § 2000e-2(m) (2012) (emphasis added).

188. Desert Palace, Inc. v. Costa, 539 U.S. 90, 94–95 (2003).

does not mention, much less require, that a plaintiff make a heightened showing through direct evidence."[189] Thus, the Court, through its textual inquiry, departed from its previous terms of art. The same can hold true for legislation regulating the states under the Commerce Clause. By departing from the word "nexus" or even the phrase "physical presence rule" and using the content behind those words in the statute, Congress can greatly increase the likelihood of successfully winding back *Wayfair* in the realm of income taxation.

CONCLUSION

The clamor to overturn *Quill* reached a climax in *South Dakota v. Wayfair, Inc*. The Court's opinion focused heavily on the competing policy positions of the states and the remote retailers that relied on the physical presence rule to avoid sales-tax-collection obligations. In the end, the Court made a policy decision based on the available information and determined that remote retailers should not enjoy the protection of the physical presence rule. Besides the interests of remote retailers pertaining to sales-tax collection, a second segment of taxpayers relied on the physical presence rule to avoid state income taxes. The significance of this interest, however, went unconsidered by the Court, even though the Court emphasized the importance of protecting reliance interests when considering whether to overturn precedent. The Court, according to its own rule regarding reliance interests and stare decisis, should not have overturned *Quill*, because this second reliance interest had not been considered in its analysis. The Court's error could disrupt commerce across the country if left unaddressed, but a simple congressional fix bandaging the wound could resolve the issue and leave the state of affairs exactly as the Court intended.

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189. *Id.* at 98–99.

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