State Taxation of Interstate Commerce: *Quill, Allied Signal*, and a Proposal

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The United States Supreme Court has recently decided a pair of 
cases involving two core issues relating to state taxation of interstate 
commerce. *Quill Corp. v. North Dakota*¹ addressed the question when 
does a state have sufficient contact or nexus with an interstate 
business carried on within its borders to justify a tax? Insufficient 
nexus with the taxpayer means the state has no power to tax. 
Sufficient nexus means the state has power to tax and the focus shifts 
from whether the state may tax to what it may tax. The unitary

business principle has played a central role in determining the scope of state taxation of interstate commerce, and in Allied-Signal, Inc. v. Director, Division of Taxation, New Jersey launched a frontal assault on that principle. Both cases are significant not merely because they involved fundamental issues concerning state taxation of interstate commerce, but because Quill broke new ground by diminishing due process constraints on state taxation, while Allied-Signal reaffirmed and perhaps expanded the unitary business concept. This article begins with an examination of Quill and the nexus requirement. It argues that while the pre-Quill approach needed revision, Quill is a short-sighted, poorly reasoned decision likely to create more problems than it solves. Next, Allied-Signal and the unitary business principle are examined. This examination discloses that while the Court implicitly recognized the defects in the prior law, the Allied-Signal decision is unable to cure these defects. In sum, neither decision does anything to improve the jurisprudence of this “impoverished territory.” The purpose of the article is to suggest that if genuine progress is to be made, the Court must disentangle due process and commerce clause constraints on state taxation of interstate commerce. One way to achieve this is to build on the Quill notion that due process constraints be reduced, and primary reliance be placed on the commerce clause as a means of curbing excessive state taxation of interstate commerce.

2. Nexus and the unitary business principle are related but distinct concepts. The nexus requirement goes to whether the taxing state has a sufficient connection with either the taxpayer, or the activity or value being taxed. Nexus may exist with respect to a taxpayer (for example, because the taxpayer is physically present within the taxing state), but not with respect to a particular activity or value the state seeks to tax. Thus, if a taxpayer is engaged in an interstate business partly conducted within state A, and is physically present in state A, there is a nexus between state A and the taxpayer, and it may properly impose a tax. The unitary business principle may then be used to determine what kind of tax state A can impose. It would allow state A to tax a portion of all income derived from unitary business activities, regardless of where they occur, but would not support a tax on other income realized by the taxpayer. For a tax on such income to be allowed, it must be connected with state A in some other way. Essentially, the unitary business principle provides a means for determining whether the subject matter of a tax, income in the case of an income tax, meets the nexus requirement. It may serve a similar role with respect to other types of taxes such as a gross receipts tax or a capital stock tax. For a fuller explanation see text, following note 84 infra.


4. Tyler Pipe Indus., Inc. v. Washington State Dep’t of Revenue, 483 U.S. 232, 265 (1987)(Scalia, J., dissenting). According to Justice Scalia the commerce clause decisions limiting state taxation of interstate commerce have “made no sense.” Id. at 260. He is not the first Justice to have expressed this view. See Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457 (1959)(Justice Clark, writing for the Court, characterized the decisions in this area as a “tangled underbrush”).
I. QUILL AND THE NEXUS REQUIREMENT

Quill was a Delaware corporation selling office equipment and supplies to customers in North Dakota. It had no outlets, sales representatives, or employees in North Dakota. It owned no property located within the state except for "a few floppy diskettes" containing a computer software program which Quill had licensed to some of its North Dakota customers, enabling them to check Quill's current prices and to place orders directly. Although the Court characterized its ownership of tangible property in the state as "either insignificant or non-existent," Quill was the sixth largest seller of office supplies in North Dakota with about 3,000 customers and annual sales of one million dollars. It solicited orders through catalogs, flyers, advertisements in national periodicals, and telephone calls. Delivery to North Dakota customers was by mail or common carrier from out-of-state locations.

Like most states, North Dakota imposes a sales tax on retail sales within the state and a complementary use tax which applies at the same rate as the sales tax to goods purchased outside the state for use within the state. Retailers are required to collect either a sales or a use tax and remit it to the state. Until 1987 Quill was not required to collect the tax because it was not a "retailer" under the North Dakota statute. The statutory definition of "retailer" was then changed to include an out-of-state seller like Quill who regularly solicits customers within the state. Regular solicitation means three or more advertisements during a year. Thus, since 1987, Quill and other mail-order companies advertising within the state were required to collect a use tax on sales to North Dakota residents, even if they had no property or personnel within the state.

The North Dakota statute was plainly at odds with National Bellas Hess, Inc. v. Department of Revenue, which held a similar Illinois statute violative of both the due process clause of the Fourteenth Amendment and the commerce clause. Relying on Bellas Hess, Quill declined to comply with North Dakota's use tax collection statute. In an enforcement action brought by the state, the North Dakota Supreme Court concluded that Bellas Hess had lost its authority due to

6. Id. at 1907 n.1.
7. Id. at 1907.
economic and legal change, and upheld the statute.\textsuperscript{12} Noting that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today,"\textsuperscript{13} the United States Supreme Court applied the \textit{Bellas Hess} rule, reversed the North Dakota Supreme Court decision, and struck down the North Dakota statute. Despite Quill's very substantial sales to North Dakota residents the nexus requirement of the commerce clause was not satisfied.\textsuperscript{14}

Before turning to an analysis of the \textit{Quill} decision, it will be helpful to place both \textit{Quill} and \textit{Bellas Hess} in proper perspective.

A. \textit{Bellas Hess} in Perspective

Prior to its 1967 \textit{Bellas Hess} decision, the Supreme Court had considered the power of a state to impose the duty to collect a use tax on interstate transactions in a variety of circumstances. The cases typically involved claims that the use tax collection statute violated both the due process clause and the commerce clause. As the Supreme Court noted in \textit{Bellas Hess}, "These two claims are closely related."\textsuperscript{15}

The due process clause provides that no person shall be deprived of property without due process of law. At the threshold, it requires a nexus between the taxing state and the taxpayer. In determining whether a sufficient nexus or connection exists the Court has stated: "The simple but controlling question is whether the state has given anything for which it can ask return."\textsuperscript{16} In addition, the due process clause requires that the tax be measured in a way that is rationally related to the nexus between the taxpayer and the taxing state. In \textit{Moorman Manufacturing Co. v. Bair},\textsuperscript{17} the Court described the two-prong test of the due process clause as applied to a state income tax:

> The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed, unless there is some minimal connection between those activities and the taxing State. . . . Second, the income attributed to the State for tax purposes must be rationally related to "values connected with the taxing state."\textsuperscript{18}

The commerce clause grants Congress exclusive power to regulate

\textsuperscript{14} Id. at 1914.
\textsuperscript{15} National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 (1967).
\textsuperscript{17} 437 U.S. 267 (1978).
\textsuperscript{18} Id. at 272 (quoting Norfolk & Western R. Co. v. State Tax Comm'n, 390 U.S. 317, 325 (1968)). In the context of a use tax the due process clause will generally be satisfied if the first condition is met. This is because a use tax is measured by the sale price (value) of property used within the taxing state, and this measurement automatically meets the second condition. \textit{Id}.
commerce among the several states. Under the so-called negative or dormant commerce clause, state regulation which unduly burdens interstate commerce may be held invalid as inconsistent with the exclusive grant of regulatory authority to Congress.19 Prior to the Supreme Court's 1977 decision in Complete Auto Transit, Inc. v. Brady,20 the commerce clause added three conditions to those of the due process clause. First, interstate commerce was immune from direct taxation by the states.21 Second, taxes which discriminated against interstate commerce were invalid.22 Third, the states could not subject interstate commerce to multiple or cumulative taxation.23 Complete Auto abandoned the tax immunity rule with its distinction between direct and indirect taxation of interstate commerce, and set out a four-prong test under which a tax will be sustained against a commerce clause challenge if it: "[1] is applied to an activity with a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."24 Although the Complete Auto test does not include multiple burdens terminology, taxes that are not apportioned or that discriminate violate the commerce clause because of the multiple or undue burdens they cast on interstate commerce.

The relationship between the due process and commerce clauses, as applied to state taxation of interstate commerce, always has been somewhat murky.25 Even before Complete Auto and its explicit adoption of a nexus test under the commerce clause, it was apparent that a good deal of overlap existed. For example, if a taxpayer is conducting an interstate business in states A and B, but has no connection with

22. See Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 329 (1977)("The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the [C]ommerce [C]lause.")
25. Two noted authorities on state and local taxation have stated:

It is interesting to note the similarity of the conception of extraterritoriality as the basis for invalidating taxes under the Due Process Clause and the requirement of apportionment as the prerequisite of validation under the Commerce Clause. Both simmer down to essentially the same result, namely, that a State can tax only what is "justly attributable" to it. Under both clauses, the judgment of what is "justly attributable" to a State is made by the Court.

JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE AND LOCAL TAXATION §30, n.16 (5th ed. 1988). Extraterritorial taxation occurs when a state imposes a tax without an appropriate nexus.
state C, a tax imposed by state C would violate the nexus requirement of the due process clause; and, since any tax imposed by state C could also be imposed by states A or B, which do have a nexus with the taxpayer, the state C tax would also violate the multiple burdens doctrine of the commerce clause. Furthermore, although states A and B have a nexus with the taxpayer, if either imposed an unapportioned tax on an item subject to taxation by both, such a tax likely would violate both clauses. For instance, if state A imposed an income tax on all income derived from interstate activities conducted in both states, the risk of multiple taxation which would materialize if state B taxed all or a portion of the same income would mean state A’s tax violates the multiple burdens doctrine of the commerce clause. The tax might also be viewed as unconstitutional under the second prong of the due process test. The fact that state A has a nexus with a taxpayer does not necessarily mean a tax on all income realized by the taxpayer is rationally related to the nexus.

In light of this overlap, perhaps it is not surprising that the Court, in the words of its Quill opinion, has “not always been precise in distinguishing between . . . the Due Process Clause and the Commerce Clause.”27 Bellas Hess was one of many cases in which the Court blended due process and commerce clause analysis. There the Court stated:

[T]he test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a

26. See text accompanying note 15 supra.

27. Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1909 (1992). The Court’s failure to deal separately with due process and commerce clause concerns is not new. In 1944 Justice Rutledge observed, “Due Process” and “[C]ommerce [C]lause” conceptions are not always sharply separable. . . . To some extent they overlap. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes “undue.” But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones.

International Harvester Co. v. Department of Treasury, 322 U.S. 340, 353 (1944)(Rutledge, J., concurring in part and dissenting in part); see also, David F. Shores, State Taxation of Gross Receipts and the Negative Commerce Clause, 54 Mo. L. Rev. 555, 563 (1989)(“Complete Auto and other recent decisions . . . fused due process and commerce clause concerns. That is unfortunate. Minimally, separating the analysis of whether a state has power to tax under the due process clause, from the analysis of whether a tax has imposed an undue burden on interstate commerce, would help clarify why the court concluded a state tax either was or was not unconstitutional. Beyond that, it might contribute to the Court’s insights and have a positive effect on its conclusions.”)
State's compliance with the requirements of due process in this area are similar. As to the former, the Court has held that "State taxation falling on interstate commerce... can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the "simple but controlling question is whether the state has given anything for which it can ask return." The same principles have been held applicable in determining the power of a State to impose the burdens of collecting use taxes upon interstate sales.28

Under the principles described in Bellas Hess, the Court in prior cases had upheld the power of a state to impose a use tax collection duty upon an out-of-state seller where sales were arranged by the seller's agents within the taxing state;29 where an out-of-state mail-order seller maintained local retail stores within the taxing state;30 and where the out-of-state seller solicited orders within the taxing state through independent wholesalers and jobbers.31 On the other hand, in Miller Brothers Co. v. Maryland,32 the Court did not allow Maryland to impose a use tax collection obligation upon a Delaware seller who had no retail outlets or sales solicitors in Maryland. The seller advertised in Maryland by newspaper, radio, and mailing circulars. It made sales to Maryland customers at its Delaware store and made deliveries into Maryland with its own trucks and drivers. Observing that there was a "wide gulf" between continuous local solicitation through traveling sales agents and the transportation of goods sold in Delaware to Maryland customers with no solicitation other than general advertising, the Court concluded that there was "no invasion or exploitation of the consumer market in Maryland."33 The seller's contact with Maryland, the Court held, did not meet the "time-honored concept: that due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."34 Since the Maryland statute violated the due process clause, the Court declined to considered the taxpayer's commerce clause claim.

As already noted, the Court was less explicit as to the basis for its holding in Bellas Hess where, relying on Miller Brothers, it observed that "the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with

33. Id. at 347.
34. Id. at 344-45.
customers in the State is by common carrier or the United States mail.\textsuperscript{35} Since Bellas Hess only mailed catalogs and advertising flyers to residents of the taxing state and made deliveries by common carrier or the mail, the Court found its contact to be even less than that involved in \textit{Miller Brothers}. After reviewing prior cases in which the limiting principles of both the due process and commerce clauses had been applied, the Court concluded:

\begin{quote}
[It] is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government."

The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.\textsuperscript{36}
\end{quote}

A vigorous dissent by Justice Fortas, with whom Justices Black and Douglas joined, argued that regular solicitation of orders through the mail evidences just the kind of regular and continuous exploitation of the consumer market found lacking in \textit{Miller Brothers}. As to the Court's concern that use tax obligations might entangle mail order sellers in a welter of complicated administrative and record keeping requirements, the dissent felt this concern "vastly underestimates the skill of contemporary man and his machines."\textsuperscript{37}

In a subsequent case, the Court declined to apply the \textit{Bellas Hess} rule to mail order sales by National Geographic Society to customers in California. In \textit{National Geographic Society v. California Board of Equalization}, although the Society's contacts with its California customers were exclusively by mail or common carrier, the Society did maintain two offices in California which performed no duties in connection with the sales.\textsuperscript{38} The Court limited \textit{Bellas Hess} to interstate sellers with no physical presence within the taxing state and who only communicate with customers by mail or common carrier as part of an interstate business. Therefore the Society's California offices provided a sufficient nexus for imposition of a use tax collection duty even though the offices were not involved with the taxed sales. \textit{Na-}

\begin{itemize}
\item \textsuperscript{35} National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 758 (1967).
\item \textsuperscript{36} Id. at 759-60 (footnotes omitted).
\item \textsuperscript{37} Id. at 766 (Fortas, J., dissenting).
\item \textsuperscript{38} 430 U.S. 551, 560 (1977).
\end{itemize}
tional Geographic made clear that the nexus requirement of Bellas Hess does not apply on a transactional basis. That is, so long as the taxpayer is physically present within the state, no connection between the sales transaction triggering the use tax collection liability and the taxing state, whether delivered by mail or common carrier, is required.

B. The Pre-Quill Climate

Economic and legal changes since Bellas Hess caused many to call for its overruling. The main criticism, based on economic grounds, was that whatever may have been the case when Bellas Hess was decided, technological developments such as the use of toll-free telephone lines, fax orders, computer "catalogs", and 24-hour home shopping television channels, have greatly facilitated mail-order sales making the physical presence test of Bellas Hess obsolete. Since Bellas Hess was decided, mail-order sales have skyrocketed from an estimated $2.4 billion in 1967 to $183 billion in 1989.

Concerning legal changes, language in the Bellas Hess opinion suggested the Court was influenced by the tax immunity doctrine that banned direct state taxation of interstate transactions which was rejected by it in Complete Auto. Thus, it was arguable that the change of law represented by Complete Auto undercut the Bellas Hess holding. Indeed, this was the principal ground upon which Justice White based his opinion dissenting from that part of the Quill decision which upheld the commerce clause branch of Bellas Hess. He stated: "[w]hat we disavowed in Complete Auto was not just the 'formal distinction between "direct" and "indirect" taxes on interstate commerce,' but also the whole notion underlying the Bellas Hess physical presence rule that 'interstate commerce is immune from state taxation.' "


41. "[I]t is difficult to conceive of commercial transactions more exclusively interstate in character than the mail-order transactions here involved." National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 (1967).

42. See text following note 53 infra for a discussion of the commerce clause aspect of Quill.

43. Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1917 (1992). Justice White also argued that the National Geographic Court's rejection of a transactional nexus requirement made clear its reliance on "a due process-type minimum contacts analysis that examined whether a link existed between the seller and the State.
It was also urged that Congress overrule *Bellas Hess*.\textsuperscript{44} Such legislative action would have raised the sticky question whether *Bellas Hess* was grounded on the due process clause or the commerce clause. If it was a commerce clause decision it was clearly subject to revision by Congress. This follows logically from the negative commerce clause doctrine which holds that Congress' power to regulate interstate commerce implies a limitation on state power to regulate or otherwise burden commerce that must be explicated by the Court only so long as Congress remains silent.\textsuperscript{45} If *Bellas Hess* was based on the due process clause, it was by no means clear that Congress had power to alter it.\textsuperscript{46} However, respected commentators had argued that Congress could overrule due process decisions limiting state taxing power. The theory was that since the due process clause of the Fourteenth Amendment does not apply to Congress, and under the commerce clause Congress has plenary power to regulate interstate commerce, it could exercise its commerce clause authority to displace due process or equal protection restraints on state taxation of interstate commerce.\textsuperscript{47} This theory has been put to rest by the *Quill* decision where the Court stated: "While Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce, it does not similarly have the power to authorize violations of the Due Process Clause."\textsuperscript{48} After

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{44} See Hartman \textit{supra} note 39 at 1015.
\item \textsuperscript{45} For a fuller explanation see \textit{TRIBE, supra} note 19, at 325-26. See also \textit{HELLERSTEIN, supra} note 25, at 326 ("The power of Congress to lift the Commerce Clause barriers to State taxation is unquestioned and, indeed, that power is well established by decisions of the Supreme Court.")
\item \textsuperscript{46} See ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 350, n.14 (1982)(Justice O'Connor, dissenting, stated: "It has long been established that Congress generally has the power to 'overrule' a decision of this Court invalidating state legislation on Commerce Clause grounds. By contrast, Congress generally cannot waive a ruling of this Court decided under the Due Process Clause."(citations omitted).
\item \textsuperscript{47} See, William Cohen, \textit{Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma}, 35 STAN. L. REV. 387, 388 (1983)("In appropriate circumstances, Congress should be able to authorize the states to enact legislation that, in the absence of congressional consent, would run afool of the due process or equal protection clauses of the [fourteenth amendment."]);
\item \textsuperscript{48} Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1909 (1992)(citations omitted).
\end{enumerate}
\end{footnotesize}
Quill there is a clear need for distinguishing restraints on state taxing power under the due process clause from restraints under the commerce clause, since only the latter can be modified by congressional action.

C. The Quill Decision

The Court began its analysis by observing that the Bellas Hess decision relied on both the due process clause and the commerce clause. Thus, under Bellas Hess the North Dakota statute violated both constitutional provisions. However, it pointed out that since the clauses reflect different constitutional concerns, they impose distinct limits on the taxing power of the states. While a state may have authority to tax under the due process clause, the imposition of a tax may nonetheless violate the commerce clause.

Turning to the due process limitation, the Court noted that “Our due process jurisprudence has evolved substantially in the 25 years since Bellas Hess, particularly in the area of judicial jurisdiction.”49 In that context the primary concern of the due process clause is that a defendant have sufficient contact with a jurisdiction in which it is subject to suit, so that the maintenance of a suit within that jurisdiction does not offend traditional notions of fair play and substantial justice. The recent cases have abandoned a formalistic, Bellas Hess-like approach that focused on the defendant’s physical presence within a state, in favor of a more flexible inquiry into whether the defendant’s contacts with the state made it reasonable to require it to defend a suit filed there. Quoting from its earlier decision in Burger King Corp. v. Rudzewicz,50 the Court stated that “[s]o long as a commercial actor’s efforts are ‘purposefully directed’ toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.”51

Similar reasoning, the Court concluded, justifies the imposition of a use tax collection duty on an out-of-state mail-order house engaged in continuous and widespread solicitation of business within the state. Since Quill purposefully directed its activities at North Dakota residents, those activities were of sufficient magnitude to satisfy due process requirements and the use tax which Quill was obligated to collect was related to benefits it received by virtue of making sales within the state; the Court concluded that the North Dakota statute did not violate the due process clause. To the extent that prior decisions such as Bellas Hess indicated a physical presence within the state was necessary to satisfy due process requirements for imposition of a use tax

49. Id. at 1910.
collection duty, those decisions were expressly overruled.\textsuperscript{52}

This much of the Quill opinion adopts the view of the dissenting justices in \textit{Bellas Hess} that regular solicitation of orders through the mail, or by other means not involving physical contact, demonstrates regular exploitation of a consumer market within the taxing state. This provides a sufficient nexus to sustain a use tax collection duty. Despite the Court's claim that this view gained support from post-\textit{Bellas Hess} cases involving judicial jurisdiction, it seems clear that it had ample support in pre-\textit{Bellas Hess} cases involving jurisdiction to tax. As early as 1940 the Court announced that the critical inquiry in determining whether sufficient nexus exists for taxation purposes is "whether the state has given anything for which it can ask return."\textsuperscript{53} It can hardly be disputed that anyone who substantially benefits from a consumer market, which has been nurtured by the state's infrastructure, can be asked for some return. It seems likely the \textit{Bellas Hess} Court was blind to this fact because the tax immunity doctrine precluded state taxation of interstate commerce. As the \textit{Bellas Hess} Court observed,\textsuperscript{54} it is hard to imagine a transaction more exclusively interstate in character than a mail-order transaction crossing state lines. Since purely interstate transactions were immune from state taxation, it made some sense to buttress the immunity with due process reasoning, even though the tax immunity rule originated in the commerce clause. The faulty and unpersuasive due process reasoning of \textit{Bellas Hess}, finally rejected in Quill, can thus be attributed to the Court's penchant for blending due process and commerce clause considerations in state taxation cases.

As delineated in Quill, the minimum contact necessary to satisfy due process for taxation purposes will exist whenever a commercial activity is \textit{purposefully directed} at residents of a taxing state. Regular solicitations within the state by any means will presumably suffice.

Turning to the commerce clause aspects of the case, the Quill Court reiterated \textit{Complete Auto}'s four-prong test,\textsuperscript{55} and acknowledged that \textit{Complete Auto} repudiated prior decisions which had embraced the tax immunity rule. Conceding that \textit{Bellas Hess} was decided in 1967 when the immunity rule was enjoying its "latest rally,"\textsuperscript{56} the Court nonetheless rejected the state's argument that \textit{Bellas Hess} was an offshoot of the tax immunity rule and should join it in the dustbin of history. Instead, the Court concluded that the physical presence test "of \textit{Bellas Hess} furthers the ends of the dormant Commerce

\textsuperscript{52} \textit{Quill Corp. v. North Dakota}, 112 S. Ct. 1904, 1912 (1992). For a statement of the four-prong test see text accompanying note 22 supra.


\textsuperscript{54} National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 759 (1967).

\textsuperscript{55} Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1912 (1992). For a statement of the four-prong test see text accompanying note 22 supra.

\textsuperscript{56} \textit{Id.}
The Court faced two obstacles in developing a rationale to support its commerce clause conclusion. First, and most importantly, *Complete Auto* rejected formalistic tests of prior commerce clause decisions and instead looked to practical realities. *Bellas Hess* ignored the practical reality that an out-of-state seller could benefit from a retail market within the taxing state while not being present there. So its physical presence test is formalistic and inconsistent with *Complete Auto*. Second, as the Court acknowledged, *Bellas Hess* was a nexus case. No prior decision had established, or even suggested, a distinction between the nexus requirements of the due process and commerce clauses. How then could the Court reconcile its repudiation of the due process branch of *Bellas Hess* with its retention of the commerce clause branch of that case?

The Court attempted to clear the first hurdle by asserting that "three weeks after *Complete Auto* was handed down, [in *National Geographic*]... we affirmed the continuing vitality of *Bellas Hess*." In fact, the *National Geographic* Court did no such thing. Instead, it merely observed that in light of the traditional distinction between those taxpayers who were physically present in the taxing state and those who were not, the *Bellas Hess* holding which dealt only with the latter group was irrelevant to the determination of whether the former group met the nexus requirement. The Court held that the Society met the nexus requirement by virtue of its physical presence within the state. Contrary to the suggestion of the *Quill* Court the *National Geographic* Court had no reason to consider whether the Society would have met the nexus requirement if it was not physically present within the state, and thus had no reason to question the continuing vitality of *Bellas Hess*.

Concerning the relationship between the nexus requirements of the due process clause and the commerce clause, the Court observed that "[t]he two standards are animated by different constitutional concerns and policies," and therefore are not equivalent. Due process is primarily concerned with the fundamental fairness of government activity and thus asks "[w]hether an individual's connections with a

57. *Id.* at 1914.
58. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 443 (1980)(citations omitted), the Court stated: "In several recent cases [including *Complete Auto*], this Court has attempted to clarify the apparently conflicting precedents it has spawned. In an endeavor to establish a consistent and rational method of inquiry, we have examined the practical effect of a challenged tax..."
60. *Id.* at 1912.
State are substantial enough to legitimate the State's exercise of power over him.63 The central concern of the commerce clause is not fair treatment for an individual taxpayer but "structural concerns about the effects of state regulation on the national economy. . . . Accordingly, . . . a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause."64

While it has been long recognized that the due process and commerce clauses are animated by different concerns, the Court did not make it clear why those different concerns call for different nexus standards. The different concerns explain why the commerce clause but not the due process clause requires, in addition to nexus, that a tax be fairly apportioned and not discriminate against interstate commerce. These additional requirements are obviously aimed at preventing states from imposing undue burdens on interstate commerce. But it remains a mystery why the undue burdens doctrine mandates a nexus test for the commerce clause unlike that of the due process clause. Indeed, if as Complete Auto suggests, economic realities are to govern, the Court's due process holding that commercial activity purposefully directed at residents of the taxing state demonstrates that the state has given something for which it can ask return, implies that a tax imposed under such circumstances cannot automatically be viewed as an undue burden.

Significantly, the Court did not attempt to reconcile its holding in Quill with the fundamental principle of Complete Auto that a "tax should be judged by its economic effects."65 The Court implicitly acknowledged that the Bellas Hess rule which allows out-of-state sellers to regularly exploit a consumer market within the taxing state without paying tax, so long as it has neither personnel nor property within the state, is a formalistic rule. However, it observed that "not all formalism is alike."66 The formalism of decisions under the tax immunity rule repudiated in Complete Auto focused on the words of the taxing statute. A direct tax on interstate commerce held invalid under the tax immunity rule could be recast by the legislature and validated through a mere change in words.67 The Court concluded that such

63. Id.
64. Id. at 1913-14 (citations omitted).
65. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 280 (1977). The underlying philosophy of the Complete Auto decision and its adoption of the four-prong commerce clause test was that under the tax immunity rule economically identical activities were treated differently for tax purposes. The four-prong test was intended to emphasize economic substance rather than formalities in determining the constitutionality of a tax. Id. at 288.
verbal formalism served no legitimate commerce clause propose. However, "the demarcation of a discrete realm of commercial activity that is free from interstate taxation," under the bright-line rule of Bellas Hess, serves the commerce clause by avoiding the need for a case-by-case evaluation of the actual burdens imposed by use taxes and reducing litigation concerning those taxes. Finally, the Court stated, "a bright-line rule in the area of sales and use taxes also encourages settled expectations," and thus facilitates growth in the mail-order industry.

The problem with the Court's defense of the Bellas Hess brand of formalism is that it applies equally to other brands of formalism, including that engendered by the tax immunity rule. Under that rule interstate commerce was free of direct state taxation. Similarly, under the bright-line test of Bellas Hess, interstate commerce involving no physical presence within a state is free of state taxation. As did the tax immunity rule, the physical presence test avoids the need for determining the economic effect of a tax on a case-by-case basis by focusing on a formality having little or nothing to do with whether the state has given anything for which it can ask return. Both can be said to reduce, but not eliminate, the need for litigation. Just as the tax immunity rule called for a case-by-case determination of what constitutes a direct verses an indirect tax, the bright-line test of Bellas Hess calls for a case-by-case determination of what constitutes physical presence within the taxing state. Perhaps the physical presence test is easier to apply than the direct-indirect test and is therefore more desirable. However, the basic shortcoming of each test is the same. Under each test economically similar activities may be treated differently depending on the outcome of a formalistic test. So far as growth in the mail-order industry is concerned, it seems likely that growth was attributable to technological change and the tax exemption provided by Bellas Hess, rather than the predictability of its bright-line rule.

69. Id.
70. Id. at 1915.
71. Id.
72. It has been suggested that the industry specific reasons provided by the Court for retaining the Bellas Hess physical presence test may indicate the Court will take a different approach with taxpayers outside the mail-order industry. Walter Hellerstein, Supreme Court Says No State Use Tax Imposed On Mail-Order Sellers... for Now, 77 J. OF TAXATION 120, 124 (1992). As the author recognized, the devel-
Finally, the Court reiterated that "we have, in our decisions, frequently relied on the Bellas Hess rule in the last twenty-five years."73 However, the cases to which the Court referred did not rely on Bellas Hess. The only case in which Bellas Hess was given significant consideration was National Geographic Society v. California Board of Equalization.74 As discussed above, that case did not rely on Bellas Hess for its holding but distinguished it as irrelevant to determining whether a taxpayer physically present within the taxing state can be compelled to collect a use tax. In all of the other cases, Bellas Hess was merely cited without significant discussion.75

The Court did give two legitimate reasons for upholding Bellas Hess. First, the Court observed in a footnote76 that within the United States there are some 6,000-plus state and local taxing jurisdictions which impose sales and use taxes. Compliance with the various rates of tax, allowable exemptions, and administrative and record-keeping requirements could entangle a national mail-order house in a virtual welter of obligations. Although this concern looks to the economic effects of the tax and is thus consistent with the philosophy of Complete Auto, it is not encompassed within the four-prong Complete Auto test. This concern is answered by the fact that Congress can limit state taxing power to avoid such excessive entanglement problems. Indeed, as the Court observed,77 there is precedent for such congressional action.78

Furthermore, the Court has never evaluated taxes under the commerce clause through a balancing process in which the burden of entanglement with state and local taxing jurisdictions is compared with the jurisdictions' need for revenue. That sort of balancing process, appropriate enough for the legislature, has little to commend it as a judicially applied test for determining the validity of taxes under the commerce clause. As experience with the fourth prong of the Complete Auto test demonstrates,79 the Court has had little success in app-
plying such open-ended tests in the context of state and local taxation.

The second legitimate but unpersuasive reason offered by the Court in support of its Quill holding was grounded on principles of stare decisis. Standing by what has previously been decided in order to protect reliance interests, may be sound so long as what has been decided in a prior case fits rationally within the pattern of decisional law created by subsequent cases. However, as Justice White correctly noted in his dissenting opinion, after Complete Auto and its rejection of the tax immunity rule, "the illogic of retaining the physical presence requirement . . . is palpable."80

Despite the Court's protestations to the contrary, its Quill decision harks back to the tax immunity rule, although without its reliance on the direct-indirect dichotomy. Under the new tax immunity rule of Quill there exists a "discrete realm of commercial activity that is free from interstate taxation."81 This discrete realm is defined by a physical presence test which is unaffected by commercial activity purposefully directed at exploiting a retail market within the taxing state. The state may provide something, but within this discrete realm it may not ask return. Disconnected from economic realities, the test is inconsistent with the philosophy of Complete Auto.

Beyond that, Quill for the first time establishes a separate and distinct nexus test for due process and commerce clause purposes. The immediate effect of overturning the due process branch of Bellas Hess while retaining its commerce clause branch is apparent. As the Quill Court noted,

[N]o matter how we evaluate burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. Indeed, in recent years Congress has considered legislation that would "overrule" the Bellas Hess rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in Bellas Hess that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with the duty to collect use taxes.82

Congress would have had the same freedom had the Court chosen to overrule the commerce clause branch as well as the due process clause branch of Bellas Hess. Perhaps it was simply the Court's incompatible desires to allow Congress to legislate, and simultaneously avoid a judicial change in the taxation of the mail-order industry, which led the Court to adopt a different nexus test for due process and com-

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81. Id. at 1914.
82. Id. at 1916.

state. See text accompanying note 22 supra. For an analysis of the fourth prong, see David F. Shores, State Taxation of Interstate Commerce: Quiet Revolution or Much Ado About Nothing?, 38 TAX L. REV. 127, 162-63 (1982).
merce clause purposes. Result oriented reasoning frequently has unforeseen and undesirable consequences. It seems unlikely Quill will do much to improve the jurisprudence of this "impoverished territory."  

Quill did, however, provide one ray of hope. Bellas Hess amply demonstrates the immense confusion and uncertainty that have been created by the Court's consistent failure to separate due process and commerce clause restrains on state power to tax interstate commerce. As the Quill Court acknowledged, the need for treating due process and commerce clause limitations as separate and distinct rather than intermingled ones has long been recognized. The Court's careful separation of due process and commerce clause analysis in the Quill opinion, its holding that due process constraints on state taxing power are not subject to revision by Congress, and its adoption of different nexus tests under each clause, suggest it might be more mindful of that need in the future. Unfortunately, as will be seen below, within three weeks of its Quill decision the Court in Allied-Signal forgot its own admonition, and applied an inseparable blend of due process and commerce clause conceptions in determining the scope of state power to tax interstate commerce. Thus, the one ray of hope created by Quill was promptly extinguished.

II. ALLIED SIGNAL AND THE UNITARY BUSINESS CONCEPT

Allied-Signal, Inc. was the successor-in-interest to the Bendix Corporation, a Delaware corporation with its principal place of business in Michigan. Bendix was engaged in four lines of business, including the production of aerospace products, development and manufacturer of which was conducted in New Jersey. It did business in all fifty states and twenty-two foreign countries. In the late 1970's Bendix acquired a 20% stock interest in ASARCO Inc., a New Jersey corporation with its principal place of business in New York, and a leading producer of nonferrous metals. In 1981 Bendix sold its stock to ASARCO at a gain of $211.5 million. New Jersey assessed a tax on a portion of that gain, and Bendix successfully challenged the tax on constitutional grounds.

83. Tyler Pipe Indus., Inc. v. Washington State Dept' of Revenue, 483 U.S. 232, 265 (1987)(Scalia, J., dissenting). Within months of the Quill decision the question arose whether its separate nexus tests for due process and commerce clause purposes apply to all taxes or just to sales and use taxes. In Geoffrey, Inc. v. South Carolina Tax Comm'n, No. 23886, 1993 WL 248641 (S.C., July 6, 1993). The South Carolina Supreme Court indicated the physical presence test of Quill applied only to sales and use taxes. Id. at n.4. For a review of the issues in Geoffrey, see 54 STATE TAX REV. No. 39, 6-9 (C.C.H. Sept. 27, 1993).


85. The Quill Court stated: "although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct." Id. at 1909.
Unlike the Quill Corporation, Bendix clearly had a substantial presence in the taxing state and could not claim it was beyond New Jersey's power to tax under the nexus test of either the due process or the commerce clause. Instead, Bendix claimed that while its connection with New Jersey was sufficient to support some tax, it did not support a tax on gain realized from sale of the ASARCO stock because the stock had no connection with its New Jersey activities. In short, while the Quill case involved the question of whether a state had power to tax, Allied-Signal focused on what the state could tax. As put by the Allied-Signal Court: "The constitutional question in a case such as Quill Corp. is whether the State has the authority to tax the corporation at all. The present inquiry, by contrast, focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax."

A. Apportionment and the Unitary Business Principle

Determining the scope of a state's power to tax interstate commerce usually poses a far more difficult question than determining whether the power of taxation exists. For example, if a corporation conducts an interstate business and has property or personnel in all fifty states it is clear all have power to tax. But, if the corporation realized net income of $1 million in a given year, how should one determine the portion of that income taxable by each state? Apportionment by formula and the unitary business concept have traditionally been used to answer this question. As applied to an income tax this means that income produced by a unitary business is taxable by all states in which the business is conducted. Furthermore, no state need establish an actual connection between the taxpayer's in-state activities and a specific portion of the unitary income which it taxes. Instead, the state may apply a formula based on in-state sales, property or payroll compared to total sales, property or payroll, to determine the portion of income which is deemed to be attributable to in-state activities and therefore subject to tax. For example, if state A employs a single factor apportionment formula based on property, and 40% of the taxpayer's total property used in the unitary business is located within state A, then state A may tax 40% of the income generated by the taxpayer's unitary business partly conducted within state A.

The efficacy of the unitary business principle as a justification for apportionment by formula was cemented by Butler Brothers v. McColgan. Butler Brothers made it practically impossible for a taxpayer to

87. See Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).
88. See Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).
challenge formula apportionment by tracing income from a unitary business to activity conducted outside the taxing state.\textsuperscript{90} Thus, in the above example, the taxpayer could not successfully argue that although 40\% of its property was located in State A, unitary business activities within State A accounted for less than 40\% of unitary income, and therefore State A's apportionment was excessive.

As far as income tax action is concerned, after \textit{Butler Brothers} the only practical means for challenging apportionment by formula is for the taxpayer to demonstrate that the apportioned item of income was not derived from a unitary business partly conducted within the taxing state. The burden is a heavy one. First, the taxpayer must convince the state court by "clear and cogent evidence" that extraterritorial values are being taxed, that is, that the apportioned income is derived from out-of-state activities unrelated to the unitary business conducted within the state. Second, on review, the federal courts will "if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a unitary business."\textsuperscript{91} If the taxpayer carries this burden of showing that the apportioned item was derived from an activity unrelated to the unitary business, then the item (such as gain realized by Bendix on sale of the ASARCO stock) cannot be linked to the taxing state by the unitary business principle. Unless some other link is demonstrated, the tax will fall. On the other hand, if it is found that the gain was derived from unitary business activities partly conducted within the taxing state, the link is established and the tax will be upheld. Thus,

\textsuperscript{90} In \textit{Moorman Mfg. Co. v. Bair}, 437 U.S. 267, 275, n.9 (1978), the Court suggested a taxpayer may be able to overcome apportionment by formula if accounting evidence demonstrated that the income allocated to a particular state by formula was actually attributable to activities outside the state. However, in \textit{Exxon Corp. v. Wisconsin}, 447 U.S. 207, 221 (1980), the Court rejected this proposition noting: "As this Court has on several occasions recognized, a company's internal accounting techniques are not binding on a State for tax purposes." Citing \textit{Butler Bros. v. McColgan}, 315 U.S. 501 (1942). Quoting from its earlier decisions in \textit{Mobil Oil Corp. v. Commissioner of Taxes}, 445 U.S. 425 (1980), and \textit{Moorman Mfg. Co. v. Bair}, 437 U.S. 267 (1978), the \textit{Exxon} Court continued:

\begin{quote}
The 'linchpin of apportionability' for state income taxation of an interstate enterprise is the 'unitary-business principle.' If a company is a unitary business, than a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing state.' In order to exclude certain income from the apportionment formula, the company must prove that 'the income was earned in the course of activities unrelated to . . . [the unitary business conducted within the taxing state].' The Court looks to the 'underlying economic realities of a unitary business,' and the income must derive from 'unrelated business activity' which constitutes a 'discrete business enterprise.'
\end{quote}

\textsuperscript{91} \textit{Container Corp. of America v. Franchise Tax Bd.}, 463 U.S. 159 (1983).
the scope of a state's power to tax income of a corporation carrying on an interstate business within its borders depends upon the scope of the unitary business concept. Income derived from all activities which constitute part of the unitary business may be taxed on an apportioned basis by each state in which unitary business activities take place.

The Allied-Signal Court began its analysis with a brief summary of the development of the unitary business principle. That principle, the Court stated,

is a recognition of two imperatives: the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income which cannot in fairness be attributed to the taxpayer's activities within the State. It is this second component, the necessity for a limiting principle, that underlies this case.92

New Jersey's power to tax Bendix on a portion of its gain from sale of the ASARCO stock turned on whether that gain could "in fairness" be partly attributed to Bendix's activities in New Jersey.

B. The Recent Precedents

A similar issue arose in Mobil Oil Corp. v. Commissioner of Taxes,93 where Mobil, a New York corporation with its principal place of business in New York and doing business in Vermont, challenged Vermont's power to tax a portion of dividend income realized by Mobil on its holdings in subsidiaries and affiliated corporations. Announcing that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," the Court concluded that in order for Mobil to succeed in its challenge, it must show "that the income was earned in the course of activities unrelated to the sale of petroleum products in [Vermont]."94 So far as could be determined from the record, Mobil's dividend income was derived from a single unitary business carried on by Mobil and its related corporations. Since the dividends had their source in this unitary business partly conducted in Vermont, Vermont was entitled to tax an appropriate portion of the dividend income. The Court cautioned,

[w]e do not mean to suggest that all dividend income received by corporations

94. Id. at 439. Mobil argued that New York, its domicile, could tax all of its dividend income, and to avoid multiple taxation no other state should be allowed to tax any part of the same income. The Court noted that New York had not imposed such a tax and the scope of its taxing power was not in issue. However, it broadly hinted that New York's taxing power was limited to taxation on an apportioned basis. The Court stated: "Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained. We find no adequate justification, however, for such a preference." Id. at 444-45 (citations omitted).
operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.95

Two years after the Mobil decision, that possibility became a reality in ASARCO, Inc. v. Idaho State Tax Commission,96 (the taxpayer in this case was the same corporation as that in which Bendix purchased stock which was later sold at a gain giving rise to the Allied-Signal case); and F.W. Woolworth v. Taxation & Revenue Department.97 Like Mobil, ASARCO and Woolworth involved taxes on dividend income received by nondomiciliary corporations doing business within the taxing state. In contrast to Mobil, the Court concluded in each case that the payor and payee of the dividends were not engaged in a unitary business partly conducted within the taxing state, and therefore the payee was not subject to taxation by the nondomiciliary state on its dividend income. In other words, since the taxpayer's activities within the taxing state were unrelated to the business activities of the dividend paying corporations, and the taxpayer was not domiciled within the taxing state, there was no sufficient connection between the taxing state and the dividends it sought to tax. As explained by the Court in Allied-Signal, "[i]n those cases the States sought to tax unrelated business activity."98 Furthermore, the Allied-Signal Court concluded that those cases were directly relevant to the Allied-Signal issue since "for constitutional purposes capital gains should be treated as no different from dividends."99

The announcement by the Mobil Court that the linchpin of apportionment is the unitary business principle arguably carried a negative implication. If dividend income was apportionable because the payor and payee were engaged in a unitary business, and the unitary business principle was the linchpin of apportionment, perhaps dividend income could never be apportioned unless the payor and payee were engaged in a unitary business.

ASARCO and Woolworth seemed to adopt this negative implication of the Mobil dictum. In holding that dividends received by a nondomiciliary corporation from subsidiaries with which it was not engaged in a unitary business did not constitute unitary income subject to apportionment, the ASARCO Court observed that in Mobil the state "prevailed because it was clear that the corporations operated unitary businesses with a continuous flow and interchange of common products. ASARCO has proved that these essential factors are wholly ab-

95. Id. at 441-42.
99. Id. at 2259.
sent in this case."  

Similarly, the *Woolworth* Court rested its holding that a nondomiciliary state could not tax dividend income received by a corporation doing business within the state, on the finding that the payor and payee of the dividends were not engaged in a unitary business. In her *ASARCO* dissent Justice O'Connor criticized the Court for failing "to consider the possibility that ASARCO's investments were simply an interim use of long term funds accumulated for ultimate use elsewhere in the business." Under this theory the investments would have been viewed as used in a unitary business partly conducted in the taxing state, and income produced by the investments would have been subject to apportionment.

*Mobil*, *ASARCO*, and *Woolworth* indicated that dividend income is subject to apportionment only if the payor and payee are engaged in a unitary business. The principal factors in determining whether one corporation is engaged in a unitary business with another corporation in which it holds stock are: (1) functional integration; (2) centralization of management; and (3) economies of scale. Subsequently, in *Container Corporation of America v. Franchise Tax Board*, the Court applied this three factor test in holding that a corporation and its foreign subsidiaries were engaged in a unitary business. Emphasizing that a unitary business may exist without a flow of goods between the corporations, if there is a flow of value; the Court indicated that the three factors may be shown by transactions not undertaken at arm's length, a management role for the parent with respect to the subsidiary's activities, and the fact both corporations were engaged in the same line of business.

The central idea of the flow of value concept presumably is to include within the unitary business all activities which may benefit, however indirectly, from the protection, opportunities, and benefits provided by the taxing state. For example, if there had been a flow of value from Bendix to ASARCO due to functional integration, centralized management or economies of scale achieved through joint operations, the corporations would have been engaged in a unitary business and any benefit provided by New Jersey to the unitary business would have automatically benefited both corporations. Gain realized by Bendix on its sale of ASARCO stock would then have had its source in business activities nurtured by New Jersey, and would have been subject to New Jersey taxation. On the other hand, if, as was found to be the case in *Allied-Signal*, Bendix and ASARCO operated entirely independently of one another, benefits provided by New Jersey to Bendix did not affect ASARCO. Therefore, ASARCO activities that

101. Id. at 353 (O'Connor, J., dissenting).
enhanced the value of its stock could not be viewed as nurtured by New Jersey. Since the unitary business principle provided no link between New Jersey and the enhanced value of the ASARCO stock, New Jersey could not tax that value although it was realized by Bendix, a corporation doing business within New Jersey.

C. The Allied-Signal Court's Analysis of the Precedents and Determination of the Governing Principles

New Jersey stipulated that "Bendix and ASARCO were unrelated business enterprises each of whose activities had nothing to do with the other." This essentially precluded a finding that they were engaged in a unitary business. Under the negative implication of Mobil, dividends received by Bendix on the ASARCO stock could not be taxed by New Jersey and neither could the gain realized on the sale of the ASARCO stock. However, New Jersey contended that the unitary business principle should be abandoned and all income of a nondomiciliary corporation doing business within the state should be taxable on an apportioned basis. Under this approach the due process clause would require only that the taxpayer (not each taxed activity) have a nexus with the taxing state. Multiple tax problems engendered by virtue of a taxpayer having a nexus with several states and thus being subject to tax in multiple states would be dealt with under the commerce clause, primarily the apportionment prong of the Complete Auto test. The Court rejected New Jersey's theory as inconsistent "with the concept that the Constitution places limits on a State's power to tax value earned outside of its borders."

Actually New Jersey did not claim it could tax income earned outside its borders free of constitutional constraints. Rather it disagreed with the taxpayer over the nature of the constraints. The taxpayer claimed New Jersey could not tax any part of the gain realized on its sale of ASARCO stock. New Jersey claimed it could tax a portion of the gain within the confines of the constitutional limitation of apportionment.

New Jersey's claim that it could tax even if Bendix and ASARCO were not engaged in a unitary business drew support from the treatment of income derived from short-term investments of working capital used in a unitary business. The Court acknowledged these investments produce unitary business income subject to apportionment even if earned by a nondomiciliary corporation in an out-of-state bank. Presumably, the theory is that working capital is necessary

104. Id. at 2261.
105. Id. at 2261.
106. Id. at 2263.
to the operation of the business and income earned on short-term investments of working capital is therefore related to business operations. As Justice O'Connor argued forcefully in her dissenting opinion in *ASARCO v. Idaho State Tax Commission*, "[t]he interim investment of retained earnings prior to their commitment to a major corporate project... merely recapitulates on a grander scale the short term investment of working capital prior to its commitment to the daily financial needs of the company." Therefore, income derived from long-term investments, such as Bendix's purchase of ASARCO stock, made to meet the long-term needs of a unitary business is related to the business in just the same way as is income derived from short-term investments of working capital and should similarly be viewed as unitary income.

Justice O'Connor's theory was very close to Idaho's proposal that unitary business income should include income derived from investments undertaken "for purposes relating or contributing to the taxpayer's business." The *ASARCO* Court rejected the proposal observing that since virtually any investment can in some sense be said to serve the purposes of the corporation's business, "This definition of unitary business would destroy the concept." In effect, New Jersey, like Justice O'Connor, found the working capital analogy compelling. It agreed with the *ASARCO* Court that the logical implications of the working capital analogy destroyed the unitary business concept, and concluded that the concept should be abandoned.

Rejecting New Jersey's proposal, the Court chose to retain the unitary business principle but recognized an alternative route to apportionment of income derived from long-term investments. It did so by drawing a fine line between long-term investments which, like short-term investments of working capital serve an operational function, and those which merely serve a passive investment function. The former produce unitary business income subject to apportionment, while the latter do not.

Like Justice O'Connor, the *Allied-Signal* Court concluded that long-term investments should be treated consistently with short-term investments of working capital. Consistent treatment means that income from long-term investments serving a purpose similar to the purpose served by working capital should be treated as unitary income. In the Court's view, the critical factor in characterizing income

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107. See *ASARCO Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 331 (1982), (O'Connor, J., dissenting). The payor and payee of the interest income would not be engaged in a unitary business, nor could it be claimed the out-of-state bank benefited from New Jersey services.

108. *Id.* at 338, (O'Connor, J., dissenting).

109. *Id.* at 326.

110. *Id.* at 326.

derived from working capital as unitary income is not that working capital serves a business purpose, but that it serves an operational function; that is, working capital is needed in order for the business to operate properly. Thus, income from long-term investments which serve an operational function is, like income from working capital, unitary income. And since stock investments which constitute an interim use of capital accumulated for future operation of the unitary business serve an operational function, any resulting income is unitary income subject to apportionment.112 In the words of the Court, such income is not "earned in the course of activities unrelated to [those carried on in the taxing] State."113

Although Mobil, ASARCO, and Woolworth seemed to require a unitary business relationship between the payor and payee of dividend income as a prerequisite to apportionment, Allied-Signal tells us this is not so.114 Under Allied-Signal dividend income received by nondomiciliary corporations is subject to apportionment if the payor and the payee of the dividends are engaged in a unitary business (the unitary business test), or the investment serves an operational rather than an investment function for the payee (the operational function test).

Despite the Court's claim that both tests were implicit in the earlier decisions, it seems clear that Allied-Signal represents a significant shift from ASARCO and Woolworth. A comparison of Justice O'Connor's dissents in all three cases supports this proposition. In ASARCO, which was decided in tandem with Woolworth, she characterized the majority opinion as "groundless" and contrary to "common sense and business reality."115 Although both long-term and short-term investments could serve similar purposes, the majority had treated these investments of working capital differently. In contrast, Justice O'Connor was "largely in agreement with the Court's analysis"116 in Allied-Signal, disagreeing not with the governing principles, but their application. An examination of Justice O'Connor's dissenting opinions in ASARCO, Woolworth, and Allied-Signal demonstrates

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112. Id. at 2263.
113. Id.
114. To be sure, the existence of a unitary relation between the payor and the payee is one means of meeting the constitutional requirement. Thus, in ASARCO and Woolworth we focused on the question whether there was such a relation. We did not purport, however, to establish a general requirement that there be a unitary relation between the payor and the payee to justify apportionment, nor do we do so today.
that she did not revise her view of the governing principles. Rather, the governing principles changed.

D. Application of the Governing Principles

Since there was no serious contention that Bendix and ASARCO were engaged in a unitary business, the case turned on whether Bendix's purchase of ASARCO stock served an operational function. The Supreme Court did not question the trial court's finding that Bendix purchased the ASARCO stock in implementing a corporate strategy of expansion through acquisition, and that the ASARCO stock was sold to raise capital for an unsuccessful bid to acquire Martin Marietta, an aerospace company whose business would have complemented Bendix's aerospace business conducted in New Jersey. These facts led the New Jersey Supreme Court to conclude that purchase and sale of the ASARCO stock was "an integral operational activity" growing out of Bendix's "ingrained acquisition-divestiture policy" designed to expand and enhance its existing operations partly conducted within New Jersey. Thus the tax was upheld. The United States Supreme Court disagreed.

Apart from semantics we see no distinction between the "purpose" test we rejected in ASARCO and the "ingrained acquisition-divestiture" policy approach adopted by the New Jersey Supreme Court. The hallmarks of an acquisition which is a part of the taxpayer's unitary business continue to be functional integration, centralization of management, and economies of scale... . . . It is undisputed that none of these circumstances existed here.\footnote{118}

The opinion is confusing. In articulating the governing principles the Court was very clear that income could be characterized as unitary income under either the unitary business test or the operational function test. Yet, in applying the principles the Court said that long-term investments undertaken to facilitate a corporate acquisition strategy do not serve an operational function if they take the form of stock holdings in a corporation not engaged in a unitary business with the taxpayer. This interpretation is buttressed by the Court's statement that: "Even if we were to assume that Martin Marietta, once acquired, would have been operated as part of Bendix's unitary business, that reveals little about whether ASARCO was run as part of Bendix's unitary business."\footnote{119} In other words, because Bendix and ASARCO were not engaged in a unitary business, New Jersey could not apportion Bendix's gain on the ASARCO stock; despite the Court's earlier flat statement that the unitary business test was not the exclusive road to apportionment.

In addition to pointing to the fact Bendix and ASARCO were not

\footnote{117. Id. at 2257, 2261.}
\footnote{118. Id. at 2264 (citations omitted).}
\footnote{119. Id. at 2264.}
engaged in a unitary business, the Court observed that the ASARCO stock, which was held for about two years, did not amount to a short-term investment of working capital. While this is correct, the governing principles again articulated by the Court indicate it should not have been fatal to characterizing the investment as serving an operational function. As Justice O'Connor observed in dissent: "Any distinction between short-term and long-term investments cannot be of constitutional dimension." The Court provided no alternative explanation as to why Bendix's investment in ASARCO stock did not serve an operational function, or why it should be treated differently than a short-term investment of working capital.

In short, the two reasons provided by the Court for its conclusion that the purchase and sale of ASARCO stock did not meet the operational function test which it set out, do nothing to inform one of the contents of that test. Indeed, the same reasons would have supported a decision favorable to the taxpayer under the pre-Allied-Signal view that for investment income to be unitary income subject to apportionment, either the payor and payee must be engaged in a unitary business or the investment income must be derived from the short-term investment of working capital. One might conclude the Allied-Signal Court revised the governing principles but in applying them failed to revise its analysis. This leaves in doubt the practical effect of the operational function test. It may be that the Court will apply it in a fashion so stilted as to rob it of any practical significance.

The Court did suggest that defining capital transactions which serve an operational function in a way that corresponds to the definition of business income under the Uniform Division of Income for Tax Purposes Act (UDITPA) "may be quite compatible with the unitary business principle." UDITPA defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." It undoubtedly is true that an activity integral to the taxpayer's New Jersey business would serve an operational function. However, all precedent indicates that for New Jersey's taxing power to be constitutionally curbed, it must be reaching activities that "have nothing to do with" the taxpayer's New Jersey business.

Surely, an activity may not be integral to, but still have something to do with, the New Jersey business. Thus, while UDITPA is compatible with the prior decisions, it cannot properly be viewed as marking the

120. Id. at 2266 (O'Connor, J., dissenting).
121. Id. at 2262.
123. See text accompanying notes 93 and 96 supra.
outer boundaries of the state's power to tax. In a word, the UDITPA rule is underinclusive. It cannot plausibly be viewed as including all income that can "in fairness be attributed to the taxpayer's activities within the [taxing] State."124

The Court also pointed125 to its earlier decisions in Container Corporation of America v. Franchise Tax Board,126 and Corn Products Refining Co. v. Commissioner,127 for guidance in distinguishing capital transactions which serve an investment function from those which serve an operational function.128 Container (like Mobil) held that a parent corporation doing business in the taxing state and its foreign subsidiaries were engaged in a unitary business. In reaching this conclusion the Court noted that one factor which may be taken into account is whether there was a flow of value from the parent to its subsidiaries. Because the parent corporation made loans to its subsidiaries on terms more favorable than would have been accepted in an arm's length transaction, such a flow of value was obvious.129 And, citing Corn Products, the Court stated that "capital transactions can serve either an investment function or an operational function."130

Unfortunately Container provides no guidance for resolving the issue at hand. No party claimed that Bendix had made an investment which resulted in a flow of value from itself to ASARCO. If it had, as Container makes clear, such a flow of value would have been some evidence that Bendix and ASARCO were engaged in a unitary business. But that issue was foreclosed by the stipulated facts and Container suggests nothing concerning whether the Bendix purchase of ASARCO stock served an operational function in Bendix's aerospace business.

Corn Products, at first blush, might seem to provide a more powerful analogy. It involved whether a company engaged in the business of converting corn into syrup and other corn products realized capital gain or ordinary income under the Internal Revenue Code when it sold corn futures. Although a literal application of the statute indicated that corn futures were capital assets, the Court noted that the futures were purchased to assure a ready supply of corn at a predictable price and that Congress intended "that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss."131 Since maintaining a supply of corn was part of the everyday operation of the business, gain

125. Id. at 2264.
130. Id.
or loss on corn futures transactions was held to be ordinary rather than capital.132

The original *Corn Products* doctrine, which has been substantially revised,133 had much in common with the UDITPA rule discussed above.134 Critical to each is whether a given activity is integral to the taxpayer's ordinary business activity. For the reasons given above in connection with the UDITPA rule, *Corn Products* may be useful in determining what activities are clearly within the scope of a state's taxing power, but the outer boundaries remain elusive.

While *Allied-Signal* says unitary income may include investment income other than that received from a payor engaged in a unitary business with the payee, and that received from short-term investments of working capital; the extent to which this is so is unclear. Presumably, transactions which are integral to a business conducted within a state generate income subject to apportionment. But that test cannot, consistently with precedent, define all that a state may tax.

E. The Dissent

Criticizing the majority for leaving "operational function" largely undefined,135 Justice O'Connor argued in dissent that any investment intended to benefit business activities conducted within the taxing state should be viewed as serving an operational function. Under this approach the operational function test is essentially identical to the business purpose test urged by Idaho and rejected by the Court in *ASARCO*, and is broader than the UDITPA/*Corn Products* ordinary business activity test. In Justice O'Connor's view, Bendix's acquisition of *ASARCO* stock was functionally related to its New Jersey business activities because it was intended to benefit those activities by accumulating capital for their future expansion.

This theory is less comprehensive than that urged by New Jersey which would have viewed all income earned by a nondomiciliary cor-

132. The *Corn Products* doctrine soon expanded beyond the recurring, everyday transactions from which it sprang. Most of the litigated cases in which it was applied involved taxpayers who claimed an ordinary loss on stock which had been purchased for a business purpose such as assuring a source of supply, or cultivating the goodwill of a customer. See *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962); *FS Servs., Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969); *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984).

133. In *Arkansas Best Corp. v. Commissioner*, 485 U.S. 212 (1988), the Court reexamined *Corn Products* and concluded that the decision was not based on the notion corn futures transactions were integral to the taxpayer's business operation, but on the fact corn futures were a substitute for inventory. The *Corn Products* doctrine was limited to transactions integral to the taxpayer's inventory purchase system.

134. See text accompanying note 122 *supra*.

poration as subject to apportionment. Justice O'Connor agreed with the majority that New Jersey's theory went too far.136

Justice O'Connor avoided the analytical pitfalls of the majority and, as she had done earlier in ASARCO, correctly pointed out that the distinction between income earned from short-term investments of working capital and income earned from long-term investments which serve business needs is not a principled one. Unfortunately, she failed to provide a persuasive explanation as to why her theory was superior to New Jersey's in answering the fundamental question: Did the taxing state give anything for which it can ask return? She stated:

I agree with the Court that we cannot adopt New Jersey's suggestion that the unitary business principle be replaced by a rule allowing a State to tax a proportionate share of all the income generated by any corporation doing business there. Were we to adopt a rule allowing taxation to depend upon corporate identity alone, as New Jersey suggests, the entire Due Process inquiry would become fictional, as the identities of corporations would fracture in a corporate shell game to avoid taxation. Under New Jersey's theory, for example, petitioner could avoid having its ASARCO investment taxed in New Jersey simply by establishing a separate subsidiary to hold those earnings outside New Jersey. A constitutional principle meant to insure that States tax only business activities they can reasonably claim to have helped support should depend on something more than manipulations of corporate structure.137

The complete answer to Justice O'Connor's concern is that under New Jersey's theory, corporate presence within the state could serve as a sufficient but not a necessary condition for proportionate taxation of all the corporation's income. Thus, had Bendix formed a New York holding company to hold the ASARCO investment and all other facts remained the same, gain realized on the investment could still be reached by New Jersey on the theory the investment benefited a unitary business partly conducted within New Jersey.

Essentially, Justice O'Connor agreed with the majority's statement that: "in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax."138 She properly criticized the Court for its analytical failure but in the end disagreed only on whether the necessary connection was established in this case, not on whether it should be required. The question remains whether there are good reasons for requiring such a connection.

136. She stated: "It is not just that the ASARCO investment was made to benefit Bendix as a corporate entity. As the Court points out, any investment a corporation makes is intended to benefit the corporation in general. The proper question is rather: Was the income New Jersey seeks to tax intended to be used to benefit a unitary business of which Bendix's New Jersey operations were a part?" Id. at 2266 (O'Connor, J., dissenting).

137. Id. at 2265 (O'Connor, J., dissenting)(citations omitted).

138. Id. at 2258.
III. SHOULD THE NEXUS REQUIREMENT APPLY SEPARATELY TO EACH TAXED ACTIVITY?

The Quill Court, quoting Justice Rutledge, stated that: "'Due process' and 'commerce clause' conceptions are not always sharply separable in dealing with these problems . . . And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached . . . at least tentatively as if they were separate and distinct, not intermingled ones." With this admonition in mind, the question will be considered first from the standpoint of the due process clause, then from that of the commerce clause.

A. The Due Process Clause Nexus Requirement

The central concern of due process is assuring the fundamental fairness of government activity. Just as it would be fundamentally unfair and violative of due process to impose a tax on one who has no connection with the taxing state, because no benefit has been received from the state; so it may be fundamentally unfair to tax an activity engaged in by one who has a connection with the taxing state, but who has received no benefit in connection with the taxed activity. This is the underlying due process rationale of the Allied-Signal holding that a nondomiciliary state must have a connection with the taxed activity, not merely with the taxpayer. However, as Mobil, ASARCO, Woolworth, Container Corporation, and Allied-Signal demonstrate, determining whether an activity has benefited from state services is no easy matter. The question becomes whether a state may avoid this difficult factual determination by engaging in a presumption that some part of all income earned by a taxpayer present within the state and engaged in interstate business (an interstate taxpayer), is derived from activities that have benefited from state services. If such a presumption is fundamentally fair to the taxpayer, then all income producing activities may be automatically linked through the presumption to any state in which the taxpayer is present. If the presumption is unfair, a link must be demonstrated with respect to each taxed activity. Although Allied-Signal adopted the latter approach, it provided no explanation for why fair treatment requires such an approach. In considering the fairness issue, insight may be gained from a comparison of resident and nonresident taxpayers.

In the case of a resident taxpayer due process constraints on the state's power to tax are minimal. This may be because all activities

140. Id. at 1913.
141. See Cohn v. Graves, 300 U.S. 308 (1937)(New York resident may be taxed by New York on rental income from land located in New Jersey. "Enjoyment of the priv-
of one who is domiciled within a state are deemed to benefit from state services; or because a resident, as a citizen of the state in which he resides, is an actual or potential beneficiary of all state services and therefore has a general duty to contribute to the support of government. Thus, the Court has stated that so far as due process is concerned the nature and measure of taxes imposed on a resident (including a corporation domiciled within the state), "is largely a political matter." In this context the nexus requirement may be viewed as only running to the taxpayer. Since residency provides a nexus with the taxpayer, all activities are subject to tax. Alternatively, residency may be viewed as automatically establishing a nexus with all activities of a resident taxpayer. The choice of theory has no practical significance. The salient point is that due process does not require the state to demonstrate a connection with each taxed activity of a resident.

A state may, of course, also tax nonresidents with whom it has a sufficient nexus. Since in the case of nonresidents, nexus is based on some activity (including the ownership of property) within the state, it naturally follows that the scope of the taxing power as applied to nonresidents will be more limited than as applied to residents. Within the context of a nonresident taxpayer not engaged in interstate commerce (a nonresident intrastate taxpayer) it is plain that the due process nexus requirement should run to the particular activity subject to tax. For example, it would be arbitrary to hold that a nonresi-

142. Miller Bros. Co. v. Maryland, 347 U.S. 340, 345 (1954). The power to tax a resident is not exclusively a political matter, however; as is demonstrated by the due process constraint which prohibits a state from taxing a resident on real property located outside the state. See Senior v. Braden, 295 U.S. 422 (1935); Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929). Some commentators believe this constraint should be abandoned as inconsistent with the general theory which views the power to tax residents as limited only by political considerations. See Boris I. Bittker, Taxation of Out-of-State Tangible Property, 56 YALE L.J. 640 (1947); HEL-LESTEIN, supra note 25, at 830.

143. Shaffer v. Carter, 252 U.S. 37 (1920)(State may tax income earned by a nonresident from property located within the state.).

144. In Shaffer, the Court emphasized that the taxing state "assumed no power to tax non-residents with respect to income" derived from property or business beyond the borders of the State." Id. at 53. Shaffer, together with Cohn v. Graves, 300 U.S. 308 (1937), means residents are taxable on all income regardless of where its source is located, while nonresidents are taxable only on income derived from sources within the taxing state. See also International Harvester Co. v. Wisconsin, 322 U.S. 435, 441 (1944)("A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.")
dent taxpayer owning property within the taxing state and subject to tax on income derived from such property may also be taxed on all income regardless of its source. While the state provided benefits with respect to the ownership of property located within its borders, that does not imply that it also provided benefits with respect to income from sources outside the state. Since the taxpayer is not engaged in an interstate enterprise of which the in-state activity is arguably a part, the state cannot claim that it is difficult to determine whether its services were beneficial to the taxpayer's activities in another state. Thus, with respect to an intrastate taxpayer there is no need and certainly no basis for presuming that the taxpayer's out-of-state activities were benefited by state services.

At least so far as intrastate taxpayers are concerned, it makes sense to distinguish between residents and nonresidents and to require the state to demonstrate a connection with each taxed activity of a nonresident even though no such requirement applies to residents. This distinction comports with the fundamental fairness purpose underlying the due process clause because it is clear the state provided benefits to the nonresident intrastate taxpayer only with respect to the in-state activity, while the same cannot be said of the resident taxpayer.

The question arises whether due process analysis should be different in the case of a taxpayer engaged in interstate commerce. The purpose of the due process clause remains the same: to prohibit fundamentally unfair taxation by limiting the taxing power to situations in which the state has given something for which it can ask return. The theories that support taxation of all income realized by resident intrastate taxpayers seem equally applicable to resident interstate taxpayers, including corporate taxpayers domiciled within the taxing state. There is nothing to suggest those theories are somehow undermined by a resident taxpayer engaging in interstate commerce. Although the states traditionally have not done so, there is no apparent due process obstacle to a domiciliary state taxing all income earned by resident interstate taxpayers whether derived from interstate operations or any other source. 145

Similarly, the theory that supports limiting taxation of nonresident intrastate taxpayers to income derived from activities conducted within the state, might be thought to apply equally to nonresident interstate taxpayers. This thought (although not articulated) seems to underlie the requirement of Allied-Signal and its forerunners that a connection exist between a nondomiciliary state and each activity it seeks to tax. Just as a state can tax a nonresident intrastate taxpayer on income derived from sources within the state but not an income

145. See Paul J. Hartman, Federal Limitations on State and Local Taxation, 470.
from other sources; so New Jersey could tax *Allied-Signal* on income derived from activities demonstrably connected with New Jersey but not an income derived from other activities. Thus, for purposes of due process analysis, current decisional law supports no distinction between taxpayers depending upon whether they are engaged in interstate commerce. Residents are taxable on all income. Nonresidents are taxable only on income derived from activities demonstrably connected with the taxing state. Before evaluating the validity of this approach, it will be useful to consider the impact of the commerce clause.

**B. The Commerce Clause Nexus Requirement**

While the due process clause is aimed at assuring fundamentally fair treatment of the taxpayer, the commerce clause stands on a different footing. As the *Quill* Court stated: "In contrast, [to the due process clause] the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." "Structural concerns" means concerns about state taxes or regulations which unduly burden interstate commerce, as for example, by exposing it to a risk of multiple taxation.

The *Allied-Signal* holding that the state must demonstrate a connection with each taxed activity was grounded on both the due process and commerce clauses. The commerce clause question is whether there is a principled basis for requiring that the state have a demonstrable connection with each taxed activity of a nonresident interstate taxpayer, as opposed to merely a connection with the taxpayer.

The risk of multiple taxation, which the Court properly identified as the concrete commerce clause concern, does not support such a requirement. This is because requiring a connection with the taxed activity is an ineffective method for dealing with multiple taxation. Since more than one state will frequently have such a connection, the multiple tax problem will persist despite the existence of a demonstra-

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146. In the case of nonresidents engaged in an interstate business partly conducted within the taxing state, the connection may be established by the unitary business principle. *See supra* text following note 84.
148. *Id.*

The reason the Commerce Clause includes this limit [requiring a connection between the state and the person, property or transaction it seeks to tax] is self-evident: in a union of 50 states, to permit each state to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation.

*Id.* at 2258.
ble nexus between the state and the taxed activity. Thus, at most, requiring that there be such a nexus avoids multiple taxation only in the rare case of an activity engaged in by an interstate taxpayer which plausibly can be viewed as connected with only one state. Furthermore, as the chain of decisions culminating in Allied-Signal make clear, defining the scope of "connected" activities is a difficult and uncertain task. The cost of such a definition clearly outweighs any occasional benefit which might be achieved by way of preventing multiple taxation in the rare case of an activity plausibly connected with only one state. To put the matter bluntly, requiring a demonstrable connection between the state and the taxed activity in order to reduce the risk of multiple taxation makes no sense. This requirement is an utterly ineffective means of achieving that goal.

On the other hand, apportionment by formula holds the potential for a complete solution to the multiple taxation problem. If every state were permitted to tax a part of every item of income accruing to an interstate taxpayer doing business within its borders, no state should be permitted to tax any item of income in its entirety. As the Mobil Court stated concerning proper application of the commerce clause: "Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate." Furthermore, if the apportionment requirement were rigorously applied, it would deal effectively with the risk of multiple taxation and thus meet the structural concerns of the commerce clause. For example, if each state were required to use the same apportionment formula, multiple taxation would be drastically reduced if not eliminated. While there may be no sound basis for the Court imposing a single formula, it certainly could do much to reduce the diversity of formulas currently used. If necessary, Congress could impose a single formula and provide for uniform methods of application.

150. Although there is no clear holding on the issue, prominent commentators have suggested that income derived from interstate activities may be taxed in full by the domiciliary state and on an apportioned basis by nondomiciliary states in which the activities are conducted without offending the commerce clause. Others disagree. See infra note 152. The proposition conflicts with the central purpose of the commerce clause which is to prevent multiple or otherwise burdensome taxation of interstate commerce, see Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251, 2258 (1992), and seems doubtful. It may, however, explain why New-Jersey took the position in Allied-Signal that as a nondomiciliary state it could tax all income on an apportioned basis, and the domiciliary state could tax without apportionment all income derived from intangibles. Respondent's Brief on Reargument at 38-39, Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251 (1992). This, of course, significantly undercut New Jersey's theory.


A number of advantages would attend an approach that allowed any state in which an interstate taxpayer does business to tax all of the taxpayer's income on an apportioned basis. First, unlike the Allied- Signal holding that the nexus requirement of the commerce clause requires a demonstrable connection with each taxed activity, this approach furthers the underlying purpose of the commerce clause to prevent multiple taxation. This advantage should not be lightly dismissed in an area of law which is widely recognized as intellectually impoverished. Second, it would eliminate the need for attenuated distinctions between those activities which are demonstrably connected with the taxing state, and those which are not. Third, since no tax significance would attach to where an interstate taxpayer is domiciled, it would discourage unhealthy competition among the states aimed at attracting corporate headquarters through tax breaks. Fourth, since the domiciliary state, like nondomiciliary states, could tax all income but only on an apportioned basis, the Court would not have to decide which state has the best claim to tax when two or more states claim domiciliary status. Fifth, it would make clear that the domiciliary state cannot tax in full any item of income realized by an interstate taxpayer, since nondomiciliary states could tax the same income on an apportioned basis. Finally, if the competing claims of states to tax an item were resolved under the apportionment requirement of the commerce clause, rather than the nexus requirements of


154. Under Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936), a corporation may have a commercial domicile (if the corporation has "made that the actual seat of its corporate government." Id. at 212) different from its legal domicile which is the state of incorporation. Under the proposed approach domiciliary status would become meaningless and irrelevant to determining the scope of a state's power to tax income realized by an interstate taxpayer. Instead, the scope of taxation, that is, the portion of income subject to tax, would depend on actual contacts such as property, sales or employees within the taxing state compared to total property, sales or employees.

155. Despite the Court's often repeated view that the commerce clause is aimed at preventing multiple taxation, (see Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251, 2258 (1992), for the latest version) leading commentators have disagreed on whether a domiciliary state has power to tax all income realized by an interstate taxpayer, while nondomiciliary states may tax the same income on an apportioned basis. Cf., PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 470 (Cum. Supp. 1992). GEORGE T. ALTMAN & FRANK M. KEESLING, ALLOCATION OF INCOME IN STATE TAXATION 30-31 (2d ed. 1950); with JEROME R. HELLERSTEIN, STATE TAXATION 306-08 (1983). That the effectiveness of the commerce clause in dealing with such an obvious multiple tax problem is a matter of controversy, provides powerful testimony to the failure of the Court's commerce clause jurisprudence in the area of state taxation of interstate commerce.
both the due process and commerce clauses, any judicial solution to the multiple tax problem would be subject to revision by Congress.

In contrast, since Allied-Signal relied on the due process clause as well as the commerce clause, it would presumably be unconstitutional for Congress to adopt an apportionment formula and provide for its application to all income realized by a nonresident interstate taxpayer doing business within a state. In view of the immense complexity of apportionment issues such a restraint on legislative action is inappropriate.

C. The Relationship of the Due Process and Commerce Clauses in the Context of State Taxation of Interstate Commerce

But what of the due process clause? Can the due process notion that fundamental fairness requires a demonstrable connection between the state and the taxed activity of a nonresident taxpayer (whether or not engaged in interstate commerce), be reconciled with the proposed commerce clause notion that any connection between the state and an interstate taxpayer will do? The answer is no. Current due process requirements preclude the proposed commerce clause analysis.

However, two reasons suggest due process analysis should be affected by whether the taxpayer is engaged in interstate commerce. First, as the decisional law makes clear, linking specific income with specific activities undertaken by an interstate taxpayer is a task of extraordinary difficulty. The extent to which state efforts to do so have divided the Court suggests the process is likely to be speculative and the results less than satisfying. In light of this problem states ought to be allowed to presume all activities carried on by an interstate taxpayer doing business within the state are connected with the state, unless it is very clear such a presumption would impose a fundamentally unfair burden on the taxpayer. Second, as has already been pointed out, if all states having contact with an interstate taxpayer could tax all income on an apportioned basis, a necessary corollary would be that no state could tax on an unapportioned basis. In other words, partial taxation by all would mean full taxation by none. In contrast, since the apportionment requirement of the commerce clause does not apply to intrastate taxpayers, no constitutional principle would mandate apportionment by all states having contact with the intrastate taxpayer. Thus, all states having sufficient contact with an intrastate taxpayer could tax all income in full. This raises questions of fundamental fairness which would not arise with respect to an interstate taxpayer.

156. See supra text accompanying note 46.
157. See supra text accompanying note 150.
In light of these reasons, the traditional due process requirement that a nondomiciliary state have a connection with each taxed activity is more difficult to defend in the case of an interstate taxpayer than in the case of an intrastate taxpayer. Both the states’ need for avoiding such a requirement and the practical effect of abolishing it are dramatically affected by whether the taxpayer is engaged in interstate activities. It is difficult to see how allowing all states having sufficient contact with an interstate taxpayer to tax all income on an apportioned basis can plausibly be viewed as fundamentally unfair. Treating interstate and intrastate taxpayers identically for purposes of due process analysis suggests apportionment is irrelevant to determining whether a tax on an activity touching more than one state is fundamentally unfair. Such an approach, it seems, makes no sense.

In light of these considerations, it is proposed that once a nexus is established between a state and an interstate taxpayer, all due process requirements respecting what the state may tax be satisfied. This would, of course, sharply curtail current due process limitations on state taxation of interstate commerce. It would simply ask whether the state has given the interstate taxpayer anything for which it can ask return. If the answer is yes, due process analysis would end and the state would have power to tax the taxpayer’s entire net income subject to commerce clause restraints. Commerce clause analysis would begin and multiple taxation would be dealt with under the apportionment prong of the Complete Auto test. The useless second prong of the due process test (the rational relationship requirement) set out in Moorman158 would be jettisoned. The Court never has made clear why apportionment formulas designed to meet commerce clause concerns should be evaluated under the due process clause.159

158. See supra text accompanying note 15, for a description of the two prong test. All due process requirements are arguably useless as applied to an interstate taxpayer because they duplicate commerce clause requirements. See note 23 supra. However, the first prong of the Moorman test (minimal contact requirement) may serve a useful purpose by denying Congress power to permit taxation of interstate commerce without regard to contact. To say the second prong is useless is too mild. As explained in note 157 infra, it has had a harmful effect on commerce clause jurisprudence.

159. Evaluating apportionment formulas under the due process clause has been the source of much mischief. As one would expect in light of the due process concern for fundamental fairness, the Court has been extremely generous to the states. For example, in Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274 (1978), the Court declared that a formula would be upheld unless the taxpayer demonstrated through “clear and cogent evidence” that the income attributed to the taxing state was “out of all appropriate proportion to the business transacted . . . in that State.” This standard makes sense if the goal is simply to assure fundamental fairness. It does not make sense if apportionment is properly viewed as a commerce clause requirement aimed at preventing the risk of multiple taxation. See Id. at 281 (Brennan, J., dissenting). While the proposed approach would reduce the role of the due process clause as a limitation on state taxation of interstate
The fact is multiple taxation of interstate commerce is a commerce clause problem and it ought to be addressed as such. It is hard to imagine a more appropriate subject for federal legislation, or a less appropriate subject for judicial solution. Deciding which of the fifty states having a connection with an interstate taxpayer has the highest and best claim to taxation of a particular item of income is mainly a political, not a legal issue. No fundamental principle of constitutional law is at stake or suggests a solution. Perhaps investment income should be taxed exclusively by the state of commercial domicile, perhaps by the state of legal domicile, or perhaps all states contributing to the success and value of the taxpayer should be able to tax. While arguments can be made to support each option, no option can persuasively be viewed as fundamentally unfair to the taxpayer so long as any state seeking to tax can do so only on an apportioned basis. What should be clear, but is not under the doctrinal hodge-podge of current decisional law, is that if one or more states can tax income on an apportioned basis, no state should have power to tax without apportionment. Thus, the concern for preventing multiple taxation of interstate commerce expressed by the Court in *Allied-Signal*, and the structural policies recognized by the *Quill* Court as animating the Commerce clause, would be advanced rather than retarded by the proposed approach. Furthermore, a general shift in emphasis from the due process to the commerce clause with the concomitant enhancement of Congressional authority over state taxation of interstate commerce is entirely consistent with the *Quill* decision.

**IV. CONCLUSION**

A proper separation of due process from commerce clause concerns in dealing with state taxation of interstate commerce not only would contribute to clarity of analysis but would avoid infusing due process with commerce clause values springing from the doctrine of undue burdens. Traditionally, the due process clause has been overemphasized as a limitation on state taxation of interstate commerce. The results have not been good. Most importantly, greater reliance on the commerce clause would assure that judicial decisions designed to safeguard commerce clause values are subject to legislative review and revision. In a very real sense a shift in emphasis from the due process clause to the commerce clause would deconstitutionalize federal limitations on state taxation of interstate commerce. While the negative commerce clause doctrine has been controversial, not even its strongest proponents would claim that the commerce clause vests the

commerce, it would likely lead to elevated scrutiny under the commerce clause. This would be entirely appropriate and desirable since judicial error would be subject to legislative correction.
Supreme Court with power to regulate state taxation of interstate commerce, free of Congressional supervision. Yet, this is precisely the result when commerce clause values are fed into the due process clause.