Will Surfing the Web Subject One to Transient Tax Jurisdiction? Why We Need a Uniform Federal Sales Tax on Internet Commerce

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I. INTRODUCTION

Since the 1930s, states have generated revenue by taxing business transactions, including the sale of goods.[1] One of the most prominent forms of state taxation is the sales tax and its complementary use tax.[2] A state may levy a tax on sales made within its borders (a "sales" tax) and collect the tax from the merchant. A state may complement its sales tax with a "use" tax on property used in the state as well, thereby reaching sales that took place beyond its borders but that resulted in property purchased for use within its borders.

Often a use tax must be collected from the purchaser, but the purchaser rarely pays the tax. As a consequence, many mail order or Internet[3] purchases from out-of-state vendors escape tax altogether. This tax avoidance has recently become a major revenue issue for states because the Internet has experienced massive growth in retail sales. Exactly how much commerce is being conducted over the Internet is difficult to say. However, it is safe to say that the figure is already very large and will continue to grow at a frenetic pace, perhaps into the hundreds of billions of dollars in the very near future.[4]

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1. *See* PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 578 (1981).

2. *See id. See also* William F. Fox, *Importance of the Sales Tax in the 21st Century*, *in* THE SALES TAX IN THE 21ST CENTURY 1 (Matthew N. Murray & William F. Fox eds., 1997) (stating that from 1932 to 1969 forty-five states enacted a sales tax); Jon Gworek, *The Imposition of Use Tax Collection Liability on Mail-Order Retailers: What Happens When the Bellas Hess Barrier Is Removed?*, 23 CONN. L. REV. 1087, 1090 (1991) (stating that forty-five states currently have enacted both sales and use taxes and that only Alaska, Delaware, Montana, New Hampshire, and Oregon have neither tax).

3. As used in this article, the term "Internet" has the same meaning as in the Internet Tax Freedom Act, Pub. L. No. 105-277, § 1104(4), 112 Stat. 2681, which defines "Internet" as "the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected worldwide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio."

4. Depending on what one classifies under the heading "Internet commerce," the figures of current and projected revenues vary widely, but all are quite large. *See* John Swartz, *Clinton Sides with Retailers; President Behind Bill for Tax-Free Internet*, S.F. CHRON., Feb. 26, 1998, at C1 (estimating that on-line retail shopping would double from $2.4 billion in 1997 to $4.8 billion in 1998); John Swartz, *E-Commerce Is Hottest Thing at Net Show*, S.F. CHRON., March 12, 1998, at E1 (estimating that "e-commerce sales" will grow to between $80 billion and $255 billion by the year 2000, with a White House estimate of $300 billion by 2002); Jube Shiver Jr., *The New Marketplace Electronic Commerce Is Finally Taking Off*, L.A. TIMES, Sept. 14, 1997, at D1 (providing an estimate of growth in "Internet business" from $8 billion in 1997 to $327 billion in 2002); Leslie Kaufman & Saul Hansell *Estimates for On-Line Shopping Exceed the Most Bullish Forecasts*, N.Y. TIMES, Dec. 29, 1998, at A1 (estimating that on-line retail sales in 1998 would reach $5 billion—surpassing the $4.8 billion estimate in the Swartz article above); Michael Gannon, *From Content to Commerce: VCS Flocked to E-Commerce*, VENTURE CAPITAL J., Jan.

It is a fair assumption that the retail sales conducted over the Internet represent, to a significant extent, retail sales that once took place locally. Thus, the inability of states to tax these sales has pushed Internet taxation to the forefront of many tax policy discussions. Of central concern is that the imposition of taxes on Internet commerce may stifle the fledgling industry's growth.

If merchants must collect an Internet sales tax, the dramatic growth of Internet sales may be curbed because smaller merchants may find compliance onerous. Alternatively, trying to collect a use tax from Internet purchases may place such a great burden on states that only a minimal amount of tax will be collected.

As a reactionary measure, Congress has enacted the Internet Tax Freedom Act, placing a moratorium on many new Internet taxes, at both the state and federal levels, so that the issue can be studied.[5] Given the impending expiration of the moratorium,[6] it is likely only a matter of time before some method of taxing Internet commerce is adopted.

Although there are many possible ways to tax Internet sales, both the Commerce and Due Process Clauses of the Constitution limit state taxation of sales made through mail-order catalogues or the Internet. These constitutional impediments to state taxation will have to be addressed regardless of the method of taxation that legislatures eventually adopt. The longer we postpone legislating a tax on Internet transactions, the greater the cost for Internet industries to implement its collection.

The remainder of this Comment considers how Internet sales could be taxed if Congressional action is taken to remove the Commerce Clause impediments, which would leave only Due Process Clause limitations on Internet taxation. Though three potential

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1, 1999 (estimating on-line retail sales at $7 billion for 1998 and projected growth to $41 billion by 2002); Richard W. Stevenson, *Tangled Web of Taxes*, N.Y. TIMES, Sept. 27, 1998, § 4, at 3 (reporting estimates that shortly after the turn of the century states could be losing up to $12 billion in sales tax revenue, roughly 8% of the total revenues from such taxes).

5. The Internet Tax Freedom Act, Pub. L. No. 105-277, § 1101(a)(2), 112 Stat. 2681, provides that "[n]o State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending 3 years after the date of the enactment of this Act." It then prohibits "discriminatory" taxes, which are defined as taxes that include attempts to appoint local service providers as agents of remote sellers for purposes of determining tax collection obligations, as well as a variety of other methods that could also be used in an attempt to implement a sales or use tax on such commerce. *Id.* at § 1104(2). Furthermore, the Act exempts taxes "otherwise permissible by or under the Constitution of the United States," which, as this Comment discusses, does not include sales taxes on Internet commerce. *Id.* at § 1101(b).

6. *Id.*

solutions are addressed and analyzed for their potential treatment under the Due Process Clause, this Comment concludes that a federal uniform tax on Internet sales of goods will achieve the best balance of interests while avoiding Due Process problems. Part Two provides the reader with a basic description of the current law in the area of sales and use taxes and the problems the Internet poses for that framework. Part Three presents three possible models for taxing Internet commerce and highlights the problems each model presents, both economically and within the legal framework described in Part Two. Proceeding on the assumption that Congress has removed the Commerce Clause impediment, Part Four then applies the Due Process Clause to each model, concluding that a federal uniform tax achieves the best balance of interests while avoiding the Due Process Clause problems inherent in the other models. Part Five then discusses the federal uniform tax in more detail, including several policy issues that make a federal solution the most desirable considering the international scope of the Internet.

II. DEFINITION OF SALES AND USE TAXES AND CURRENT JURISDICTIONAL ISSUES

Although a sales tax is familiar to most people, a use tax is not. A "sales tax" is a tax added to the price of an item by a merchant at the point of sale to the consumer. The consumer pays the tax on top of the price of the item. The merchant then sets aside the tax and remits it to the state in accordance with the taxing state's statute.[7]

On the other hand, a "use tax" is a tax on the "privilege of using, consuming, distributing or storing tangible personal property after it is brought into [the] State from without [the] State."[8] For example, a use tax may be levied on a person who purchases a product in one state for use in the taxing state. The purchaser pays the tax, which generally equates with the sales tax the purchaser would have paid had he purchased the item within the taxing state[9] minus any sales tax paid in the state of purchase.[10] The goal of the use tax is to ensure that the consumer pays the same amount of tax on any taxable item no matter where the item is purchased.[11] The ultimate purpose is to make tax a neutral factor in the purchaser's decisions.

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7. *See* Kathryn L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 176-77 (1997).

8. *Id.* at 177 (citing Woods v. M.J. Kelley, Co., 592 S.W.2d 567, 570 (Tenn. 1980)).

9. *See id.*

10. *See id.*

11. *See id.*

The merchant collects and remits a sales tax, while the purchaser pays a use tax.[12] While the two taxes are economically identical from the purchaser's perspective, because they place the same burden on the purchaser in terms of the amount of tax paid and the items to which the tax is applied,[13] in reality the two taxes yield very different revenues for the state because of the difficulty in collecting the use tax from purchasers who are legally required to pay it.[14]

From the state's standpoint it is beneficial to have merchants collect and remit all taxes related to the sale of tangible goods. States are only able to place this burden of collection on merchants physically present within the state's boundaries.[15] This limitation is due to historical developments in Due Process Clause and Commerce Clause jurisprudence.[16] The result is that a state is powerless to force an out-of-state merchant to collect the use tax owed by the state's citizens when that state's citizens venture out of the taxing state to make purchases.

The problems of sales and use tax jurisdiction can be best demonstrated through the following hypothetical:

STATE A	STATE B
M1	M2
C	

C is a resident of State *A*. *M1* is a retailer doing business only in State *A*. *M2* is a retailer doing business only in State *B*. State *A* levies a sales tax of ten percent on all purchases. It also levies a use tax of

12. *See* Moore, *supra* note 7, at 176-77.

13. *See id.* at 177.

14. *See* Saba Ashraf, *Virtual Taxation: State Taxation of Internet and On-Line Sales*, 24 FLA. ST. U. L. REV. 605, 611 (1997).

15. *See* HARTMAN, *supra* note 1, at 579-80.

16. For a detailed explanation, see Part IV.A, *infra*. At this juncture the only point to recognize is that, from the state government's standpoint, requiring a merchant to collect and remit tax is much simpler than placing that burden on consumers. There are fewer merchants than consumers, and a state can enforce the law much more easily against merchants. Generally speaking, the relatively small amount of use tax the average consumer is legally obligated to remit each year would make the collection of the use tax administratively unfeasible, yet in the aggregate, the amount of revenue lost each year due to the inability to enforce the use tax is probably quite large in most states. *See generally* R. Scot Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. L.A. ENT. L.J. 603, 644 (1996).

ten percent on its residents, but allows a credit against the use tax for any sales tax already paid on the item. State *B* levies a sales tax of five percent.

If *C* purchases a widget from *M1* for $100, *C* pays a sales tax of $10. *M1* will collect and pay the tax to State *A*. Under this traditional sales tax, State *A* has the power to tax *C* and burden *M1* with the collection duty because both are physically present within State *A*.[17] Additionally, *C* would also be liable for remitting the use tax to State *A*; however, *C* would get a credit for the sales tax already paid, which would reduce the use tax to zero. It is in this manner that use taxes are effectively only applicable to out-of-state purchases.[18]

If *C* makes the same purchase in State *B* for $100, *C* pays a sales tax of $5. *M2* will collect and remit this tax to State *B*. If *C* uses, consumes, distributes, or stores the widget in State *A*, *C* must remit the appropriate use tax to State *A*. In this case, the use tax is $10 minus the $5 credit for the sales tax paid for a total use tax of $5. The total tax burden on *C* is $10 either way.[19]

When the sales and use taxes work properly, they reduce the shifting economic effects inherent in most tax schemes. That is, the imposition of the taxes has no effect other than to raise revenue. A shifting economic effect is a collateral effect of taxing a transaction; the most common effects will be a consumer's decision to purchase elsewhere, or a vendor's decision to either reduce prices or move to a lower tax jurisdiction.

The practical problem with a theoretically pure tax scheme is that when *C* returns to State *A*, *C* is unlikely to remit the use tax and State *A* is unlikely to have any knowledge of *C*'s purchase in State *B*. This results in a disadvantage to *M1* who cannot compete with *M2*'s effectively lower prices because of the higher tax placed on *M1*'s sales. The fundamental purpose of the use tax is to correct this problem.[20] Of course, the efficacy of this solution diminishes the closer a merchant is to the border of a lower tax jurisdiction. When traveling to the lower tax jurisdiction is no longer a significant burden on the

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17. *See* State Tax Comm'n of Utah v. Pacific States Cast Iron Pipe Co., 372 U.S. 605, 606 (1963) (holding that "a State may levy and collect a sales tax . . . [when] passage of title and delivery to the purchaser took place within the State").

18. There is an obvious problem if both a sales and use tax are imposed on the same item and no credit is allowed against the use tax for sales tax already paid. The result is double taxation. However, as a practical matter, state statutes contain the same description on items subject to both taxes. Theoretically, such a double tax would be permissible because technically the taxes are aimed at different activities: sales and uses.

19. *See* Ashraf, *supra* note 14, at 611.

20. *See* HARTMAN, *supra* note 1, at 613-14.

purchaser, it is likely that a merchant required to collect a higher tax will have to lower its prices and ultimately bear some of the sales tax itself to remain competitive.

States, lacking the resources to chase down every consumer liable for the use tax, have attempted to require out-of-state vendors to collect and remit the use tax owed by that state's residents.[21] The central issue is whether the state has jurisdiction over the vendor. The United States Supreme Court has recently set out the constitutional requirements that enable a state to place the burden of collecting its sales and use taxes on merchants. In *Quill Corp. v. North Dakota*,[22] the Court held that the Due Process Clause's "minimum contacts" test must be satisfied and that the Commerce Clause requires the merchant to have a "physical presence" within the taxing state.[23]

This decision clarifies the confusion created by *National Bellas Hess Inc. v. Illinois Department of Revenue*,[24] in which the Court stated that physical presence was required by the Constitution, but did not specify which part of the Constitution.[25] The facts in the *Quill* case were virtually identical to those in *Bellas Hess*. In *Quill*, North Dakota sought to impose responsibility to collect its use tax on Quill Corporation, which had no contact with the State of North Dakota other than sending mail order catalogues to customers within North Dakota.[26]

The Court first acknowledged that *Bellas Hess* relied on both the Due Process and Commerce Clauses of the Constitution.[27] It then stated that each clause fulfills a distinct purpose in limiting the ability of a state to tax an out-of-state vendor. The result is that a state may have the requisite jurisdiction under the Due Process Clause, but yet be unable to tax because the imposition of the tax would violate the Commerce Clause.[28] Perhaps most importantly, the Court stated that Congress has plenary power to regulate in the area of interstate commerce, but has no similar power to "authorize violations of the Due Process Clause."[29]

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21. For a discussion of these state attempts, see Part B of this section.
22. 504 U.S. 298, 318 (1992).
23. *Id.* at 314-15, 318.
24. 386 U.S. 753 (1967).
25. *Id.* at 760.
26. *Quill*, 504 U.S. at 301-02.
27. *Id.* at 305.
28. *Id.*
29. *Id.*

When analyzing the Due Process Clause, the Court defined the limits of modern due process analysis by stating that the crucial issue is whether the vendor aims any purposefully directed activity at the forum state in such a manner as to provide fair warning to the vendor that it may be subject to that state's jurisdiction.[30] The Court concluded that the magnitude of Quill Corporation's activities[31] and the obvious direction of those activities toward the state of North Dakota were sufficient to satisfy the Due Process Clause.[32] Due to the sheer volume of catalogues sent to North Dakota, it would have been difficult to justify any other outcome.

When analyzing the Commerce Clause, the Court held that the fundamental purpose of that clause differs from that of the Due Process Clause because the Commerce Clause protects the national economy from undue burdens any one state might create, whereas the Due Process Clause protects the individual from the burden of being forced to litigate in a distant jurisdiction without notice.[33] The Court stated that the bright line physical presence test, while artificial in some respects, benefits the area of state taxation by providing a clear rule and creating settled expectations.[34] In the end, the Court freely acknowledged that, because of Congress' plenary power over Commerce Clause issues, "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[35]

Given this current state of the law, and the distinction between the Due Process and Commerce Clause requirements, many commentators have discussed possible methods of imposing use tax collection responsibility on out-of-state vendors within the current framework; however, these commentators do not focus specific attention on retail sales and specific constitutional issues relating to sales of this type.[36] It seems clear that if Congress did nothing, the current state of the law would prohibit states from imposing use tax collection responsibility on out-of-state vendors whose only means of advertising is through a

30. *Id.* at 308.

31. The state court noted that Quill Corporation mailed out twenty-four tons of flyers and catalogues every year to North Dakota residents. *Quill*, 504 U.S. at 304.

32. *Id.* at 308.

33. *Id.* at 313.

34. *Id.* at 317.

35. *Id.* at 318.

36. *See generally* Grierson, *supra* note 16, at 657-664. Many of the suggestions in the Grierson article and in other articles address issues of service providers and do not focus specific attention on the actual sale of tangible goods, which is the main focus here.

web site.[37] After all, if physically mailing catalogues into a state is not enough, then it is hard to imagine that maintaining a web site would be.

The basic assumption of the remainder of this Comment is that Congress will remove the Commerce Clause's physical presence requirement. Once this is done, the only hurdle remaining will be the Due Process Clause.[38] The Due Process Clause analysis will be applied to whatever plan is adopted and, unlike Commerce Clause analysis, cannot be manipulated through Congressional action. The remainder of this Comment will analyze the application of the Due Process Clause to three possible solutions to the Internet taxation problem.[39] However, first we must examine the jurisdictional problems created by the Internet.

The Internet is not a tangible thing, but rather a concept.[40] Physically, it is made up of tiny computer networks scattered across the globe, all of which share common computer languages and all of which are linked through telecommunications.[41] The Internet is accessed through a personal computer connected to one of these tiny local computer networks.[42] The local computer network is then able to contact all of the other local networks that make up the Internet, and it allows the local consumer to access information anywhere the Internet reaches.[43]

While a variety of information is stored in the networks that can be accessed via the Internet, one of the most prominent types of information available is advertising. A vendor can establish a web site

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37. Depending on where a sale made through a web site is deemed to take place, it may be appropriate to speak of sales tax collection responsibility as well. This issue centers on whether a sale takes place in the vendor's or purchaser's jurisdiction and is a matter discussed in Part Four *infra*.

38. It is important to note that the nexus requirement is only one prong of a four-prong test applied to determine the constitutionality of state taxes. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). The four prongs are: that the tax must be (1) applied to an activity having substantial nexus with the taxing state (implicating the Due Process Clause and Commerce Clause concerns of this Comment), (2) fairly apportioned, (3) nondiscriminatory against interstate commerce, and (4) fairly related to the services provided by the state. *See id.*

39. The distinction between the Internet and mail-order industries is crucial because, based on *Quill* alone, if Congress removes the physical presence requirement, then the mail-order industry will be required to collect and remit taxes to the states where they make sales because the act of bombarding a state's residents with catalogues fulfills Due Process requirements. The same cannot be said for contacts between vendors and consumers made over the Internet.

40. *See* Grierson, *supra* note 16, at 609.

41. *See id.*

42. *See* Craig Peyton Gaumer, *The Minimum Cyber-Contacts Test: An Emerging Standard of Constitutional Personal Jurisdiction*, 85 ILL. B.J. 58, 59 (Feb. 1997).

43. *See* Ashraf, *supra* note 14, at 606-07.

on a local server that can be reached anywhere by anyone having access to the Internet.[44] Often these web sites are referred to as "virtual storefronts"[45] because they fill the same purpose as a display window in a shop. The web site physically resides on the local computer network often located in the same city as the vendor, but it has the potential to be seen by an innumerable and far-reaching audience.[46]

The Internet, as a concept, defies traditional application of jurisdictional jurisprudence because of its amorphous geographic nature.[47] It is not found in any one location. When a portion of the Internet becomes inaccessible for any reason, the remainder of the Internet continues to function by simply rerouting communications.[48] Due to the complexity of routing and the random method by which individuals actually "surf"[49] through the available Internet resources, it becomes nearly impossible to track communications and transactions conducted between different users and to tie those transactions to any specific location.[50]

As was pointed out above,[51] the problematic geographical nature of the Internet is coupled with the large and continuously increasing amount of commerce conducted via the Internet.[52] The potentially large number of taxable transactions available to states increases the likelihood of a push toward taxation of on-line commerce.[53] This push will come both from states in need of revenues[54] and from local industry no longer happy with the ability of on-line industries to evade

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44. A "server" is a provider of space on a computer network that is accessible by others having access to the Internet. A "web site," or "home page," refers to the actual space provided. A vendor can place whatever information is desired on its web site. The concept of a web site generally refers to what is seen on the consumer's computer screen.

45. *See* Ashraf, *supra* note 14, at 607.

46. *See id.* at 608.

47. *See* Evantheia Schibsted, *Net Taxes: States Try to Cash in on On line Commerce*, CAL. LAW. Mar. 1997, at 26.

48. *See* Gaumer, *supra* note 42, at 59.

49. "Surfing" is a term commonly used to describe the manner in which an individual travels from web site to web site. Web sites often provide "links" to other related sites; all an individual has to do is click a mouse on the link, and the computer will access the intended web site, which may be physically located on a computer network thousands of miles away from the one the individual was previously accessing. In this way, the individual can be conceptualized as floating or "surfing" through a nebulous sea of available information.

50. *See* Schibsted, *supra* note 47, at 26.

51. *See supra* note 4.

52. *See* Ashraf, *supra* note 14, at 609.

53. *See* Schibsted, *supra* note 47, at 26 (stating that state tax authorities are eager to "tap into electronic commerce" and providing snippets of interviews with consultants representing both government and industry).

54. *See* Grierson, *supra* note 16, at 615.

sales tax and sell their goods at lower prices.[55] There is some indication that at least some companies will not mind being subject to tax if the requirements are uniform and predictable.[56] At this point in the debate, the only certain thing is gridlock between states that desire new ways to raise revenues and industries that resist the imposition of new taxes outright, or at least that resist a piecemeal development of Internet tax policy. There will need to be resolution to be sure, though the current official policy adopts a plan of inaction.[57] The current moratorium expires on October 21, 2001.[58] If it is permitted to expire, a plan will need to be in place to guide the state taxation that is sure to follow.

III. THREE POTENTIAL SOLUTIONS PERMITTING STATE TAXATION OF INTERNET COMMERCE

Although there are many ways states could tax Internet commerce, this Comment addresses only three.[59] First, the purchaser could pay the sales tax for the jurisdiction where the vendor is located (the "source" model). Second, the Internet vendor could collect and remit the use tax of the jurisdiction where the purchaser is located (the "destination" model). Third, federal legislation could preempt any separate state taxes, establish a uniform tax rate, and give pro rata refunds to state governments based on each state's share of Internet consumption.

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55. *See Another Jurisdiction Issue: Collecting Taxes*, 5 COMPUTER L. STRATEGIST 5 (1997) (discussing the case of Amazon.com, Inc., v. Barnes & Noble, Inc., No. 97 Civ. 3466 (JKG) (S.D.N.Y. amended answer and counterclaim of Amazon.com filed Aug. 15, 1997), describing litigation between Barnes & Noble, a bookseller with physical stores in most states, and therefore subject to collection of state sales taxes, and Amazon.com, an on-line bookseller able to avoid state taxes due to a lack of physical nexus with any state other than its home state of Washington. This case presents a twist on these issues because Amazon.com is suing to force Barnes & Noble to collect sales taxes on all orders placed through Barnes & Noble's web site and sent to states where Barnes & Noble has a physical presence).

56. *See* Schibsted, *supra* note 47, at 27 (quoting Ellen K. Fishbein, assistant general counsel at America Online: "We're not saying don't tax our industry . . . [but] if states are going to tax us, they need to come up with uniform definitions and tax rates.").

57. *See generally* Internet Tax Freedom Act, *supra* note 3. It should be noted, though, that the Internet Tax Freedom Act does require the formation of a commission to study problems relating to Internet taxation, including sales and use taxes. Internet Tax Freedom Act, § 1102(g)(2)(D)(i).

58. *See supra* note 5.

59. As a practical matter, while discussion in this Comment is limited to Internet commerce, any solution adopted would probably be applied to mail-order sales as well because there is no sound reason to treat the two differently. However, there is a crucial difference in a much broader context because the Internet extends to a wider variety of activities making any jurisdictional analysis more significant for Internet activities than for mail-order sales.

A. *Requiring the Purchaser to Pay the Sales Tax of the Vendor's Jurisdiction*

One solution to the problem is to deem all purchases made over the Internet to have taken place in the vendor's jurisdiction. Returning to the hypothetical set out above, this would mean that if *C* ordered his widget from *M2*'s virtual storefront on the Internet, then the transaction would be treated in the same manner as if *C* had physically gone to *M2*'s actual storefront in State *B* and made the purchase. This would be administratively simple for *M2* because the sale would be treated in the same manner as any other sale. *M2* would simply collect the sales tax due on the purchase and remit it to State *B*.

Of the three models outlined in this paper, a tax of this type would be the easiest to implement. A vendor could simply state what the tax rate is in his jurisdiction on the web site itself, and the consumer could add that cost to the purchase price just as a consumer now factors in additional shipping and handling charges. Some commentators refer to this as a source tax because it is calculated at the source of the merchandise or production.[60]

What this method offers in simplicity and ease of administration, it lacks in overall economic soundness. Sales tax rates for states and for local tax jurisdictions within states vary widely throughout the country.[61] This does not create any problem in terms of administration because the consumer will know the rate to which the purchase is subject at the time the purchase is made. However, this very same information produces unwanted economic effects.

Using our hypothetical, imagine that *C* wants to buy a very expensive widget that costs $1000. Further assume that to have the object shipped to *C* there will be added a $25 shipping fee. If State *A* is a state like Mississippi with a sales tax of 7.0%,[62] the widget will cost *C* $1070 (assuming *C* picks it up from *M1*'s physical storefront). If State *B* is a state like Virginia with a sales tax of 3.5%,[63] and *C* makes the purchase from *M2*'s web site, then under this tax regime *C*

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60. *See* William F. Fox & Matthew N. Murray, *The Sales Tax and Electronic Commerce: So What's New?*, NAT'L TAX J. (Vol. L No. 3 1997), 573, 574.

61. For example, the State of Mississippi levies a statewide sales tax of 7.0% (MISS. CODE ANN. § 27-65-17(1) (1998)), whereas Virginia levies a statewide sales tax of 3.5%. (VA. CODE ANN. § 58.1-603 (Michie 1997)), and the State of Oregon levies no sales tax at all. Fox, *supra* note 2. In addition, because many smaller jurisdictions add an additional amount of sales tax to the statewide minimum, there are generally minor fluctuations in the applicable sales tax rate within most states.

62. *See supra* note 61.

63. *Id.*

will pay $1035 for the widget plus an additional $25 for shipping for a grand total of $1060. We can already see the unfair advantage an Internet provider enjoys over a local retailer because it is able to avoid the imposition of *C*'s state sales tax. Add to this State *X*, which, like the State of Oregon, imposes no sales tax.[64] If *C* purchases from a web site of a vendor located in State *X*, then the total will be $1025 (the $1000 purchase price, on which there is no sales tax, and the additional shipping charge). If we assume that *C* is economically motivated and will purchase the widget at the lowest price, then *C* and everyone similarly situated will purchase from the vendor in State *X*.

The example above demonstrates one of the shifting economic effects of a source tax: consumers will favor a jurisdiction with the lowest rate of tax. There is an additional shifting economic effect based on the same mentality. The vendors themselves will prefer to locate in a jurisdiction with the lowest rate of tax in order to keep their own production costs lower.[65] The result is a shift in the location of businesses to jurisdictions with low or no sales tax. The long term result of a source tax system is a distorted economy where states with lower tax rates receive an inordinately high proportion of the business from Internet commerce.

By making out-of-state vendors subject to their own jurisdiction's tax rate, the source tax would take a step toward resolving the inherent unfairness of the current system that gives all out-of-state Internet vendors an advantage over local retailers. However, this system creates a different type of problem. When established Internet vendors relocate to or new vendors choose to start up in jurisdictions with low or no sales tax, the same inherent unfairness will result because these vendors will still be able to undersell some local retailers due to the substantial tax savings. In addition, a new problem is created for states that were once home to a piece of the industry because these states lose the benefits of that industry when it relocates to other states.

In support of a source tax is the argument that the ease of administration outweighs either of these results because the alternatives create compliance costs that are too high. In addition, states wishing to retain Internet vendors will simply have to amend their existing tax laws to entice that industry. This will create competition amongst the states as they vie for their share of Internet vendors. Market forces will likely result in a stabilization of tax rates combined with other nontax incentives to retain this industry in any given state. The

64. *See supra* notes 2 and 61.
65. *See* Fox & Murray, *supra* note 60, at 576, 586.

problem with this economic speculation is that it is merely *speculation.* Internet vendors are not likely to want to participate in such a "price war" because relocation is expensive, and if tax rates were to change suddenly, then the cost of choosing the wrong location could be high. This does not offer the industry the kind of predictability it desires.[66] In addition to the inability of industry to plan activities, such a system creates problems for the states themselves because they will not be able to accurately predict revenues in an unstable tax system.[67]

B. *Requiring the Vendor to Collect and Remit the Use Tax of the Purchaser's Jurisdiction*

Those who are dissatisfied with the source model because of the problems laid out above may be attracted to a "destination" model. The destination system makes the Internet vendor responsible for collecting and remitting the use tax levied by the jurisdiction of the purchaser.[68] This type of system removes the unwanted secondary economic effects created by a source tax, but instead creates high compliance costs not associated with a source tax.

The amorphous geographical nature of the Internet makes it difficult to determine the tax jurisdiction of the purchaser. Given the mobility of laptop computers and the wide availability of Internet access, a single individual could access the Internet and purchase an item from a seemingly endless number of locations.[69] Determining *where* the consumer is located becomes difficult, if not impossible, from the vendor's point of view. Proponents of this model often solve the problem by linking the consumer's tax rate to the jurisdiction to which the merchandise is shipped, through a billing address or a zip code.[70]

Even granting the fact that a consumer-on-the-go might actually make the purchase in a jurisdiction with a sales tax rate different from that of the jurisdiction to which the merchandise is shipped, this method of implementing a destination determined Internet sales tax comes much closer to economic precision. If we examine our hypothetical, again assuming that *C* desires to purchase a $1000 widget and that States *A*, *B*, and *X* have tax rates of 7.0%, 3.5%, and 0%, respectively, we can see that *C*'s incentive to purchase from State *X* is

66. *See supra* note 56 and accompanying text.

67. *See* Adam L. Schwartz, *Nexus or Not? Orvis v. New York, SFA Folio v. Tracy and the Persistent Confusion Over Quill*, 29 CONN. L. REV. 485, 487 (1996).

68. *See* Fox & Murray, *supra* note 60, at 576.

69. *See* Scott H. Walters, *What Are the Sales Tax Consequences of Retail Marketing on the Internet?*, STATE & LOCAL TAXES WEEKLY, Mar. 24, 1997, at 12.

70. *See* Fox & Murray, *supra* note 60, at 587.

removed. If Internet vendors in all jurisdictions other than those located in State *A* are required to collect and remit the use tax levied by State *A*, then it will make no difference from whom *C* makes the purchase. *C* will be required to pay a tax of 7.0% from *M1*, *M2*, or the vendor in State *X*. In addition, *C* will be charged for shipping if an order is placed with a vendor in another state. Thus, if *C* is economically motivated, under this system *C* will purchase from *M1*, his local retailer.

The destination model makes tax irrelevant to the consumer because taxes do not produce total cost differences between vendors. This forces retailers to compete based on the price of their merchandise and not on the taxes applicable to that merchandise. With such economic perfection, one may wonder what could possibly be wrong.

The problem becomes obvious when one asks the question, how will *M2* or the vendor in State *X* know what the tax rate is in *C*'s jurisdiction? With over 30,000 taxing jurisdictions[71] the problem of compliance with a destination tax places an incredibly large burden on vendors.[72] Some commentators believe that the compliance burden placed on vendors is not nearly as large as it may seem given the current and continuing developments in computer software applications that can be used to keep track of the necessary data.[73]

Granted, software applications can make compliance easier. Additionally, few could argue that giant vendors such as L.L. Bean or Victoria's Secret could not afford to absorb the compliance costs. These large Internet vendors will be able to develop their own software or to purchase complex and expensive software permitting them to comply with a destination tax. However, one of the unique features of the Internet is its benefit to small-time entrepreneurs doing business with little capital and attempting to reach the broadest customer base possible. A small Internet start-up would likely be unable to afford the computer software necessary to comply with complicated tracking and computation requirements of a destination tax.[74]

One author has estimated that a small Internet vendor would have to earn revenues of $500,000 per year before it could afford the expense of both the software and the updating services required to stay

71. *See* Schibsted, *supra* note 47, at 26.

72. *See* Fox & Murray, *supra* note 60, at 586.

73. *See* Ashraf, *supra* note 14, at 619. *See also* Gregory A. Ichel, *Internet Sounds Death Knell for Use Taxes: States Continue to Scream Over Lost Revenues*, 27 SETON HALL L. REV. 643, 658-59 (1997).

74. *See* Edward A. Morse, *State Taxation of Internet Commerce: Something New Under the Sun?*, 30 CREIGHTON L. REV. 1113, 1142 (1997).

abreast of the constant changes in tax rates.[75] Estimates like this have prompted some commentators to propose that an exemption from the tax be given to vendors with less than a specified amount of revenue.[76] This suggestion, however, undermines the entire purpose of the destination tax because it removes a large piece of the economic solution that a destination tax provides.

The purpose of the destination tax is to ameliorate the shifting economic effects of the current system. A destination tax eliminates these effects to a much greater extent than does a source tax, but at a much greater compliance cost. If a safe harbor were provided to exempt small Internet vendors from the tax, due to compliance costs, then these vendors would enjoy the benefits of the shifting economic effects because they could use their tax exemption to undersell local retailers.

Often the competing local retailers will be small local businesses as well. These local retailers will therefore receive little protection from a destination tax that includes a safe harbor provision. Because the protection of local retailers is one of the primary goals of such legislation, a safe harbor provision seems counter-productive. Certainly this analysis does not make the implementation of a destination tax useless, but it would greatly reduce the effectiveness of the tax in achieving its economic goals. When this reduction in effectiveness is coupled with the very high compliance costs associated with such a tax, and because these costs will be shouldered by those who are subject to it, the proponents of such a system find themselves on shaky ground.

C. *Federal Legislation of a Uniform Tax Rate*

Both of the models presented above have advantages and drawbacks. A wholehearted acceptance of either must necessarily embrace both the good and bad associated with it. The source tax provides such simplicity that most vendors would hardly notice its implementation but for the increase in the amount of taxes they collect and remit to their home states; however, while it is fairer than the current system, it contains a high risk of shifting economic effects that drastically reduces its overall effectiveness. The destination tax, on the other hand, if implemented purely, achieves near perfect economic

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75. *See* Steven J. Forte, *Use Tax Collection on Internet Purchases: Should the Mail Order Industry Serve as a Model?*, 15 J. MARSHALL J. COMPUTER & INFO. LAW 203, 216, n.61 (1997).

76. *See* Walter Hellerstein, *Transaction Taxes and Electronic Commerce: Designing State Taxes That Work in an Interstate Environment*, 50 NAT'L TAX J. 593, 600 (1997).

effects because the rate of tax paid will always be the same from the purchaser's standpoint. However, this perfection comes at such a high compliance cost that it would either stifle the entrepreneurial spirit of the Internet or require a safe harbor provision. A safe harbor provision dramatically reduces the system's effectiveness while at the same time retaining the high compliance cost burden. An optimal system would attain the economic efficiency of the destination tax, while being as simple as the source tax. A federally mandated uniform tax rate on all Internet sales of tangible goods would do just that.

This solution proposes that Congress regulate state taxation of Internet commerce. Setting a uniform sales tax rate on purchases of tangible goods over the Internet would greatly reduce the shifting economic effects of a source tax without creating the high compliance costs of a destination tax. Under this system, a uniform rate would be applied to all sales of tangible goods over the Internet. The rate could be set at the average rate of tax already applied by the states, which is 5.0%.[77] An additional uniform rate could be added to this to represent the average local sales tax rate.

Applying this system to our hypothetical, and assuming that the uniform rate is 6.0%, we can see that this system offers a good balance between the source and destination models. *C* will still pay a rate of 7.0% on purchases within State *A*, and the shifting economic effects are still present if *C* were to travel to State *B* (where the rate is 3.5%) or to State *X* (where there is no sales tax); however, these effects are substantially removed if a purchase via the Internet is subject to a rate of 6.0%. Here *C*'s purchase of a $1000 widget would cost $1070 in State *A*, and it would cost $1060 in States *B* or *X*, but it would also be subject to the $25 shipping charge for a grand total of $1085. If *C* is economically motivated, then the Internet will not steal any business away from State *A*'s local retailers.[78]

Some shifting economic effects will certainly remain under a system such as this; however, those effects are fewer than if a source tax system is used. In addition, the simplicity of compliance with a uniform federal rate reduces compliance costs to such an extent as to be almost unnoticeable when compared to the huge compliance burden of a destination tax system.

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77. The average sales tax rate levied by the states as of 1994 was just slightly over 5.0%, the median rate was also 5.0%. Fox, *supra* note 2, at 4-6.

78. In the facts of this hypothetical, the price of the widget would have to exceed $2500 before the Internet vendors would be able to undercut the local retailer in State A.

1. Reduction of Vendor's Tendency to Relocate

Although the rate of tax will be uniform and applied at the federal level, there will still be some variation of actual local tax rates for non-Internet purchases under this system. Though vendors may still be tempted to relocate to states with low or no sales tax, because the local rate of tax will be levied only on items it purchases for its own use, such as office supplies, this will not affect the decisions of Internet businesses any more than it will affect any other business. One can hardly imagine that decisions about where to locate one's business would hinge on whether sales tax would be paid on pencils and paper clips.

In addition, the simplicity of one uniform rate will make overall compliance much easier. Ease of compliance is likely to actually increase collections. This potential increase in overall collections must be factored into any equation that focuses on the potential drawbacks of having a different rate of tax applied to Internet commerce.[79]

2. Reduction in Tax-Driven Consumer Choices

In addition, Internet vendors' ability to undercut the prices of local retailers will be greatly reduced. Again, because local rates of sales tax vary from state to state, there will be some potential for some tax driven choices if a local rate is higher or lower than the federal rate. For example, if the national sales tax rate on Internet sales is 5%, Internet vendors will still enjoy an advantage over a local retailer in a state where the sales tax is anything above 5%, but Internet vendors will be placed at a disadvantage with regard to local retailers in states where the sales tax is below 5%.[80] In the aggregate, the differences will likely be minimal.

While not achieving the economic purity of a destination tax, a federal uniform tax rate more closely approaches economic parity than the source tax because the rate can be set to approximate the median or mean overall sales tax rate, as well as the mean or median rate levied by smaller jurisdictions such as municipalities or counties. This will

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79. *See* Morse, *supra* note 74.

80. In the hypothetical, we saw an example of a slight advantage when the local rate of tax was higher than the uniform rate applied to Internet sales; however, the price of the item would ordinarily have to be quite high before the Internet vendor is able to overcome the cost of shipping and able to rely on the lower tax rate to undersell the local competition. *See supra* notes 77 and 78 and accompanying text. The other side of this problem results in a penalty to the Internet vendor. In a state like Virginia, where the sales tax is 3.5%, it will be very difficult for an Internet vendor subject to a 6.0% rate to compete with local retailers.

create a rate that reflects the combined national average of state and local sales taxes. Thus, while consumers will not pay the identical rate they would pay on a local purchase, as they would with a destination tax, the use of an average rate will ensure that the rate paid will not be subject to the radical fluctuation in the tax rates that would likely occur under a source tax regime. Overall, the uniform tax will be less likely to influence a consumer's choice of vendors.

3. Compliance Cost Burden is Borne Collectively

Though a call for additional government regulation is not often welcome, Internet commerce probably represents the purest of interstate activities, making it a prime candidate for federal regulation pursuant to the Commerce Clause.[81] Federal regulation in this area could solve a number of potential problems;[82] however, the focus of this Comment is on economic benefits.

Under this proposed uniform tax system, a local vendor need only be concerned about two rates of tax: the local rate of sales tax, which must be collected and remitted to the state; and the tax on Internet sales that will be collected and remitted to the federal body in charge of collecting and disbursing the tax. This is a dramatic simplification over the destination tax, which requires each individual vendor to keep track of the taxing jurisdiction to which every item is shipped, determine that jurisdiction's rate of tax, collect that tax, and then remit it to the proper state. The federal solution places on a federal agency the burden of collecting all of the tax and figuring the amount to be refunded to each state. Thus, the burden is borne collectively. This could be done by the Internal Revenue Service or by a new agency established solely for this purpose.

An additional benefit of a uniform tax is that the federal solution is just that—a new solution to a new problem. What this solution avoids is the need to tamper with existing jurisdictional jurisprudence. The Internet represents a completely new medium that defies our traditional concept of physical space. However, we must realize that most of our activities take place in the real world rather than the virtual world and that a manipulation of due process requirements for jurisdictional purposes simply to permit taxation under a source or destination model may have unwanted side-effects. The Due Process Clause involves a much broader range of issues than just jurisdiction.

81. U.S. CONST. art. 1, § 8, cl. 3 (giving Congress the express power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes").

82. *See infra*, Part Five.

The jurisprudence associated with this key constitutional clause should not be altered needlessly, especially when a viable alternative solution is available.

IV. DUE PROCESS IMPLICATIONS OF EACH MODEL

A long-standing constitutional muddle was clarified in the *Quill* case, which held that the Commerce Clause requires physical presence in a state before one is subject to that state's tax and that the Due Process Clause does not have such a requirement.[83] The previous section of this Comment posed three possible models for implementing a tax on Internet commerce once the physical presence requirement is removed. This section considers how the Due Process Clause affects each solution.

A. *The Evolution of Minimum Contacts and State Sales and Use Taxes*

In the landmark jurisdictional case of *Pennoyer v. Neff*[84] the Supreme Court stated that:

> The several States of the Union are not, it is true, in every respect independent, many of the rights and powers [that] originally belonged to them being now vested in the government created by the Constitution. . . . [E]xcept as restrained and limited by that instrument, they possess and exercise the authority of independent states.[85]

While these concepts were by no means new in 1877, they highlighted the tension inherent in our federalist form of government. Not only is there a separation between federal and state government, but there are distinct separations between the states themselves, each being an equal sovereign body. What *Pennoyer* stated, among other things, was that a state "possesses exclusive jurisdiction and sovereignty over persons and property within its territory" and that "no [s]tate can exercise direct jurisdiction and authority over persons or property without its territory."[86] While the first proposition remains true,[87]

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83. *See supra* notes 27-29 and accompanying text.

84. 95 U.S. 714 (1877).

85. *Id.* at 722.

86. *Id.*

87. This idea was essentially reaffirmed in *Burnham v. Superior Court*, 495 U.S. 604 (1990), when the Court stated "[a]mong the most firmly established principles of personal jurisdiction in American tradition is . . . . the view developed early that each State had the power to hale before its courts any individual who could be found within its borders . . . no matter how fleeting his visit." *Id.* at 610-11.

the second has been substantially relaxed by the minimum contacts test first pronounced in *International Shoe Co. v. Washington.*[88]

International Shoe addressed the question of a state's power to exercise jurisdiction over those not present within its physical borders. Society became much more mobile in the period between 1877, when *Pennoyer* was decided, and 1945 when the Court finally promulgated a test for permitting states to achieve jurisdiction over nonresidents. However, the minimum contacts test today, much like *Pennoyer* in 1945, is not a sufficient solution to the current developments involving the Internet. It is insufficient because the minimum contacts test is inescapably rooted in notions of state sovereignty and physical space. In rejecting *Pennoyer* and announcing its new standard, the *International Shoe* Court stated that:

> [D]ue process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice."[89]

This standard was sufficient to resolve most of the conflicts of the time, including suits involving tax matters, as in *International Shoe.*[90] In that case, the defendant had no office in the taxing state, made no contracts there, and stored no merchandise there, but it did employ traveling salesmen who solicited orders from customers there.[91] These facts bear a striking resemblance to two early state tax cases decided the year before *International Shoe.*

Tax cases prior to *International Shoe* had already held that the appropriate place to impose a sales tax was where transfer of possession from vendor to purchaser took place.[92] One of the first cases, which came before the Supreme Court in 1940, dealt with a retail sales tax levied by New York City on sales of coal within the city limits.[93] Berwind-White was a coal company with an office in New York City. The company arranged contracts for coal mined in Pennsylvania to be delivered to customers in New York City.[94] This seemed clearly to

88. 326 U.S. 310 (1945).

89. *Id.* at 316 (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)).

90. This is true in a general sense. To be more precise, *International Shoe* involved a dispute over a statute requiring payments into an unemployment compensation fund.

91. *International Shoe*, 326 U.S. at 313.

92. *See* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940); McGoldrick v. Felt & Tarrant Mfg. Co., 309 U.S. 70 (1940).

93. *Berwind-White Coal Mining Co.*, 309 U.S. 33.

94. *Id.* at 44.

be a transaction involving interstate commerce, yet the Court reasoned that the imposition of the tax was not an undue burden on interstate commerce.[95] Even though the imposition of the tax caused an increase in the price of Berwind-White's coal, the Court held that it did not discriminate against interstate commerce but rather was merely an equalizer because every merchant within the city was also subject to the tax.[96] The notion of laying the tax at the place of destination was a major theme to emerge from the case.[97] The Court reasoned that this tax was permissible because it was levied on "a local activity," which was the act of delivering "the goods within the state upon their purchase for consumption."[98]

In one sense it seems somewhat arbitrary to classify delivery at the final place of sale as purely local because the classification merely taxes the endpoint of an otherwise interstate activity. It would seem to be equally logical to classify the other end of the journey, the point of shipment, as the taxable event.[99] This possibility of multiple taxation events during an interstate shipment of goods was one of the main hurdles the Court had to overcome in these early cases. If two or more states levy taxes on interstate shipments, a severe burden is placed on interstate commerce, resulting in the exact impediment the Commerce Clause was designed to avoid.[100]

In a case decided at the same time as *Berwind-White*, the Court added to the analysis more language that seemed to remove much of the risk of multiple taxation. In *McGoldrick v. Felt & Tarrant Manufacturing Co.*,[101] the Court followed the *Berwind-White* holding that the place of destination was the proper taxing jurisdiction, but further justified it as the correct location for imposition of the tax because the "transfer of possession" from the seller to the purchaser took place there.[102] Thus, these two early decisions stood for the proposition that the place of destination was the appropriate place to levy a sales tax when that location was also the place where the

95. *Id.* at 46 (citing Western Live Stock v. Bureau, 303 U.S. 250, 254 (1938)) ("[I]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce of their just share of state tax burdens, merely because an incidental or consequential effect of the tax is an increase in the cost of doing business.").

96. *Id.* at 49.

97. *See* HARTMAN, *supra* note 1, at 586.

98. *Berwind-White Coal Mining*, 309 U.S. at 58.

99. *See* HARTMAN, *supra* note 1, at 585.

100. *See id.* at 586.

101. 309 U.S. 70 (1940).

102. *Id.* at 77.

ultimate transfer of the product from the seller to the purchaser occurred.

This is a sound rule and a very familiar one. If we return to the hypothetical set out above, we can see that this essentially covers all of the situations in which *C* physically meets with either *M1* or *M2* and makes a purchase. At either point, *C* will be subject to the sales tax of the jurisdiction where *C* is physically located. In both cases, these are "local" transactions in the sense of *Berwind-White*, even though the product *C* purchases may well be one that traveled in interstate commerce. In both cases, State *A* and State *B* are able to force the merchant to collect the tax and remit it to the state just as New York City required in *Berwind-White*.[103] At this point in the Court's analysis, there was little to indicate whether it was the Commerce or Due Process Clause that compelled this result.

Berwind-White and *Felt & Tarrant* were jurisdictionally sound under *Pennoyer* because both parties were physically within the jurisdiction when the tax was levied. Thus one might conclude that the Due Process Clause was all that was necessary to reach these decisions. However, the notion of physical presence was not seriously examined or tested until *McLeod v. J.E. Dilworth Co.*[104] and *General Trading Co. v. State Tax Commission of Iowa*[105] were decided. In each of these cases, the vendor was a nonresident whose only presence in the taxing state was embodied by its traveling salesmen. In both cases, elements of the Commerce Clause began to creep into the analysis.

In *Dilworth*, the State of Arkansas sought to levy a sales tax on several out-of-state companies with home offices in Tennessee but no offices in Arkansas. They were not qualified to do business in Arkansas, but did have traveling salesmen soliciting orders there.[106] The orders were sent to the offices in Tennessee for approval, were accepted in Tennessee, and the goods were shipped via common carrier from Tennessee.[107] The Court differentiated the situation in this case from that in *Berwind-White*, stating that in *Berwind-White* the entire transaction took place within New York City, whereas in *Dilworth* the seller was "[done] selling in Tennessee . . . under these circumstances the sale—the transfer of ownership—was made in

103. *Berwind-White Coal Mining Co.*, 309 U.S. at 43.
104. 322 U.S. 327 (1944).
105. 322 U.S. 335 (1944).
106. *Dilworth*, 322 U.S. at 328.
107. *Id.*

Tennessee."[108] The Court held that Arkansas' attempt to levy a sales tax on these transactions was an "assumption of power by a State [that] the Commerce Clause was meant to end."[109]

The Court then went on to differentiate a sales tax from a use tax, stating that while the two different types of tax will often achieve the same result, they are fundamentally different in that a use tax in this situation would be permissible but a sales tax would not.[110] Justice Frankfurter drew the distinction between the two types of tax as a distinction between the different types of transactions upon which they are levied.[111] The fundamental difference is that a sales tax "is a tax on the freedom of purchase,"[112] whereas a use tax "is a tax on the enjoyment of that which was purchased."[113] The Court reasoned that the imposition of a sales tax on a company located in another state was an exercise of power extending too far beyond the state's borders, but that a use tax was levied on the use of a product within the state and was therefore permissible in situations when a sales tax was not.[114] Thus, had Arkansas simply called its tax a use tax, it might have been able to force J.E. Dilworth to collect and remit it.

The Court had previously upheld the validity of a compensating use tax[115] based on a similar distinction, stating that a use tax "is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end."[116] With this distinction, even in its reiteration in *Dilworth*, the Court did not address anything further than the mere validity of such a tax. Because the references to the use tax were merely dicta in *Dilworth*, one might have been left to ponder the true question with which the states were concerned: to what extent could states force the out-of-state seller to collect the state's *use* tax from the purchaser and remit it to the consumer's state of residence? Given the difficulty of collecting use taxes, this was the real question states wanted answered.

That answer came in *General Trading* when the Court held that the State of Iowa could compel a Minnesota company to collect and remit a use tax on sales made in Iowa by traveling salesmen employed

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108. *Id.* at 330.
109. *Id.*
110. *Id.* at 330-31.
111. *Id.*
112. *Id.* at 330.
113. *Id.*
114. *Id.* at 331.
115. *See* Henneford v. Silas Mason Co., 300 U.S. 577 (1937).
116. *Id.* at 582.

by a Minnesota company.[117] General Trading Co. had no offices in Iowa, had never qualified to do business in Iowa, and its orders were sent back to Minnesota for approval and shipping.[118] The Court in *General Trading* relied on the Iowa Supreme Court's interpretation of its use tax, which held that General Trading Co. was a "retailer maintaining a place of business in th[e] state."[119] Based on this interpretation, the Court upheld the tax.[120] Thus, it appeared that, if only by accident, Iowa had succeeded where Arkansas had mistakenly relied on a sales rather than a use tax. As a result, all a state had to do was enact a use tax statute and it would be able to reach out-of-state vendors doing business within its borders.

The Constitutional foundation on which these cases rested was unclear. Though both *Dilworth* and *General Trading* were decided a year prior to *International Shoe*, these two decisions made sense within the minimum contacts scheme, the basic tenets of which were surely on the minds of the Justices in 1944. In *International Shoe*, the Court stated that, to the extent one has minimum contacts with the forum state, those contacts may give rise to corresponding obligations, and that "so far as those obligations arise out of or are connected with the activities within the state, a procedure that requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue."[121] Looking to the type of contacts in *Dilworth* and *General Trading* and comparing them with the obligations sought to be enforced, the results of those cases do not seem paradoxical.

In *Dilworth*, traveling salesmen solicited orders within the taxing state; however, the obligation sought to be enforced was collection and remittance of a sales tax.[122] The Court had already decided that a sales tax was appropriately levied where transfer of possession from vendor to purchaser took place.[123] In *Dilworth*, this transfer occurred out-of-state, and thus not even the minimum contacts test could reach the transaction. In *General Trading*, the contacts with the state were the same; however, the obligation sought to be enforced was entirely

117. *General Trading*, 322 U.S. at 338.
118. *Id.* at 337.
119. *Id.*
120. *Id.*
121. *International Shoe*, 326 U.S. at 319.
122. *Dilworth*, 322 U.S. at 328.
123. *See supra* note 102 and accompanying text.

different.[124] A use tax statute simply appoints the out-of-state vendor as an agent for the collection and remittance of the use tax otherwise owed by the consumers. In *General Trading*, the salesmen had contacts with the consumers, and the appointment as surrogate tax collector was certainly related to those activities. Thus, the use tax as applied to an out-of-state vendor comports with due process, while a sales tax as applied to that same vendor does not.

The interesting question is why the Commerce Clause was relied upon in both *Dilworth* and *General Trading* when the Due Process Clause was sufficient to resolve the issues. The Commerce Clause was specifically relied upon in *Dilworth* as a block to the sales tax,[125] while the Supreme Court of Iowa's interpretation of its use tax emphasized the maintenance of a "place of business" within the state as a justification for the use tax.[126] Because the Due Process Clause was sufficient to address the problem in its entirety, it is unclear why the Commerce Clause and thus, the physical presence requirement, crept into the analysis. The minimum contacts test would not be announced for another year, and this confusion might be the result of the Court's thoughts on the subject still being in a nebulous state. Whatever the reason, the presence of the Commerce Clause in the analysis would cause great difficulty in the following years.

The Court also struggled with variations on the *Dilworth* and *General Trading* facts. In *Nelson v. Sears, Roebuck & Co.*,[127] the Court held that Iowa could properly require Sears to collect the state's use tax on sales made solely through its catalogues to Iowa consumers.[128] In this case, Sears also maintained twelve retail stores within Iowa,[129] and it argued that there was no "local activity . . . which generate[d] or which relate[d] to the mail orders."[130] The Court rejected this argument and held that the mail order sales were "not unrelated to [Sears'] course of business in Iowa. . . . Hence to include them in the global amount of benefits [that Sears] is receiving from Iowa business is to conform to business facts."[131] Thus, a company cannot avoid being appointed as a tax collecting agent for the state by

124. In *General Trading*, the state imposed a use tax. *See supra* note 117 and accompanying text.

125. *See supra* note 109 and accompanying text.

126. *See supra* note 119 and accompanying text.

127. 312 U.S. 359.

128. *Nelson*, 312 U.S. at 366.

129. *Id.* at 362 n.3.

130. *Id.* at 364.

131. *Id.*

simply bifurcating its business into one business that has physical offices and one that does not.[132]

Another unsuccessful attempt to avoid use tax collection liability involved a modification of the *General Trading* facts. In *Scripto, Inc. v. Carson*,[133] a Georgia corporation was required to collect and remit Florida's use tax on sales made to Florida customers that had been solicited on behalf of Scripto by independent contractors operating within the state of Florida.[134] The Court found the distinction between the full-time traveling salesmen in *General Trading* and the part-time independent contractors in *Scripto* to be immaterial.[135] The Court instead saw the employment of ten part-time independent contractors as constituting a sufficient "continuous local solicitation"[136] that gave Scripto a sufficient nexus with Florida to make it liable for collecting Florida's use tax.

The cases in the wake of *International Shoe* addressed the issue of how minimal the contacts with a state could be while still supporting jurisdiction. It seemed clear that not just any contact with the forum state would do. The limit was tested in the state tax area in *Miller Bros. Co. v. Maryland*,[137] in which the appellant was a retailer with a store in Wilmington, Delaware, that advertised in local newspapers and on local radio stations.[138] Appellant was not qualified to do business in Maryland, but its advertisements reached Maryland customers and sales were made to Maryland residents, often requiring delivery of the merchandise to their homes within the State of Maryland.[139] Additionally, the store often mailed supplemental fliers to former customers, which included Maryland residents.[140]

The State of Maryland attempted to force Miller Brothers to collect and remit the Maryland use tax on all of the merchandise delivered to addresses within its boundaries.[141] The Court decided the case on Due Process grounds, noting that for Maryland to be able to subject a resident of Delaware to its taxing jurisdiction there must be a "definite link, some minimum connection, between a state and the

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132. *Nelson*, 312 U.S. 359. *See also* National Geographic Soc'y v. California Equalization Bd., 430 U.S. 551 (1977).
133. 362 U.S. 207 (1960).
134. *Id.* at 211.
135. *Id.* at 212.
136. *Id.* at 211.
137. 347 U.S. 340.
138. *Id.* at 341-42.
139. *Id.*
140. *Id.* at 342.
141. *Id.*

person, property or transaction it seeks to tax."[142] The Court failed to find a sufficient connection, noting specifically that there was "a wide gulf" between the "active and aggressive" solicitation by the traveling salesmen in *General Trading* and the "occasional delivery of goods sold at an out-of-state store with no solicitation other than the incidental effects of general advertising" in *Miller Bros.*[143]

The existence of a "wide gulf" between having employees or independent contractors soliciting orders in a state and simply mailing fliers into a state and delivering merchandise may seem both obvious and insignificant. A company deriving profits from customers located in another state certainly would be able to use that state's courts to enforce its contracts with that state's residents. Yet, on the other hand, contact solely by mail seems very casual and lacks the "active and aggressive" characteristics the Court seemed to find important in the *General Trading* and *Scripto* facts. Where the edges of the "wide gulf" were and what it might take to bridge it were open and confusing questions.

The Court attempted an answer in *Hanson v. Denckla*[144] when it added the concept of purposeful availment to the body of Due Process law. In *Hanson*, a woman executed a trust agreement with a Delaware trust company and later moved to Florida where she passed away.[145] Though the decedent had had minor contact with the trustee while domiciled in Florida,[146] the Court found that the trustee could not be subjected to the laws of Florida because "[t]he unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State."[147] The Florida courts had no jurisdiction over the Delaware trustee because the trustee had done nothing of its own volition to bring itself under the laws of Florida.[148]

Purposeful availment speaks to the reasonableness of subjecting an individual to a distant forum. This reasonableness was one of the fundamental concerns of the Court in *International Shoe* when it spoke of "fair play and substantial justice."[149] The contacts a corporation has with a state must be such that it is "reasonable . . . to require the

142. *Id.* at 344-45.
143. *Id.* at 346-47.
144. 357 U.S. 235 (1958).
145. *Id.* at 238-39.
146. *Id.* at 252.
147. *Id.* at 253.
148. *Id.* at 254.
149. *International Shoe*, 326 U.S. at 316.

corporation to defend the particular suit [that] is brought there."[150] These notions of reasonableness and purposeful availment require that a party play a part in the activities that result in it being subjected to a state's jurisdiction. However, these nebulous standards become largely meaningless for Internet vendors and consumers whose activities take place in cyberspace, which bears no correlation to physical geography.

This was the state of the law when *Bellas Hess* came before the Court. In *Bellas Hess*, the Court ultimately decided that mail order sales were not taxable in either the vendor's or purchaser's jurisdiction, unless both happened to be in the same jurisdiction. This result was reaffirmed in *Quill* except that the roles of the Due Process and Commerce Clauses were clarified. In *Quill*, the Court stated that there were sufficient minimum contacts due to the direct solicitation in the form of the catalogues.[151] Thus, if the physical presence requirement were removed, then the mail order vendor would be charged with collecting and remitting the use tax required by the purchaser's jurisdiction.[152]

Thus, to adopt the same rationale for Internet sales, the Internet vendor must be deemed to be doing business in any state where it makes a sale. This would result in a destination tax model. However, the Internet does not lend itself to a destination tax model analysis as easily as mail-order sales because an Internet vendor simply makes its web page available, while it is the consumer who must go out and find it. Consequently, there is far less purposeful availment on the part of the Internet vendor as compared to the mail order vendor. Under either a source or destination model, one of the parties can argue that the tax is unconstitutional as applied to him or her. The resulting gridlock prompts the adoption of a uniform tax as a solution; however, a uniform tax has many problems of its own. Regardless of the model adopted, it must be acceptable under the Due Process Clause.

B. *Due Process and the Source Tax Model*

Under the source tax model, the consumer pays the sales tax of the jurisdiction where the vendor is located. Thus, for tax purposes, the consumer becomes subject to the jurisdiction of the vendor's state,

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150. *Id.* at 317.

151. *Quill*, 504 U.S. at 308.

152. This is not a sales tax because the sale is deemed to take place where the transfer of possession from vendor to vendee takes place, which is the point where the merchandise is placed in the mail. *See Dilworth*, 322 U.S. at 330.

even though the consumer is not physically present in that jurisdiction. However, under the minimum contacts test, one need not be physically present in a particular jurisdiction. It can be argued that the consumer has purposefully availed himself of the "privilege of conducting activities within the [Internet vendor's] State, thus invoking the benefits and protections of its laws."[153] The consumer could, after all, use the courts of the vendor's state to bring an action for products liability, breach of implied warranty, or any manner of other claims that might arise out of the purchase of a product. However, the proper question in this case is whether the *consumer* could be sued in the taxing state. The answer is far from clear.

It is not difficult to argue that placing an order is a business activity and that, because the vendor's web page is on a local server, the business activity is conducted within the vendor's taxing jurisdiction. However, the minimum contacts test requires the contacts to be such that it is "reasonable . . . to require the [consumer] to defend the particular suit which is brought" in the taxing state.[154] Would it be reasonable to require a consumer to defend a lawsuit over tax collection for the purchase of one single item from a distant jurisdiction? The answer is unclear, and litigation may be required to define the parameters of the minimum contacts test as applied to Internet transactions.

These parameters are already being defined in nontax contexts. In *Hearst Corp. v. Goldberger*,[155] the defendant operated a web page in New Jersey that offered network and legal services to law firms under the name "ESQWIRE.COM."[156] Plaintiff, owner of Esquire magazine and a New York corporation, sued for trademark infringement in New York based on the defendant's use of the name "Esqwire" for his web site.[157] At the time of the suit, the defendant's web site was not fully operational and no products had been sold to New York residents, though the web site had been visited by many New Yorkers.[158] The court held that New York did not have personal jurisdiction over the defendant and that the web site was akin to an advertisement in a national publication and did not constitute sufficient business within the state to support jurisdiction.[159] How-

153. Hanson v. Denckla, 357 U.S. 235, 253 (1958).
154. *International Shoe*, 326 U.S. at 317.
155. 1997 U.S. Dist. LEXIS 2065, at *1 (S.D.N.Y. Feb. 26, 1997).
156. *Id.* at *1-*2.
157. *Id.* at *1.
158. *Id.* at *1, *14.
159. *Id.* at *37.

ever, the court did hint that had defendant contracted to sell his services to a New York consumer, New York likely would have had jurisdiction over him.[160]

A contract of the type that the court hinted at in *Hearst* was present in *CompuServe, Inc. v Patterson,*[161] in which the Sixth Circuit found personal jurisdiction in Ohio over a Texas defendant whose contacts with the Ohio-based plaintiff were entirely through the Internet.[162] In *Patterson,* the contacts were very extensive, lasted over a three-year period, and included the execution of an agreement that any disputes arising out of the business arrangements would be settled according to Ohio law.[163] These contacts are much more extreme than the casual contacts an individual consumer would have with an Internet vendor when the consumer makes a single purchase and has no further contact. As a result of the diverse uses to which the Internet is put, courts have struggled to construct uniform rules to guide the application of the minimum contacts test to Internet commerce.

One issue that many courts have agreed on is that a "passive" web site, that is, a web site that is the functional equivalent of an advertisement because it is not interactive between vendor and purchaser, confines jurisdiction to the vendor's location.[164] Courts addressing this issue have generally held that merely creating a web site cannot result in jurisdiction because, "like placing a product into the stream of commerce, [a web site] may be felt nationwide—or even worldwide—but, without more, it is not an act purposefully directed toward the forum state."[165]

Thus, there is essentially a continuum that begins with passive web sites that confer no jurisdiction[166] and ends with interactive web sites with a long history of conducting commercial transactions.[167] Between these two extremes are all other web sites, those with perhaps

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160. *Id.* at *36.

161. 89 F.3d 1257 (6th Cir. 1996).

162. *Id.* at 1260.

163. *Id.* at 1260-61.

164. *See* Bensusan Restaurant Corp. v. King, 126 F.3d 25 (2d Cir. 1997); Cybersell, Inc. v. Cybersell, Inc., 130 F.3d 414 (9th Cir. 1997); Edberg v. Neogen Corp., 17 F. Supp. 2d 104 (D. Conn. 1998); Mallinckrodt Medical, Inc. v. Sonus Pharm., Inc., 989 F. Supp. 265 (D.D.C. 1998).

165. *Cybersell,* 130 F.3d at 418 (quoting *Bensusan,* 937 F. Supp. at 301) (which cited the plurality opinion in Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102, 112, 107 S. Ct. 1026, 1032, 94 L. Ed. 2d 92, 104 (1992)).

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

167. *See supra* notes 160-63 and accompanying text.

minimal interstate activity, or with a minimal history of activity connected to a particular forum. In this vast middle ground, line drawing becomes difficult and "the likelihood that personal jurisdiction can be constitutionally exercised is directly proportionate to the nature and quality of commercial activity that an entity conducts over the Internet."[168] This results in ambiguities that are unacceptable in a taxing scheme because there is no meaningful standard on which a vendor can rely.

Vendors might avoid this interpretive problem by placing disclaimers on their web sites stating that "by placing an order you consent to the jurisdiction of State X." These clauses may be enforceable in light of the Supreme Court's decisions in *Burger King Corp. v. Rudzewicz*[169] and *Carnival Cruise Lines, Inc. v. Shute*.[170] However, these clauses do not clearly provide a solid jurisdictional basis.[171] Although the forum selection clause was enforced in *Carnival Cruise Lines*, the Court acknowledged that, when the occurrence giving rise to the claim is purely local in nature or when the imposition of the forum selection clause results in "serious inconvenience," the clause may be avoided.[172]

One problem with the source tax is that it poses many novel questions that must be resolved before the state of the law would be stable. One of the key components of any tax scheme is its predictability. A source tax is certain to result in litigation by consumers who will argue that it is unconstitutional to characterize a transaction as taking place in the vendor's jurisdiction. While these issues would eventually be resolved, it should be noted that nearly fifty years passed between *Dilworth* and *Quill*. Given the rapid growth of the Internet,

168. Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1124 (W.D. Pa. 1997).

169. 471 U.S. 462 (1985) (holding that Florida could exercise jurisdiction over a defendant residing in Michigan who had breached a contract containing a forum selection clause that required Florida law to govern and stated that the contractual relationship had been created in Florida).

170. 499 U.S. 585 (1991) (holding that enforcement of a forum selection clause requiring all actions to be pursued in Florida courts was proper when it was printed on the tickets (which were received only after they had been purchased) even though it was shown that the plaintiffs, who resided in Washington State, were financially incapable of litigating in Florida). In *Burger King*, the defendant was a sophisticated business man, but in *Carnival Cruise Lines* the plaintiffs were not, and in fact, the plaintiffs were likely to have been totally unaware of the forum selection clause until long after the injury occurred. Clauses such as these would be helpful to Internet vendors because they would require all suits to be conducted in the vendors' local courts.

171. *See* Thompson v. Handa-Lopez, Inc., 998 F. Supp. 738 (W.D. Tex. 1998) (where the Texas court not only subjected a California corporation to jurisdiction in Texas, but refused to enforce the contract on the corporation's web site, which contained an arbitration clause requiring arbitration in California).

172. *Carnival Cruise Lines*, 499 U.S. at 592.

a lengthy delay in resolution of this issue would result in great revenue losses to the states.[173]

C. *Due Process and the Destination Tax Model*

Under the destination tax model, the vendor becomes a surrogate tax collector for the consumer's jurisdiction. The vendor is thus charged with collecting and remitting that jurisdiction's use tax from the consumer. This model falls prey to the same arguments as the source model, except that it is the vendor who is entitled to complain. In *General Trading*, similar collection obligations were upheld, but in that case, agents of the vendor were physically present within the taxing state.[174] This "continuous local solicitation"[175] is what the Court found to be significant. Once *Quill* separated the physical presence requirement from the Due Process Clause, it became possible to construe the notion of "continuous local solicitation" so broadly as to encompass solicitations via the Internet.

It is tempting to conclude that a vendor's use of the Internet is like placing an advertisement in every local newspaper in the nation and that such use is precisely the kind of "solicitation" the Court had in mind. However, in *Miller Bros.* the Court found that an "occasional delivery of goods sold at an out-of-state store with no solicitation other than the incidental effects of general advertising" was insufficient to support an assertion of jurisdiction by the consumer's state.[176] Furthermore, many courts have already rejected a grant of jurisdiction based on an advertising analogy.[177] Again, one confronts the wide gulf between the aggressive solicitation of business sufficient to support jurisdiction in *Quill*,[178] and the passive advertising in *Miller Bros.*

There are certainly Internet vendors at both ends of the spectrum—some more like Quill Corporation and others more like Miller Brothers. To tax those who are similar to Quill and to permit those who are like Miller Brothers to avoid the tax is inequitable and requires arbitrary line drawing between large and small vendors. For the large scale Internet vendor, the web page is very much like placing an advertisement in every local newspaper in the country, and presumably

173. *See supra* note 4 for estimates concerning the growth of Internet commerce.

174. *General Trading*, 322 U.S. at 337.

175. *Scripto*, 362 U.S. at 211.

176. *Miller Bros.*, 347 U.S. at 347.

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

178. In *Quill*, the Court held that the Due Process requirements were satisfied and that, absent the physical presence requirement, jurisdiction would have been proper based on the substantial contacts Quill Corporation had with North Dakota residents. *Quill*, 504 U.S. 298.

the effect of both would be similar because both would result in the solicitation of many customers from many jurisdictions. However, the small Internet vendor who might make a sale or two in many jurisdictions scattered throughout the nation is more analogous to a shop owner with a billboard visible to consumers passing by on the information super-highway—more like the "general" advertising of *Miller Bros.*

While it is certainly foreseeable, even to the small Internet vendor, that its products may be purchased in any reachable jurisdiction, the Court has held that "'foreseeability' alone has never been a sufficient benchmark for personal jurisdiction under the Due Process Clause."[179] Rather, the Court has stated "[the benchmark] is that the defendant's conduct and connection with the forum [s]tate [is] such that he should reasonably anticipate being haled into court there."[180] The issue becomes then, whether the decision to make a sale is sufficient to subject a merchant to the jurisdiction to which the product is shipped.

If a vendor does not want to risk being haled into court in a particular jurisdiction, the vendor need only refuse to fill orders that require shipment to that location. This argument creates a standard whereby a sale to any one jurisdiction would constitute the appropriate minimum contacts for the due process prong of the nexus requirement. However, a single sale seems to fall on the *Miller Bros.* side of the wide gulf between aggressive and passive contacts, making a resulting suit unreasonable. In reality, the single sale example represents an extreme situation. Most vendors fall somewhere between a single contact and thousands of contacts. The problem is to determine where to draw the line. Those on the *Quill* side of the line will be subject to tax while those on the *Miller Bros.* side will not.[181]

Thus, like the source tax, the destination tax creates a state of confusion. If the physical presence requirement of the Commerce Clause is removed, then the imposition of a destination tax results in a model that is both difficult to apply and to enforce. Internet vendors will probably resist the imposition of the tax due to the high compliance costs associated with it.[182] As with the source tax, the possibili-

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179. World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 295 (1980).

180. *Id.* at 297.

181. *See* Maritz, Inc. v. CyberGold, Inc., 947 F. Supp. 1328 (E.D. Mo. 1996) (holding that defendant's 131 contacts with Missouri residents via electronic mail for the purposes of distributing information targeted to each potential customer's needs was sufficient contact to support personal jurisdiction in Missouri).

182. *See supra* notes 71-73 and accompanying text.

ty of successful implementation exists. However, prior to the resolution of the critical issues, the destination tax model contains the same instability and unpredictability as the source tax model.

D. *Due Process and a Uniform Federal Tax Rate*

The difficulties involving the Due Process Clause in connection with a source or destination tax occur when one state attempts to gain jurisdiction over residents of another state. The taxing state can no longer rest on the settled jurisdictional principles of *Pennoyer*[183] and must demonstrate that the individual or entity has the requisite contacts with the taxing state to support that forum's jurisdiction. For jurisdiction to be proper, the location of the contacts must correspond to the geographical boundaries of the body asserting jurisdiction. Attempts to correlate activities conducted in cyberspace with locations in physical space result in the confusion demonstrated by the source and destination tax models.

A uniform tax rate applied at the federal level and administered through a federal body could avoid the jurisdictional problems of the source or destination tax models because an interpretation of Due Process law would not be required. Federal legislation could fully occupy the area of Internet taxation based on the status of Internet commerce as interstate commerce.[184] Because everyone is subject to federal legislation, under this system there are no issues surrounding one state's assertion of power over the residents of another. Thus, due process issues will not arise.

While this approach has no jurisdictional complexities, other problems make it equally, if not more, difficult to implement than the source or destination tax. As outlined above, economic problems arise from the variation between the uniform rate and the tax rate of particular jurisdictions,[185] though one can perhaps argue that the uniform tax solution provides a happy medium between the source and destination models. While some shifting economic effects remain, they are minimized and there is no support for a safe harbor provision of the type that would undermine the destination model.

Even more problematic, however, are the administrative difficulties of implementing and managing such a system. While the compliance and administrative costs will be borne collectively, it is

183. *See supra* notes 86-88 and accompanying text.

184. In effect, this has already occurred as a result of the moratorium created by the Internet Tax Freedom Act. *See supra* note 3.

185. *See supra* notes 77-78 and accompanying text.

possible that the massive federal bureaucracy required to implement and manage the collection and redistribution will result in higher overall costs.

V. MECHANICS AND FURTHER ADVANTAGES OF A FEDERAL SOLUTION

As demonstrated, both the source tax and destination tax have economic, administrative, and compliance advantages and disadvantages[186] as well as potential controversies when applied under the Due Process Clause.[187] A federal uniform sales tax on Internet sales will combine the best of both the source and destination models while avoiding the potential due process complications of either solution.

A. *Mechanics of the Solution*

The federal sales tax rate would be set at the average rate of sales tax for the states with an additional rate added to represent the average sales tax charged by local jurisdictions within the states. The use of this rate of tax, while not eliminating tax-influenced decision making, would come quite close to the destination tax model in terms of economic effects.[188] It would also result in compliance costs similar to the source tax because Internet vendors would not have to keep track of thousands of taxing jurisdictions. They would need to keep track of only two: their own local jurisdictions and the rate for Internet sales.[189] This solution essentially creates a new cybertax jurisdiction, with one tax rate governed by a federal administrative agency.

The federal agency regulating the collection would then deduct the collection costs from the revenue collected and distribute the remaining moneys back to the states in amounts proportionate to each state's share of total Internet consumption. Thus, states would be able to collect amounts equal to their use taxes. In addition, moneys collected from international purchasers could be set aside and distributed to the states based on each state's percentage of international sales, thus also permitting a sales tax to be applied to international transactions.

The details of calculation, as well as the definition of what is included in the Internet tax base must be worked out, but these details

186. *See supra* Part III.A-B.
187. *See supra* Part IV.B-C.
188. *See supra* Part III.C.2 for further discussion of the economics of this model.
189. *See supra* Part III.C.2 for further discussion.

are beyond the scope of this Comment.[190] While the number of calculations that a federally run agency using this system would be required to do would certainly be great, this system is nevertheless advantageous because the costs would be incurred only once and would be uniform throughout the states. As the system develops, collection and remittance of Internet taxes would become much more efficient than fifty separate state collection methods could ever hope to be.

B. *Further Advantages*

Beyond the simplicity of central collection and the combination of economic benefits of a uniform federal tax rate, there are several other advantages to a federal system. A federal system will recognize overriding federal interests in the Internet; it will directly address the development of and the United States' participation in the interconnected world of global commerce; and, it will permit the comprehensive development of international agreements that recognize the need for international enforcement of Internet tax laws.

1. Overriding Federal Interests

The framers of the Constitution recognized the potential commercial problems associated with a federalist form of government. That concern is reflected in the Commerce Clause, which gives plenary power to Congress to regulate commerce among the several states.[191] In order to have a productive national economy, trade must be able to flow among the states free from undue burdens placed upon it by any one state. The opinions of the Supreme Court are replete with this concept and hold that "[t]he very purpose of the Commerce Clause [is] to create an area of free trade among the several States."[192]

The nature of the Internet makes correlation of transactions in cyberspace with geographical points in physical space nearly impossible.[193] While commerce is certainly being conducted between states, the application of traditional jurisdictional concepts is difficult at best because of the unbroken process of Internet communication. Thus, the

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190. For the details of a plan similar to this one, see Kendall L. Houghton, *How Do We Impose and Collect Sales and Use Taxes on Electronic Commerce? An Analysis of Three Substantive Suggestions*, 1997 COMM. ON STATE TAXATION 21.

191. For the text of the Commerce Clause, see *supra* note 81.

192. *Dilworth*, 322 U.S. at 330.

193. *See* Hellerstein, *supra* note 76, at 597 (stating that "[t]raditional approaches to the nexus question appear to be doomed to failure in the context of taxation of electronic commerce. To ask about the 'location' of electronic commerce . . . is to ask a question that is not worth answering.").

Internet is the quintessential vehicle of interstate commerce. Only the federal government can properly tax transactions occurring within that "cyberjurisdiction."[194] A federal tax scheme would also facilitate the resolution of other truly national concerns, such as the development of global commerce and enforcement of taxes throughout the international community.[195]

2. Participation in Global Commerce

The notion that the growth and development of the Internet has made the world a smaller place seems almost an understatement, and the outlook for the growth and development of global commerce through the Internet has prompted some bold statements.

> We are on the verge of a revolution that is just as profound as the change in the economy that came with the industrial revolution. Soon electronic networks will allow people to transcend the barriers of time and distance and take advantage of global markets and business opportunities not even imaginable today, opening up a new world of economic possibility and progress.[196]

In recognizing the global nature of Internet commerce, the current administration has called for the development of a policy that will be integrated into a comprehensive international plan to enable any Internet taxation to meet three goals. The tax should:

> [1]. neither distort nor hinder commerce, such as by discriminating among types of commerce or creating incentives that change the nature or location of transactions;
> [2]. be simple and transparent, with minimal recordkeeping requirements and easy implementation; and
> [3]. be consistent with tax systems used by the United States and its trading partners today.[197]

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194. *See Dilworth*, 322 U.S. at 331 (where the Court, in speaking of the Commerce Clause and interstate transactions, states: "That clause vested the power of taxing a transaction forming an unbroken process of interstate commerce in the Congress, not in the States.").

195. *See* Internet Tax Freedom Act, *supra* note 3. During the pendency of the moratorium on new Internet taxes, the Act created the Advisory Commission on Electronic Commerce. One of the issues to be studied by the Commission is the effect that the collection of consumption taxes in the United States and other countries will have "on the global economy, including an examination of the relationship between the collection and administration of such taxes when the transaction uses the Internet and when it does not." *Id.* at § 1102(g)(2)(B).

196. Vice President Albert Gore Jr., quoted in *White House Report "A Framework For Global Electronic Commerce" Together with Background Paper*, 127 DAILY TAX REP. (BNA) L-13 (July 2, 1997).

197. *Electronic Commerce: Clinton Unveils Report Advocating National, Global Harmony on Internet Taxes*, 127 DAILY TAX REP. (BNA) GG-1 (July 2, 1997).

Whether these goals can be met effectively is a separate issue. The position advocated by this Comment is that these are the appropriate goals and that the federal government is the only body that can effectively achieve these goals.

The issues surrounding the Internet, like the issues surrounding the Due Process Clause, are not confined to taxation. Policy in this area must be delivered by a body with the authority to resolve all of the issues and not merely the tax issues. The federal government alone has the power to enter into international agreements;[198] therefore, the federal government must lead the development and resolution of policy issues related to the Internet.[199] Given the muddling uncertainty of source and use taxes, both in terms of economic effects and due process concerns, state forays into this area might create problems due to the questionable state of the law. When the participation of international vendors is added to the calculus of Internet taxation, the resulting complexity makes it difficult to justify the imposition of state tax policy in this area.

3. International Enforcement

Controversy over tax liability is certain to grow as Internet vendors are subjected to taxes. Due to the global reach of the Internet, these controversies are certain to involve both domestic and international taxpayers. A uniform tax rate and regulations governed by a central federal body would result in a more efficient adjudication of claims. Administrative proceedings would be standardized, and international taxpayers would be familiar with collection procedures and dispute resolution procedures for any and all Internet transactions conducted throughout the United States.

A federally implemented uniform tax rate thus has a significant advantage over individually developed and implemented state systems. A state may bring an action for collection of taxes against a foreign

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198. U.S. CONST. art. I, § 10, cl. 1 denies the states this power by stating "[n]o State shall enter into any Treaty, Alliance, or Confederation." The Constitution then grants this power to the President with approval of the Senate required: "[The President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur." U.S. CONST. art II, § 2, cl. 2.

199. This sentiment is echoed in the Internet Tax Freedom Act's declaration that "[i]t is the sense of Congress that the President should seek bilateral, regional, and multilateral agreements to remove barriers to global electronic commerce through the World Trade Organization, the Organization for Economic Cooperation and Development, the Trans-Atlantic Economic Partnership, the Asia Pacific Economic Cooperation forum, the Free Trade Area of the Americas, the North American Free Trade Agreement, and other appropriate venues." Internet Tax Freedom Act, *supra* note 3, at § 1203(a).

taxpayer within the current framework of the law, but the efficiency of a federally administered system would benefit both the states and international taxpayers. States would not have to spend their resources collecting taxes directly. While the overall collection burden would be shared by all the states, the overall cost is likely to be lower due to the need to maintain only one administrative organization. Taxpayers would need to familiarize themselves with the procedures of only one organization rather than fifty separate ones.

Furthermore, because international tax agreements governing the Internet are imminent, it would make no sense for the federal government to negotiate the arrangements, which it is constitutionally compelled to do, then hand over the enforcement duties to the individual states. Uniformity has become the shibboleth of Internet tax discussions and such uniformity in enforcement can hardly develop if left to the states. While there are calls among state organizations for uniformity,[200] one can hardly imagine that a comprehensive agreement will emerge from these discussions anytime soon given the vast disparities in current state tax laws.[201]

C. *Likelihood for Success*

The controversy surrounding Internet taxation can be viewed as both a blessing and a curse. Interest in the topic is both considerable and diverse. While the Internet is still a fledgling medium, the current jurisdictional nexus requirements are evolving out of litigation involving the mail-order catalogue industry.[202] The mail-order industry is old, large, and well-established, with a vested interest in the outcome of any Internet taxation discussions. The young and disorganized Internet industries are likely to align themselves with the mail-order catalogue industry in an attempt to keep the debate going as long as possible. Although some individuals in these industries call for uniformity in taxation, the industries certainly consider uniformity a second best alternative to the current scheme of no taxation at all.

Given the influence of special interests and the debate among the individual states, some commentators have predicted a long wait for any comprehensive uniform resolution.[203] However, there is current-

200. *See State Taxes: NCSL Takes No Stand on Bill Regarding Internet Taxation*, 155 DAILY TAX REP. (BNA) H-2 (Aug. 12, 1997) (discussing an appeal by the National Conference of State Legislatures for federal, state, and local governments to seek a consensus with industry over Internet tax issues).

201. *See* Walters, *supra* note 69, at 15 (outlining some of the variety of current state laws).

202. *See Quill*, 504 U.S. 298.

203. *See* Moore, *supra* note 7, at 205.

ly an optimistic push for such a solution. President Clinton has stated that he hopes that such a solution can be in place by January 1, 2000;[204] however, the deadline imposed by the Internet Tax Freedom Act already pushes that goal back nearly two more years. Whether the development of an interconnected global economy and pressures from international interests will result in meeting either of these deadlines remains to be seen.

VI. CONCLUSION

Given the substantial growth of Internet commerce and the current inability of states to tax that commerce, consensus has been reached that a need exists for the development of a framework permitting states to capture the revenue they are currently losing while at the same time preserving the development of Internet commerce. Given the Supreme Court's holding in *Quill*, Congress is free to remove the physical presence requirement from the Commerce Clause prong of the nexus test. However, regardless of Congress' course relative to the Commerce Clause, the Due Process Clause remains as an impediment to any taxing model.

This Comment presents three models for state taxation of Internet commerce that could be used if Congress removes the physical presence requirement. Both the source and destination tax models would require court interpretation and refining to determine whether they can comport with the constitution at all and, if so, in what form and to what extent. As an alternative, a federal uniform sales tax on Internet commerce provides a solution that combines the best features of the source and destination tax models while avoiding the due process issues. Additionally, the federal solution adopts an approach in keeping with the international ramifications of our fledgling Internet policy.

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204. *See Electronic Commerce: Clinton Unveils Report Advocating National, Global Harmony on Internet Taxes*, 127 DAILY TAX REP. (BNA) GG-1 (July 2, 1997).