No. 10-1340

IN THE
Supreme Court of the United States

KFC CORPORATION,

Petitioner,

v.

IOWA DEPARTMENT OF REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Iowa

BRIEF OF *AMICUS CURIAE* INSTITUTE FOR PROFESSIONALS IN TAXATION IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST OF AMICUS *CURIAE*

This brief *amicus curiae* in support of Petitioner, KFC Corporation ("KFC"), is filed by the Institute for Professionals in Taxation ("IPT").[1] IPT is a non-profit educational organization formed in 1976. Its purposes include promoting uniform and equitable administration of state income, ad valorem and sales and use taxes. IPT has more than 4,400 members representing over 1,400 businesses across the United States and in Canada, from small businesses to most of the Fortune 500. These members span the industry spectrum, including aerospace, agriculture, manufacturing, wholesale and retail, financial, oil and gas, communications, health care, hospitality, transportation and other sectors.

Many of these businesses utilize a franchise model. In 2010, the U.S. Census Bureau released its first comprehensive report on this segment of the U.S. economy. The report[2] revealed that franchised

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[1]Pursuant to Supreme Court Rule 37.6, IPT states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus curiae*, its members, or counsel, has made a monetary contribution to the preparation or submission of this brief. Counsel of record for all parties have received timely notice of IPT's intent to file this brief, and all parties have consented to the submission of this brief in writings filed with the Clerk.

[2]http://factfinder.census.gov/servlet/EconCoreStatServlet?ds_name=EC0700A1&_lang=en&_ts=302428479696. 2007 data was used, as the most recent data then available.

businesses with employees accounted for over $1.3 trillion in sales, $153.7 billion in annual payroll and employed a workforce of 7.9 million in the 295 industries surveyed.[3] When supplemented with franchised businesses having no employees,[4] franchised businesses operated over 828,000 business establishments, providing more than 9.1 million jobs, a payroll of $304 billion, $802 billion in productive output and over $468 billion of gross domestic product ("GDP") (*i.e.*, net value added to the U.S. economy). [5]

Franchised business directly accounted for roughly the same workforce as all domestic manufacturers of durable goods, and provided more jobs than each of these sectors: financial and insurance; real estate and rental/leasing; wholesale trade; transportation and warehousing; nondurable goods manufacturing; and information (software and print publishing, motion pictures and videos, radio and television broadcasting, and telecommunications carriers and resellers). Franchised businesses so pervade all aspects of commerce that any attempt to catalog them is necessarily incomplete.[6]

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[3] This data included only businesses with paid employees; nonemployer businesses such as sole proprietors, self-employed individuals, and independent contractors were not included.

[4] *See* note 3, *supra*.

[5] THE ECONOMIC IMPACT OF FRANCHISED BUSINESSES: VOLUME III, RESULTS FOR 2007, prepared by PricewaterhouseCoopers for The International Franchise Association Education Foundation, and available at: http://www.franchise.org/IndustrySecondary.aspx?id=10152.

[6] *Gaebler Ventures*, http://www.gaebler.com/Franchise-Directory.htm (last visited, May 24, 2010) (offering "The

Many of the businesses represented within IPT's membership earn income from franchisees in Iowa and other states in which the courts have determined that the state may constitutionally impose income tax upon businesses having no physical presence in the state. These states apply a rule of law that, merely by virtue of having independent in-state customers (*e.g.*, franchisees) in the state, such businesses have an "economic presence" sufficient to satisfy the "substantial nexus" requirement of this Court's dormant Commerce Clause jurisprudence.

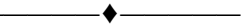
The proper rule of law to determine "substantial nexus" under the Commerce Clause for state corporate income tax purposes is the most significant issue of the day for both the states and taxpayers. State courts have employed irreconcilable interpretations of this Court's precedent in attempting to resolve this issue. For the states, the issue delimits their authority to raise revenue in hard economic times. For taxpayers, the issue poses substantial tax and compliance costs, in the billions of dollars, as they struggle with the same profoundly distressed marketplace. The matter is of special concern to small businesses because of the disproportionate impact such additional tax liabilities occasion.

The constitutionality of the "economic presence" rule of law embraced by the court below has languished since this Court's seminal decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274

World's Largest List of Franchise Opportunities").

(1977), nearly 35 years ago. Both the states and taxpayers have incurred substantial litigation, administration and compliance costs in the vacuum of mutual deference between Congress and this Court. At a time when the need for certainty is at a particular premium, IPT members' businesses find themselves in the untenable position that the Commerce Clause has a different meaning and operation from state to state, with increasingly diluted effect.

IPT submits that there is a compelling need and urgent imperative for this Court to step into the void and answer this recurring question of state taxing jurisdiction, and therefore earnestly supports Petitioner's request for review of the state court's decision below.



SUMMARY OF ARGUMENT

The Supreme Court of Iowa below decided an important question of federal law that has not been, but should be, settled by this Court. The state court determined that an out-of-state franchisor had "economic presence" through receipts from in-state franchisees sufficient to satisfy the "substantial nexus" requirement of the Commerce Clause. In so doing, that court interpreted the Commerce Clause in a manner that conflicts with decisions of other state courts on this fundamental federal question. Resolution of that question is the province of this Court.

The controversy is not a mere misapplication of

the proper rule of law, but a conflict over the fundamental reach of state taxing power. The dispute is national in scope, the financial stakes for both the states and taxpayers are substantial and the prospects for resolution without this Court's involvement are exceedingly remote. The Iowa court's decision in the context of the ubiquitous franchise business model expands "economic nexus" theory to any out-of-state taxpayer that merely receives income from an in-state customer, and presents a compelling need for the Court to settle this important federal question.[7]

The adoption of an "economic nexus" standard under the Commerce Clause is without precedent from this Court and fueled in large part by speculation, without any evidentiary basis, over the relative burdens imposed by state sales and use taxes as opposed to state corporate income taxes. IPT submits that, if there is to be a different constitutional limitation imposed on a state's power to impose different taxes, that difference must be rooted in a principled Commerce Clause analysis. In *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), the Court adhered to a bright-line physical presence nexus standard, though "artificial around the edges," because of the countervailing benefits of a clear rule. No less a clear rule is needed in this context.

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[7] The issue has particular significance in the growing number of states that – like Iowa – mandate the use of a single sales factor apportionment formula. These states apportion a corporate taxpayer's income based solely on a comparison of sales made in the state to sales made out-of-state, without regard to the location of capital investment (*i.e.*, property) and labor employed to generate that income.

The Commerce Clause values which the Court in *Quill* found were served by the "physical presence" standard apply with equal vigor to state corporate income taxes. The Commerce Clause demands more than a formalistic comparison of hypothetical "types" of taxes. Rather, it looks to the practical effect of a given state tax on the maintenance of an unfettered national economy.

The "substantial nexus" requirement of *Complete Auto Transit* is the principal means of limiting state tax burdens that unduly interfere with the free flow of interstate commerce. Giving the threshold "substantial nexus" requirement different meanings on a tax-by-tax basis invites a proliferation of unwieldy and unprincipled standards by state and local governments eager to expand their taxing reach and fill their coffers at the expense of out-of-state businesses. It would virtually assure the formulation of third, fourth and subsidiary "substantial nexus" standards as state and local governments press newly-conceived rules of law to justify their levies. There are thousands of state and local jurisdictions in a position to do so, with every incentive to find a means of exporting an augmented tax burden. In such an environment, the logic, simplicity and fair-mindedness of the "physical presence" requirement would be replaced by ever-finer and illogical distinctions among different taxes.

The "economic presence" standard amounts to nothing more than a restated Due Process "minimum contacts" test, confined to the frequency and extent of contacts between a taxpayer and the taxing jurisdiction. As this Court delineated in

Quill, "substantial nexus" is concerned not with the sufficiency of such contacts but with the burdens imposed upon interstate commerce. Left unrepudiated by this Court, "economic nexus" effectively eradicates the "substantial nexus" requirement outside of use taxes and fosters unbridled assertions of state taxing jurisdiction. If this Court's dormant Commerce Clause doctrine is to have any continuing vitality, the Court should grant the Petition and reverse the decision below.

ARGUMENT

The Proper Legal Standard for Determining "Substantial Nexus" Under the Commerce Clause for State Corporate Income Tax Purposes is an Important Question of Federal Law Decided by the Court Below That Has Not Been, But Should Be, Settled by the Court.

In *Quill*, the Court left open the question of whether a balancing test or bright-line rule would determine "substantial nexus" outside the limited context of use tax collection. It is this lingering question — whether states may constitutionally impose other taxes on businesses not physically present within their boundaries — which compels an answer from the Court.

It is difficult to overstate the significance of the issue. Businesses across the United States are at risk of being subjected to billions of dollars in state

corporate income taxes imposed by jurisdictions in which they are not physically present. The controversy has for years spawned uncertainty for state governments, the courts and taxpayers — uncertainty which confounds compliance and fosters serial litigation in state after state, with often inconsistent results.

The states and business community share a common need for certainty on this fundamental issue of state corporate income tax jurisdiction. The Court's observation in *Quill* justifying the adoption of a bright-line physical presence nexus standard is equally apropos in this context:

> Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit is important, for as we have so frequently noted, our law in this area is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'

504 U.S. at 315-16 (quoting *Northwestern States Portland Cement Co. v. Minn.*, 358 U.S. 450, 457-58 (1959)).

The tension between the physical presence

requirement in *Quill* for use tax purposes and the "economic presence" nexus theory enunciated by various state courts for corporate income tax purposes has been the subject of innumerable analyses and commentaries.[8] Professor Walter Hellerstein devotes extensive discussion to the subject in his leading treatise on state taxation, and refers to the "enormous outpouring of commentary" about this topic. HELLERSTEIN AND HELLERSTEIN, STATE TAXATION, ¶ 6.11 (3), n.234 (3d ed. 2000).

Congress has not acted to resolve the dispute, despite ample opportunity to do so.[9] For the past 11 years, bills have regularly been introduced in Congress to enact a state business activity tax nexus standard under the Commerce Clause.[10] Yet,

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[8] *See*, *e.g.*, Stombock, *Economic Nexus and Nonresident Corporate Taxpayers: How Far Will it Go?*, 61 Tax Law. 1226 (2008); Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, 26 J. of State Tax'n 29 (2008); VanLeuven, et al., *Economic Nexus and the Uncertainty of the Quill Physical Presence Test*, 38 Tax Adviser 322 (2007).

[9] Congress has enacted limited legislation on state income tax jurisdiction. The Interstate Commerce Tax Act, Public Law 86-272, is narrowly confined to solicitation for sales of tangible personal property and does not address the many nexus issues that persist outside of that precise context. Public Law 86-272 does not, for example, apply to the receipt of income from licensing intangible property to third parties, nor does it apply to the provision of services. HELLERSTEIN, ¶ 6.17. This Court's dormant Commerce Clause analysis must therefore fill in the wide gaps left open by Public Law 86-272.

[10] *See e.g.*, Business Activity Tax Simplification Act (BATSA) of 2011, H.R. 1439, 112th Cong. (2011); BATSA of 2009, H.R. 1083, 111th Cong. (2009); BATSA of 2008, H.R. 5267, 110th Cong. (2008); BATSA of 2007, S. 1726, 110th Cong. (2007);

Congress has repeatedly failed to act. The possibility of Congressional action should not deter the Court from deciding this pressing federal question. To the contrary, Congress' continuing silence calls for resolution by the Court.

In the void between Congressional inaction and this Court's refusal to grant certiorari petitions raising the issue over the past 18 years,[11] state courts have struggled to divine the answer that only this Court can give. This Court's goal in reviewing Commerce Clause challenges to state taxes has been to "'establish a consistent and rational method of inquiry' focusing on 'the practical effect of a challenged tax.'" *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981)(quotation omitted). In the absence of direction from this Court, state courts have parochially employed conflicting rules of law under a single "substantial nexus" requirement, in disregard of the practical effect that hodge-podge has on interstate commerce — a result wholly antithetical to this Court's Commerce Clause doctrine.

BATSA of 2005-2006, S. 2721 and H.R. 1956, 109th Cong. (2005-06); Innovation and Competitiveness Act, H.R. 4845, 109th Cong. (2005-06); BATSA of 2003, H.R. 3220, 108th Cong. (2003); Internet Tax Fairness Act of 2001, H.R. 2526, 107th Cong. (2001); New Economy Tax Fairness Act, S. 664, 107th Cong. (2001); and New Economy Tax Simplification Act of 2000, S. 2401, 106th Cong. (2000).

[11] *See*, *e.g.*, the cases listed by the court below, 792 N.W.2d at 320-22.

The Decision Below Epitomizes the Controversy

The decision of the court below is illustrative. In the absence of direct guidance from this Court, the Iowa court attempted to predict how this Court would resolve the issue. 792 N.W.2d 308, 322-23 (Iowa 2010). While acknowledging that certain economic nexus cases "represent the frontier of state assertions of nexus to tax out-of-state entities," *id.* at 322, the Iowa court headed in precisely that direction. The Iowa court conceded that "it might be argued that state supreme courts are inherently more sympathetic to robust taxing powers of states than is the United States Supreme Court," *id.*, and proceeded to embrace that sympathy. The "frontier of state assertions of nexus" and "robust taxing powers of states" cannot be squared with the Court's promise of a "consistent and rational method of inquiry" in *Commonwealth Edison*.

Perhaps most mystifying is the Iowa court's threshold determination that the use by in-state franchisees of KFC's intangible property amounted to the "functional equivalent" of physical presence under *Quill,* 792 N.W.2d at 324, only to later reject the notion that physical presence is required at all, *id.* at 324-26. Without dwelling on the distinctly Kafkaesque nature of that "pseudo-physical presence" logic, it is difficult to reconcile that court's conclusion with this Court's determination in *Quill* that an *actual* physical presence was *insufficient* as merely a "slightest presence." *Id.* at 315, n.8.

The unfortunate reality is that, much like the rampant "anti-*Bellas Hess*" legislation[12] that precipitated the Court's reaffirmation of *Bellas Hess*[13] in *Quill*, some states now pay little heed to this Court's dormant Commerce Clause authority. The Iowa court's observation that, "if states become overly aggressive in their tax policy, *Congress* has the express authority to intervene under the Commerce Clause," 792 N.W.2d at 325 (emphasis supplied), is telling: the Iowa court did not view *this Court* as any impediment to "overly aggressive" state tax policy. If, in fact, the Iowa court was correct in reading *Quill* to suggest "a desire on the part of the Supreme Court to defer to Congress on most nexus issues," *id.* at 327, the Court can explicitly say so, rather than leave the states and taxpayers to intractable disputes over the "substantial nexus" requirement.

Economic Nexus is Without Precedent in This Court

As a natural consequence of the guessing game which the Court's silence has engendered, state courts have employed irreconcilably conflicting rules of law interpreting the "substantial nexus" requirement. The Petition thoroughly details those conflicts. The decisions declining to apply the physical presence test rest principally upon the absence of any explicit statement from this Court that "substantial nexus" requires it. They thus

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[12] *See* Gall and Kulwicki, *The Lawmaker's Guide to Nexus – Part I*, 22 J. of State Tax'n 4, 6 (2004).

[13] *Nat'l Bellas Hess v. Dep't of Revenue*, 386 U.S. 753 (1967).

reflect no principled or affirmative rationale for using one Commerce Clause standard for use taxes and a diminished Commerce Clause standard for income taxes, but reflect, instead, opportunism facilitated by what is, at most, a negative implication from this Court's silence.

This approach turns what the Court has *not* said into a new, and variable, constitutional principle that dramatically expands the states' jurisdiction to tax. It ignores the fact that there are two things that the Court has not explicitly said: it has not expressly said that physical presence is required as a jurisdictional prerequisite to the imposition of a state income tax, and it has not said that states may levy such taxes in the absence of the taxpayer's physical presence. At best, the Court simply has not ruled upon the question, one way or the other.

What is undisputable, however, is that all of the state tax cases in which this Court has found that "substantial nexus" exists, whether entailing sales, income, franchise or other taxes, have involved physical presence by the affected taxpayer. This is a matter of which the Court, itself, took note in *Quill*, 504 U.S. at 310. The observation, which implies a single Commerce Clause standard for all state taxes, is one which the Iowa court and like-minded state courts have entirely disregarded.

In the same vein, the decisions applying the "economic nexus" theory for state income taxation cite no instance in which the Court applied different Commerce Clause standards (or other constitutional safeguards for that matter) on a tax-by-tax basis.

There are numerous examples to the contrary, in which the Court has applied the same constitutional protections across tax types. The Due Process Clause requirement of "minimum contacts," for example, has been applied to various types of state levies. *See*, *e.g.*, *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954) (use tax); *Allied-Signal, Inc. v. Director, Div. of Tax'n*, 504 U.S. 768 (1992) (income tax); and *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991) (Michigan Single Business Tax, a value-added tax). Similarly, the same Commerce Clause prohibition against discriminatory taxation of interstate commerce has been applied to: property taxes, *Camps Newfound/Owatonna, Inc. v. Town of Harrison,* 520 U.S. 564 (1997); vehicle flat taxes, *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987); gross receipts taxes, *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984); telecommunications excise taxes, *Goldberg v. Sweet*, 488 U.S. 252 (1989); sales tax, *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995); intangibles taxes, *Fulton Corp. v. Faulkner,* 516 U.S. 325 (1996); and income taxes, *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), among others.

Relative Tax Burdens Spawn from Unwarranted Speculation

If the underlying rationale for applying different constitutional standards to different taxes is that an income tax imposes a lesser burden than collection of use tax, that premise is sheer speculation. *Kmart Properties, Inc. v. Tax. and Revenue Dep't*, 131 P.3d

27, 35 (N.M. Ct. App. 2001), *cert. quashed and rev'd on other grounds*, 131 P.3d 22 (N.M. 2005). While in *Kmart* the intermediate appellate court postulated about the relative burdens created by the two taxes, speculation is not fact. The court posits that state income taxes are usually payable once a year (ignoring requirements for periodic reporting and payment of estimated tax), at a single rate (ignoring the multiplicity of rates, tax base adjustments, credits and the like), to one jurisdiction, thereby suggesting such taxes reflect a lesser burden than the use taxes described by this Court in *Quill*.

There is no indication, however, that the court based its speculation upon any actual evidence comparing the burdens imposed by sales and use taxes with the burdens imposed by state and local income taxes. The *Quill* decision reflects no findings or judgment regarding sales and use tax burdens, and IPT is aware of no court decision in which a factual record was made to support a conclusion regarding these relative tax burdens.

Moreover, even if it were appropriate to weigh these burdens based simply on the characteristics of a tax, then a compelling case can be made that state and local income taxes are *at least* as, if not more, burdensome than sales and use taxes. There is the obvious and very real difference that the taxpayer, itself, is the obligor for income tax, not simply an agent collecting and remitting sales or use tax from a customer. Comparing the burdens between the two taxes, this fact alone argues forcefully against the conclusion that the obligation to collect use tax

creates the heavier burden. *See*, *e.g.*, *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 557-58 (1977) (distinguishing burdens imposed by direct taxes – such as income taxes – and use tax collection responsibilities).

Nor is it clear that sales and use taxes are necessarily imposed by more taxing jurisdictions. One 2007 survey documented approximately 3,300 state and local tax jurisdictions that levy income, franchise and gross receipts taxes.[14] In those jurisdictions, taxpayers must contend with a multitude of unique laws and requirements which vary widely in such matters as types of returns, types of entities subject to tax (including limited liability companies, partnerships, S corporations and other pass-through entities), filing and payment requirements and the like. These taxing jurisdictions mandate different additions to and subtractions from adjusted gross federal income to build locally-specific tax bases that vary both from federal taxable income and from one another. The states also employ unique formulas to claim their respective shares of multistate income and apply distinct rules for calculating the factors used to apportion such income.

The abandonment of the "physical presence" standard would subject businesses to these and thousands of additional complexities, to say nothing of the attendant audits, protests, appeals and

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[14] *State and Local Jurisdictions Imposing Income, Franchise and Gross Receipts Taxes on Businesses*, Ernst & Young, LLP, March 7, 2007.

litigation, in jurisdictions maintaining the right to tax based upon some locally-nuanced "economic presence" test.

The Commerce Clause Demands a Single Nexus Standard

Furthermore, giving "substantial nexus" different meanings, depending upon the tax in question and the state imposing the tax, lacks a principled foundation. Sales and use taxes are surely not unique at the constitutional level. If Commerce Clause "concerns about the effects of state regulation upon the national economy" and the operation of "substantial nexus" as "a means for limiting state burdens upon interstate commerce,"[15] embrace such unlikely distinctions, it is not because logic dictates that result.

The "economic nexus" contention fails to square with the Court's directive that the Commerce Clause be applied upon the basis of the "practical effect" of the tax.[16] Any effort to distinguish a use tax as an "indirect" tax from an income tax as a "direct" levy would be a step backwards to the type of semantic formalism the Court has definitively repudiated. *Complete Auto Transit*, 430 U.S. at 288-89.

Finally, the sanctioning of two drastically different constitutional meanings of "substantial nexus," one for sales and use taxes and a second for state income taxes, patently invites the formulation

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[15] *Quill*, 504 U.S. at 313.
[16] *Complete Auto Transit,* 430 U.S. at 279.

of additional jurisdictional standards for other taxes. The rationale by which an alternative standard is adopted for state income taxation would invite more rigorous or relaxed thresholds for other types of taxes, predicated upon asserted differences between the nature and quantum of burdens they impose. The proliferation of such alternative formulations, with a third "substantial nexus" test for sundry flat taxes, a fourth for a Texas Margins Tax, TEXAS TAX CODE ANNOTATED section 171.0001 *et seq.*, another for an Ohio Commercial Activity Tax, OHIO REVISED CODE ANNOTATED section 5751.01 *et seq.*, another for the Michigan Business Tax, MICHIGAN COMPILED LAWS ANNOTATED section 208.1101 *et seq.*, and the like, is a virtually certain offspring of that first step away from the single "bright-line" test thus far articulated. The Court should grant the Petition and take this opportunity to say what it has not made explicit to this point—that the same salutary purposes which are served by using the "physical presence" standard for sales and use taxes are present when delimiting the power of state and local governments to impose income and other taxes.

"Substantial Nexus" is Not a Test of Contacts

The "economic presence" test mistakenly focuses on the contacts between the subject business and the state, rather than on the burdens imposed upon interstate commerce. The "substantial nexus" requirement, however, is not a test of contacts; the sufficiency of such contacts is the concern of the Due Process Clause. But the "economic presence"

standard merely duplicates the due process inquiry and goes no further.[17] It also effectively reduces the "substantial nexus" prong of *Complete Auto Transit* to a rehash of the fourth prong (*i.e.*, whether the tax is fairly related to services provided by the state). *E.g.*, *KFC*, 792 N.W.2d at 328 ("We hold that, by licensing franchises within Iowa, KFC has received the benefit of an orderly society within the state and, as a result, is subject to the payment of income taxes that otherwise meet the requirements of the dormant Commerce Clause").

Rather than merely repeating due process protections, the Court has made clear that "substantial nexus" is "*a means for limiting state burdens on interstate commerce*." *Quill* 504 U.S. at 313 (emphasis added). The "economic presence" analysis of the West Virginia court in *Tax Comm'r v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W.Va. 2006), *cert. denied sub nom., FIA Card Services N.A. v. Tax Comm'r*, 551 U.S. 1141 (2007), also reflected by the Massachusetts court in *Capital One Bank v. Comm'r of Revenue*, 899 N.E.2d 76 (Mass. 2009), *cert. denied*, 129 S. Ct. 2827 (2009) and the Iowa court below, is fundamentally flawed because it forsakes any inquiry into the burden that the levied tax imposes upon the national economy:

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[17] As Justice Rutledge observed in *Int'l Harvester Co. v. Dep't of Treasury,* 322 U.S. 340, 353 (1944): "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." (quoted in *Quill*, 504 U.S. at 305-06).

> Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. *See generally* THE FEDERALIST Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause.

Quill, 504 U.S. at 312. The economic nexus principle entirely disregards such structural concerns and ignores the resulting burdens imposed on interstate commerce.

As this Court recognized in *Quill*, physical presence is a "bright-line rule [that] furthers the ends of the dormant Commerce Clause." 504 U.S. at 314. The test is equitable, simple for a business of any size to comprehend and predict, and easy to enforce. Importantly, the test also favors economic growth. It allows a taxpayer to report and pay taxes in fewer states, which means less money spent complying with tax laws and in litigation and more money to invest in labor and capital. Further, it permits a business to determine with confidence, before entering a jurisdiction, whether it will be subject to taxation and the costs associated with doing business there. The test thus accommodates the concerns of "substantial nexus" for the health and integrity of a *national* economy.

The Practical Effect of Economic Nexus Undermines Commerce Clause Principles

In contrast, as a practical matter, the so-called economic presence "test" is no test at all. The standard adopted by the court below is particularly amorphous and would allow states to impose income taxes upon out-of-state taxpayers that merely earn receipts from customers in a state. The resulting burdens upon interstate commerce will only increase as more states see the potential to expand their tax bases by adopting some variety of "economic presence" as the only limit on their taxing authority. *See e.g.*, MAINE TAX ALERT, Vol. 18, No. 2, (Feb. 2008) ("[Maine Revenue Services] considers taxpayers with economic nexus alone to be subject to Maine's income tax laws"); Or. Admin. R. 150-317.010(2) (2011) ("'Substantial nexus' exists where a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer and may be established through the significant economic presence of a taxpayer in the state") The effects on small businesses would be particularly severe.

Supporters of an "economic presence" standard argue that businesses benefit from the existence of a viable economic market in the states in which they have customers, and thus should be expected to pay income taxes there. This argument illustrates that "economic presence" seeks nothing more than to exact a toll for making individual state economies part of the national marketplace for goods and services.

The taxation of non-resident individuals and entities is not easily restrained by political processes within the taxing state, as a state has every incentive to export its tax burden and interpret its laws aggressively to reach as many out-of-state taxpayers as possible. The "economic presence" theory is such an attempt to ignore state boundaries in the zeal to find new revenue sources. It would render a state's borders meaningless where taxation is concerned.

Physical presence, by contrast, confines a state's taxing powers to its borders, circumscribing the reach of a tax to businesses that, by reason of their presence, are significantly adding costs that government would not otherwise incur. The Court should grant the Petition for the purpose of putting an end to this much-litigated debate, repudiate the "economic nexus" theory, and make explicit the requirement of physical presence under the "substantial nexus" prong of the Commerce Clause for all taxes.

CONCLUSION

For the foregoing reasons, this Court should grant the Petition and reverse the decision below.

Respectfully submitted,

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May 31, 2011

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