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Hayes R. Holderness

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NAVIGATING 21ST CENTURY TAX JURISDICTION

HAYES R. HOLDERNESS*

ABSTRACT

Hailed as a massive victory for the states, the Supreme Court's 2018 decision in South Dakota v. Wayfair, Inc. *brought dated state tax jurisdiction standards into the twenty-first century, freeing the states to tax internet vendors. However, the decision left the larger state tax jurisdiction doctrine undertheorized and at a crossroads: Should the doctrine concern itself only with notice and fairness issues akin to those found in the due process personal jurisdiction realm, or should it also concern itself with protecting interstate commerce from undue state tax burdens?*

This Article will argue for the latter path by developing a robust theory of state tax jurisdiction that focuses on the potential undue burdens of tax compliance costs, burdens a threshold jurisdictional standard is uniquely able to address. From this compliance burden theory emerges a jurisdictional standard which would protect interstate commerce—particularly the activities of small businesses and entities that facilitate the commerce of others, such as online marketplaces, payment intermediaries, and common carriers—from the chilling effects of heavy state tax compliance costs. This Article will conclude by demonstrating how unanswered questions from Wayfair *provide opportunities to incorporate the proposed standard into the state tax jurisdiction doctrine, detailing the way forward from* Wayfair.

* Assistant Professor of Law, University of Richmond School of Law. My sincerest gratitude to those who have offered their time, energy, and insight to help improve this Article: Andrew Appleby, Jud Campbell, Erin Collins, Paul Crane, Jessica Erickson, Jim Gibson, Kevin Walsh, Corinna Lain, Luke Norris, Rick Pomp, Jack Preis, Danny Schaffa, Darien Shanske, Allison Tait, and Adam Thimmesch. Thanks also to the participants in the 2018 Junior Tax Scholars Conference at the University of Colorado Law School and to the faculty of the Temple University Beasley School of Law for their rigorous workshopping of this Article. Finally, for her excellent research, I owe a great deal of appreciation to Sherfón Coles-Williams.

INTRODUCTION

"So how many sales does it take?" Justice Sotomayor asked during oral arguments for *South Dakota v. Wayfair, Inc.*,[1] the landmark 2018 decision in which the Supreme Court reconsidered decades of doctrine regarding state tax power.[2] Justice Sotomayor was trying to discern when an out-of-state vendor would have a constitutionally-sufficient connection with a state such that the state could tax the vendor. The South Dakota Attorney General's answer? "[O]ne sale."[3] Internet vendors and small businesses shuddered;[4] South Dakota's position could have exposed them to a wealth of new state tax obligations.

For its part, the *Wayfair* majority skirted Justice Sotomayor's question and instead concluded that the constitutionally-sufficient connection—termed "nexus"[5]—exists when the taxpayer[6] purposefully "'avails itself of the substantial privilege of carrying on business' in that jurisdiction."[7] Students of due process personal jurisdiction doctrine perked up, but their excitement should be tempered. The *Wayfair* Court was articulating a nexus standard imposed by the dormant Commerce Clause, not the Due Process Clause,[8] and the state tax jurisprudence has recognized that the two clauses address different concerns.[9] The Due Process Clause is concerned with fundamental notions of fairness and with providing taxpayers notice of state tax

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1. 138 S. Ct. 2080 (2018).

2. Transcript of Oral Argument at 6, South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) (No. 17-494).

3. *Id*. at 6.

4. Justice Breyer has expressed concerns about state jurisdiction over small sellers a number of times, invoking the examples of a small mandolin seller and an Appalachian potter. *See* J. McIntyre Machinery, Ltd. v. Nicastro, 564 U.S. 873, 891–92 (2011) (Breyer, J., concurring); Transcript of Oral Argument, *supra* note 2, at 36–37.

5. *See, e.g.*, Walter Hellerstein, *A Primer on State Tax Nexus: Law, Power, and Policy*, 55 ST. TAX NOTES 555, 555 (2010).

6. For ease of discussion, this Article will refer to a person on whom a state is attempting to place an obligation either to collect or to pay a tax as a "taxpayer." The Supreme Court has applied the same jurisdictional rules to both tax collectors and taxpayers in the case law. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 319 (1992) (Scalia, J., concurring) ("As an original matter, it might have been possible to distinguish between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State, but we have rejected that.").

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

8. For ease of discussion, the Article refers to the Due Process Clause of the Fourteenth Amendment as the Due Process Clause. Likewise, references to due process concerns address concerns arising under the Due Process Clause of the Fourteenth Amendment, not that of the Fifth Amendment.

9. *See Quill Corp.*, 504 U.S. at 305 ("[T]he Clauses pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause.").

power over them; the dormant Commerce Clause is concerned with protecting against the "economic Balkanization" of the states.[10]

The *Wayfair* majority's due-process-esque dormant Commerce Clause nexus standard is symptomatic of one of the state tax jurisprudence's core problems: The nexus concept is complicated and confusing. This confusion manifests throughout the development of the case law, which has led to a complicated array of nexus requirements. There is a due process nexus requirement that appears to track the due process personal jurisdiction requirement,[11] and there is a dormant Commerce Clause nexus requirement that bifurcates into requiring both a state connection with the taxpayer and a state connection with the activity taxed.[12] Adding further to the complexity, the standards for both aspects of the dormant Commerce Clause nexus requirement have been undertheorized and underdeveloped in the case law, leading to decisions turning on conclusory statements about when the standards are satisfied. This Article will tackle these problems in order to provide coherence to the dormant Commerce Clause nexus doctrine.

Not to sell the decision short, *Wayfair* did provide some measure of coherence to the doctrine by scraping a questionable, but longstanding, dormant Commerce Clause nexus standard requiring a taxpayer's physical presence in the taxing state. This physical presence rule had prevented the states from requiring internet vendors like Amazon.com to collect their sales taxes, which was a major source of frustration for the states.[13] Despite bringing the dormant Commerce Clause nexus standard into the twenty-first century, *Wayfair* did little to address larger confusions over the dormant Commerce Clause nexus requirement. In particular, the opinion passed up opportunities to give meaning to its nexus standard and to better explain the relationship between the due process nexus requirement and the dormant Commerce Clause nexus requirement.[14] In short, *Wayfair* left the dormant Commerce

10. *Wayfair*, 138 S. Ct. at 2089; *Quill Corp.*, 504 U.S. at 312.

11. *See Quill Corp.*, 504 U.S. at 306–08 (discussing the due process nexus requirement).

12. This Article refers to the two aspects of the dormant Commerce Clause nexus requirement respectively as "personal nexus"—nexus with the taxpayer—and "transactional nexus"—nexus with the activity taxed. Others have used different terms to refer to the same concepts. *See* Arthur R. Rosen & Marc D. Bernstein, *State Taxation of Corporations: The Evolving Danger of Attributional Nexus*, 41 TAX EXECUTIVE 533, 534 (1989) (referring to the concepts as "presence nexus" and "transactional nexus"); *accord* Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 3 (2003) (referring to the concepts as "enforcement jurisdiction" and "substantive jurisdiction").

13. *See* Hayes R. Holderness, *Taking Tax Due Process Seriously: The Give and Take of State Taxation*, 20 FLA. TAX REV. 371, 402–04 (2017).

14. The lack of clarity regarding the relationship between the Due Process Clause and the dormant Commerce Clause in jurisdictional settings is not limited to the area of state taxation. *See generally* John F. Preis, *The Dormant Commerce Clause as a Limit on Personal Jurisdiction*, 102 IOWA L. REV. 121 (2016) (analyzing the relationship between the dormant Commerce Clause and the Due Process Clause in the context of personal adjudicative jurisdiction).

Clause nexus doctrine in an unhelpful limbo by failing to provide a clear path forward for the doctrine.

This failure has predictably spurred commentary attempting to sort out the decision's meaning, but the commentary has not fully addressed the significant crossroads for the dormant Commerce Clause nexus doctrine that *Wayfair* created.[15] Two paths diverge from the *Wayfair* crossroads, either of which the decision can be read to support: The dormant Commerce Clause nexus standard might collapse into the due process personal jurisdiction standard, or it might be strengthened into a standard that addresses in earnest the threat of economic Balkanization that the dormant Commerce Clause targets. Should the dormant Commerce Clause nexus standard be allowed to collapse into the due process personal jurisdiction standard, many taxpayers would face uncertain and potentially burdensome state tax obligations, which may chill their willingness to engage in interstate commerce.[16] Taxpayers of particular concern are small businesses and entities that facilitate the commerce of others such as online marketplaces like Amazon Marketplace and eBay, payment intermediaries like MasterCard and Visa, and common carriers like FedEx and UPS.

To prevent these harms and realize the dormant Commerce Clause's goal of protecting the national economy from unduly burdensome state actions, the *Wayfair* crossroads must be navigated carefully. Doing so demands a robust theory of the dormant Commerce Clause nexus requirement to guide the doctrine forward. This Article will seize on the opportunity presented by *Wayfair* and will develop such a theory—the "compliance burden theory"—as well as the standard that follows from that theory. While others have theorized the dormant Commerce Clause nexus requirement in the past,[17] this

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15. *E.g.*, Jaye Calhoun & William J. Kolarik II, *Implications of the Supreme Court's Historic Decision in* Wayfair, 89 ST. TAX NOTES 125 (2018); Michael T. Fatale, Wayfair, *What's Fair, and Undue Burden*, 90 ST. TAX NOTES 857 (2018); Billy Hamilton, Wayfair *Emotional Support*, 89 ST. TAX NOTES 1067 (2018); Walter Hellerstein & Andrew Appleby, *Substantive and Enforcement Jurisdiction in a Post-*Wayfair *World*, 90 ST. TAX NOTES 283 (2018); Richard D. Pomp, Wayfair *and the Myth of Substantial Nexus*, 36 J. ST. TAX'N 27 (2018); Jeffery S. Reed, *What Is the New Constitutional Test After* Wayfair*?*, 89 ST. TAX NOTES 335 (2018). Adam Thimmesch, Darien Shanske, and David Gamage have examined major implications of the decision in an informative series of articles. *See* Darien Shanske et al., Wayfair*: Marketplaces and Foreign Vendors*, 90 ST. TAX NOTES 111 (2018); Adam Thimmesch et al., Wayfair*: Sales Tax Formalism and Income Tax Nexus*, 89 ST. TAX NOTES 975 (2018) [hereinafter Thimmesch et al., *Sales Tax Formalism*]; Adam Thimmesch et al., Wayfair*: Substantial Nexus and Undue Burden*, 89 ST. TAX NOTES 447 (2018) [hereinafter Thimmesch et al., *Substantial Nexus*]. Others have considered implications of the decision outside of the tax law. *See* Allan Erbsen, Wayfair *Undermines* Nicastro*: The Constitutional Connection Between State Tax Authority and Personal Jurisdiction*, 128 YALE L.J.F. 724 (2019).

16. Professor Preis makes a similar argument in the context of personal adjudicative jurisdiction based on the registration of a business in a state; though the Due Process Clause may be satisfied, such exercises of jurisdiction over interstate businesses could prevent those businesses from registering in the state or from entering the state at all. *See* Preis, *supra* note 14, at 144–54.

17. *See, e.g.*, David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 498–503 (2012) (arguing that the dormant Commerce Clause

Article is the first to incorporate the lessons from *Wayfair* into the theory and to develop a post-*Wayfair* standard from that theory.

The compliance burden theory is realized by returning to the fundamental principle driving the dormant Commerce Clause doctrine: the protection of interstate commerce from undue burdens of state actions. This Article asks what role, if any, a threshold nexus requirement should play in fulfilling this principle in the context of state taxation. A state tax might burden interstate commerce through a high tax rate, a distorted tax base, or heavy tax compliance costs.

Established guardrails protect interstate commerce from unduly burdensome tax rates and tax bases, but heavy tax compliance costs present a different breed of problem for interstate commerce. Tax compliance costs include the labor and systems required to ensure taxes are correctly paid, the ability to access funds to pay the tax, and the costs and risks associated with handling audits by state revenue departments.[18] These costs are relatively flat; they hit interstate commerce immediately once a state tax is imposed and change little as the amount of the activity taxed increases.[19]

A threshold nexus inquiry is uniquely situated to protect interstate commerce from the burden of tax compliance costs by preventing the taxing state from imposing a tax (and thus the tax compliance costs) on interstate commerce until the amount of activity in the state is profitable enough to cover the compliance costs. From this conclusion arises the compliance burden theory. The theory requires the dormant Commerce Clause nexus requirement to target tax compliance costs,[20] rather than simply collapsing into the

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nexus requirement is concerned about the excess burden placed on interstate taxpayers subject to multiple tax compliance regimes); Hayes R. Holderness, *Questioning* Quill, 37 VA. TAX REV. 313, 331–39 (2018) (offering a rationale for the physical presence rule based on the taxpayer's ability to access funds from the activity taxed); Richard D. Pomp, *Revisiting* Miller Brothers, Bellas Hess, *and* Quill, 65 AM. U. L. REV. 1115, 1144–45 (2016) (offering a political rationale for the dormant Commerce Clause nexus requirement in that it allowed the Supreme Court to pass the issue to Congress); Edward A. Zelinsky, *Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause*, 28 VA. TAX REV. 1, 4 (2008) (offering a political-voice-based justification for the dormant Commerce Clause nexus and apportionment regimes).

18. *See infra* note 180.

19. *See infra* note 181.

20. Other commentators have reached a similar conclusion pre-*Wayfair*. *See* Gamage & Heckman, *supra* note 17, at 497 ("[T]he burden on interstate commerce that troubled the Court in *Quill* arises solely from the potential for remote vendors to be subject to excess tax compliance costs."); John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century*, 38 GA. L. REV. 343, 361–64 (2003) (arguing for the *Quill* Court's concern with cumulative tax compliance burdens on multistate taxpayers); Adam B. Thimmesch, *A Unifying Approach to Nexus Under the Dormant Commerce Clause*, 116 MICH. L. REV. ONLINE 101, 110–12 (2018) (discussing dormant Commerce Clause issues presented by cumulative tax compliance burdens). However, those commentators' analyses differ from this Article because they argue the substantial nexus requirement is concerned with the cumulative burden of multiple taxing jurisdictions placing tax compliance costs on interstate commerce, whereas this Article argues such cumulative

due process personal jurisdiction standard. The answer to Justice Sotomayor's question—"So how many sales does it take?"[21]—is that it depends on the profitability of the sales and the difficulty of complying with the state tax.

This Article will make the case for aligning the dormant Commerce Clause nexus doctrine with the compliance burden theory in order to ensure that interstate commerce is appropriately protected from the burdens of state taxes. First, Part I will provide the necessary background to understand the challenges and opportunities that the historical dormant Commerce Clause nexus case law presents for developing the nexus doctrine in this way. That discussion will culminate in an exploration of the crossroads at which *Wayfair* has left the dormant Commerce Clause nexus doctrine.

Part II, then, will map out in detail the compliance burden theory and the standard that follows from that theory before Part III will provide the path forward for the dormant Commerce Clause nexus doctrine. This path forward is illustrated by looking ahead to litigation expected to spawn from the questions left unanswered by *Wayfair*. For instance, many states are expanding their sales tax collection laws to apply to marketplaces that connect vendors to consumers, such as Amazon Marketplace and eBay. Anticipated challenges to these unprecedented expansions of state tax power provide opportunities to build on *Wayfair* by articulating a clearer dormant Commerce Clause nexus standard than *Wayfair* did.

With the case for a dormant Commerce Clause nexus doctrine that meaningfully focuses on tax compliance costs having been laid out, Part IV will conclude. The *Wayfair* case marks a high point for coherence in the evolution of the dormant Commerce Clause nexus doctrine and presents an opportunity for continued growth. As this Article will demonstrate, this opportunity must be seized upon rather than risk harms to interstate commerce resulting from an unclear and untargeted dormant Commerce Clause nexus standard.[22]

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burdens are not the proper focus of the substantial nexus requirement. *See infra* notes 186–194 and accompanying text.

21. *See* Transcript of Oral Argument, *supra* note 2, at 6.

22. Those versed in state taxation may be surprised to find no mention of the term "substantial nexus" in this Introduction. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992) (claiming the dormant Commerce Clause requires a "substantial nexus" with the taxing state before the state may impose tax on someone or something); *see also infra* notes 34–44 and accompanying text (discussing the "substantial nexus" term). Some who argue that the "substantial nexus" term is meaningless and should be abandoned, see, for example, Pomp, *supra* note 15, at 29, may be pleased by this omission. This Article avoids the term for much of the discussion in order to avoid obscuring the analysis, which is not dependent on labels. However, the Article does maintain that the "substantial nexus" term, whether meaningless before or not, provides a clear—if not necessary—place to locate the dormant Commerce Clause's threshold jurisdiction inquiry and offers insight into how courts might do so in the future. *See infra* Part III.

I. DORMANT COMMERCE CLAUSE NEXUS AND *WAYFAIR*

When a state attempts to impose a tax, the first legal question is often, "Is there nexus?" "Nexus" is a term of art in the state tax jurisprudence which refers to the constitutionally-sufficient connection a state needs with the thing it would like to subject to tax.[23] Without the appropriate nexus, the state lacks the power to tax. As straightforward as the basic concept may seem, nexus doctrine has developed into a complex muddle. This Part first provides an overview of the law on nexus and then turns to how *Wayfair* affected that law, all to provide the necessary background for the analysis that follows.

A. Dormant Commerce Clause Nexus Before Wayfair

During most of the historical state tax jurisprudence, the Supreme Court recognized that the U.S. Constitution imposes a nexus requirement on state taxes but located that requirement in the Due Process Clause and the Commerce Clause together.[24] As a result, cases appeared to turn on different applications of the nexus requirement; some applications bent more towards due process fairness and notice rationales while others bent more towards preventing undue burdens on interstate commerce.[25] The resulting "quagmire" of law did not go unnoticed by the Court.[26]

In 1992's *Quill Corp. v. North Dakota*,[27] the Supreme Court addressed this quagmire by engaging in the unprecedented splitting of the Due Process Clause and the dormant Commerce Clause analyses of nexus.[28] According to the *Quill* Court, this split was appropriate because of the different natures of the inquiries under each clause.[29]

As explained in *Quill*, the Due Process Clause demands that a taxing state have nexus with the person it seeks to tax.[30] The basic rationales for the due process nexus requirement are to ensure the fundamental fairness of state taxation and to ensure the taxpayer has notice of the state's tax jurisdiction

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23. *See, e.g.*, Hellerstein, *supra* note 5, at 555.

24. *Quill*, 504 U.S. at 305 ("[A]lthough we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct."); *see also* Pomp, *supra* note 17, at 1149 ("Prior to *Quill*, the Court never had any reason to specify whether a nexus decision was grounded on one clause or the other.").

25. *See, e.g.*, *infra* note 55 (comparing two cases with similar fact patterns which were decided by invoking different constitutional concerns).

26. *See Quill*, 504 U.S. at 315–16 (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457–58 (1959) ("[O]ur 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.'").

27. 504 U.S. 298 (1992).

28. *Id*. at 313. For a thorough analysis of the *Quill* decision and its flaws, see Pomp, *supra* note 17, at 1141–54.

29. *Quill*, 504 U.S. at 305–06.

30. *Id*. at 312.

over them.[31] This due process nexus requirement is satisfied, the Supreme Court has explained, when the taxpayer purposefully avails themself of the state's marketplace and the state provides some benefit in return to the taxpayer.[32] For the most part, the due process nexus standard maps on to the due process standard for personal jurisdiction, which considers whether the person has "minimum contacts" with the state.[33] Although the due process nexus requirement is not the focus of this Article, it does provide an important contrast to the nexus requirement of the dormant Commerce Clause.

According to the *Quill* Court, the dormant Commerce Clause requires something different than the Due Process Clause: a "substantial nexus."[34] The *Quill* Court gleaned this substantial nexus requirement from the 1977 *Complete Auto Transit, Inc. v. Brady*[35] case, but it was not clear that the *Complete Auto* Court thought the term "substantial nexus" had legal significance.[36] The term first appeared in the tax case law in *Complete Auto*,[37] and the *Complete Auto* Court casually interchanged "substantial nexus" with the term "sufficient nexus" throughout the opinion.[38]

Despite the term's history, the *Quill* Court did little to clarify the meaning of "substantial nexus"—so little that some commentators have argued that the term should be recognized as problematic and abandoned.[39] However, the Court did offer an explanation of the driving force behind this dormant Commerce Clause nexus requirement: "structural concerns about the effects of state regulation on the national economy."[40] For the first time in the jurisprudence, the Court explicitly set the dormant Commerce Clause

31. *Id*.

32. *See* Holderness, *supra* note 13, 402–04 (exploring the requirements of the due process nexus).

33. *Quill*, 504 U.S. at 306–08 (finding that due process nexus considerations are "comparable" to due process personal jurisdiction considerations).

34. *Id*. at 311 ("[W]e will sustain a tax against a Commerce Clause challenge so long as the 'tax . . . is applied to an activity with a *substantial nexus* with the taxing State . . . .'" (emphasis added) (quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977))).

35. 430 U.S. 274 (1977).

36. *Id*. at 279.

37. Pomp, *supra* note 17, at 1147.

38. *See id. Compare Complete Auto*, 430 U.S. at 279 ("These decisions . . . have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."), *with Complete Auto*, 430 U.S. at 285 ("[T]he Court held that net income from the interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the tax.").

39. *See* Pomp, *supra* note 17, at 1144–45 (arguing that the "substantial nexus" term is problematic in part because the term was not intended to have the meaning ascribed to it by the *Quill* Court, which utilized the term as a tool for the Court to split the nexus analysis to allow Congress to overturn the physical presence rule).

40. Quill Corp. v. South Dakota, 504 U.S. 298, 312 (1992).

limitations on state tax power apart from those of the Due Process Clause.[41] The Court also observed that the standards are "not identical" and "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."[42]

Finally, the *Quill* Court appeared to effectively recognize two aspects of this dormant Commerce Clause substantial nexus requirement by asking whether the "tax . . . is applied to an activity with a substantial nexus with the taxing State" and by examining whether the taxpayer had a physical presence in the taxing state.[43] This Article refers to these two aspects of the substantial nexus requirement respectively as "personal nexus"—nexus with the taxpayer—and "transactional nexus"—nexus with the activity taxed.[44] The following chart provides a visual summary of the various nexus requirements discussed above.[45]

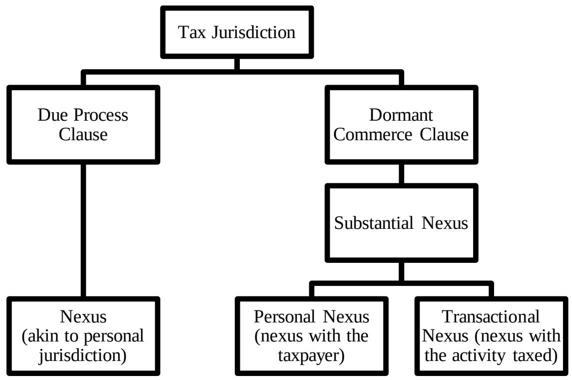
41. *See supra* note 28.

42. *Quill*, 504 U.S. at 305. Many commentators have argued that the substantial nexus standard should not impose a higher bar on states than the due process nexus standard. *See, e.g.*, Jesse H. Choper & Tung Yin, *State Taxation and the Dormant Commerce Clause: The Object-Measure Approach*, 1998 SUP. CT. REV. 193, 213 (1998) ("We do not interpret the Commerce Clause to require a separate nexus more stringent than that imposed by the Due Process Clause because that is not required to further protect interstate commerce against state taxes that accord a preference to local enterprises."); Rick Handel, *A Conceptual Analysis of Nexus in State and Local Taxation*, 67 TAX LAW. 623, 630 (2014) ("If the Due Process Clause requires certain minimum contacts with a state, the Commerce Clause does not require a greater number of contacts."); Adam B. Thimmesch, *The Illusory Promise of Economic Nexus*, 13 FLA. TAX REV. 157, 188–91 (2012) (discussing "[t]he [g]ratuitous [e]levation of the Commerce Clause over the Due Process Clause").

43. *See* Holderness, *supra* note 17, at 330–31. *Compare Quill*, 504 U.S. at 311 (citing the *Complete Auto* test, which includes the transactional nexus requirement, with approval), *with Quill*, 504 U.S. at 317–18 (upholding the requirement that the taxpayer have a physical presence in the taxing state in order to create substantial nexus).

44. *See supra* note 12.

45. As the following discussion lays bare, the nexus concepts are not neat and tidy. Readers should be cautious of allowing the tidiness of this chart to bleed into their understanding of the nexus concepts. Instead, the chart offers a high-level view of the types of nexus issues that have arisen in the jurisprudence; often it is difficult to carve out the limits of the nexus issues or to avoid overlap of the issues.



The following two subsections separately explore the history behind the personal nexus and transactional nexus aspects of the substantial nexus requirement to provide the background necessary to evaluate the impact of *Wayfair* on the dormant Commerce Clause nexus doctrine.

1. Personal Nexus

Although the personal nexus aspect of the substantial nexus requirement was first explicitly recognized in *Quill*,[46] the roots of the aspect are found in pre-*Quill* case law,[47] particularly 1967's *National Bellas Hess, Inc. v. Department of Revenue of Illinois*.[48] In *Bellas Hess*, the Supreme Court considered whether Illinois had the authority to require an out-of-state vendor to collect sales and use taxes on mail order sales to the state's residents.[49] The company had no physical location or employees in the state, accepted the orders outside of the state, and delivered them into the state through common carrier.[50] The company's only arguable physical presence in Illinois appeared to be the catalogues that it mailed to potential customers.[51]

Considering these facts, the *Bellas Hess* Court declared:

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46. 504 U.S. at 309–18 (discussing the personal nexus requirement).

47. Prior to *Quill*, the Court's tendency to refer to both the Due Process Clause and the dormant Commerce Clause together when discussing nexus obscured the source of the personal nexus requirement, and it might have been argued that such connections were solely due process concerns. *See, e.g.*, Int'l Harvester Co. v. Dep't of Treasury, 322 U.S. 340, 356–58 (1944) (Rutledge, J., dissenting in part, concurring in part) (arguing that both the origin states and market states in the *Dilworth* and *General Trading Co.* cases should have jurisdiction to tax under the Due Process Clause, and that the dormant Commerce Clause is concerned with more substantive effects of the taxes at issue). Such arguments continued to be made after *Quill*. Professor Pomp cautions against such arguments given the lack of clarity from the decisions. Pomp, *supra* note 17, at 1149–50.

48. 386 U.S. 753 (1967).

49. *Id*. at 754. Professor Pomp provides an expert dissection of the *Bellas Hess* case in Pomp, *supra* note 17, at 1133–40.

50. *Bellas Hess*, 386 U.S. at 754–55.

51. *Id*.

> In order to uphold the power of Illinois to impose use tax burdens on National [Bellas Hess] in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.[52]

In this way, the *Bellas Hess* Court displayed concern over the type of connection a potential taxpayer has with the taxing state—a concern over the scope of the personal nexus requirement. By drawing a line between mail order vendors and brick and mortar retailers, the Court indicated the personal nexus requirement could be, and perhaps must be, satisfied by the physical presence of the taxpayer.[53]

Although it is risky to characterize pre-*Quill* nexus decisions as addressing due process requirements or dormant Commerce Clause requirements because the cases rarely addressed the clauses separately,[54] the dormant Commerce Clause concerns underpinning the *Bellas Hess* decision are clear.[55] In

52. *Id*. at 758 (footnote omitted).

53. The *Bellas Hess* Court's view of the taxpayer's physical presence as a necessary condition for personal nexus is unclear because the Court relied on cases where the taxpayer was physically present in the taxing state for its position in *Bellas Hess*. *See* Holderness, *supra* note 17, at 353 (explaining that the *Bellas Hess* Court appropriately observed that its prior decisions had not found personal nexus with a taxpayer lacking a physical presence in the state but failed to contextualize this observation by noting that all but one of those decisions involved taxpayers physically present in the taxing states).

54. Pomp, *supra* note 17, at 1149–50.

55. *Bellas Hess* may be characterized as expressing dormant Commerce Clause concerns by comparing it to another case with similar substantive facts, *Miller Brothers Co. v. Maryland*. 347 U.S. 340 (1954). *Miller Brothers* involved Maryland's effort to require a Delaware-based store to collect Maryland's use tax on products the store sold to Maryland residents in Maryland. *Id*. at 341–42. As relevant here, the Miller Brothers business had no physical location or employees in Maryland, accepted the orders in question in Delaware, and delivered them into the state through common carrier. *Id*. The relevant difference between *Miller Brothers* and *Bellas Hess* is that the Miller Brothers were found not to have systematically exploited the Maryland marketplace, unlike National Bellas Hess's efforts to make sales into Illinois. *Compare id*. at 347 ("Here was no invasion or exploitation of the consumer market in Maryland."), *with Bellas Hess*, 368 U.S. at 754–55 ("Twice a year catalogues are mailed to the company's active or recent customers throughout the Nation, including Illinois. This mailing is supplemented by advertising 'flyers' which are occasionally mailed to past and potential customers.").

Because of Miller Brothers' lack of exploitation of the Maryland marketplace, the Court held that Maryland had no tax jurisdiction over the business and further stated that "we need not consider whether the statute imposes an unjustifiable burden upon interstate commerce." *Miller Bros.*, 347 U.S. at 347. Thus, viewed in today's terms, the *Miller Brothers* decision not only invoked due process standards of purposeful availment in reaching its decision, it also specifically stated that the dormant Commerce Clause inquiry was moot. *Miller Brothers* must be understood as a due process reaching its decision, the *Bellas Hess* Court observed, "The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [National Bellas Hess'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.'"[56] This concern for the burden on National Bellas Hess's *interstate business* echoed the concerns of the dormant Commerce Clause, not the notice and fairness concerns of the Due Process Clause.[57]

In 1992, *Quill* advanced the personal nexus doctrine from *Bellas Hess* in a number of ways. After explicitly separating the substantial nexus requirement from the due process nexus requirement and articulating the personal nexus aspect of substantial nexus,[58] the *Quill* Court clarified that the physical presence rule it derived from *Bellas Hess*—a taxpayer must have a physical presence in a state before the state can require it to collect sales and use taxes[59]—was housed under the dormant Commerce Clause personal nexus aspect.[60]

Perhaps most important to the post-*Wayfair* world, the *Quill* Court also articulated the different motivations for the two nexus inquires. The Court explained that "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce."[61] In a footnote, the Court described how a tax might unduly burden interstate commerce:

> [A]bsent the [physical presence] rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose

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nexus case. In contrast, the *Bellas Hess* Court could not have relied solely on due process considerations to deny Illinois's jurisdiction over the taxpayer because National Bellas Hess was actively exploiting the Illinois marketplace.

One difficulty in comparing the two cases is that the Miller Brothers Company did target Maryland customers in similar ways as National Bellas Hess targeted Illinois customers. *See Bellas Hess*, 368 U.S. at 758 ("[In *Miller Brothers*,] the seller advertised its wares to Maryland residents through newspaper and radio advertising, in addition to mailing circulars four times a year. As a result, it made substantial sales to Maryland customers, and made deliveries to them by its own trucks and drivers."). To accept the point made here in this Article, one must accept the *Miller Brothers* Court's questionable legal determination that there was no exploitation of the Maryland market by the store. The *Bellas Hess* Court did not make such a finding in its decision and strangely attempted to distinguish the *Miller Brothers* conclusion as being about how much of the commerce was interstate commerce. *Id*. at 759.

For further dissection of the *Miller Brothers* case, the faults within it, and what might have been, see Pomp, *supra* note 17, at 1121–32.

56. *Bellas Hess*, 386 U.S. at 759–60 (footnotes omitted) (quoting Freeman v. Hewitt, 329 U.S. 249, 253 (1946).

57. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992) (detailing the concerns of the Due Process Clause and the dormant Commerce Clause).

58. *See supra* notes 28–43 and accompanying text.

59. *Quill*, 504 U.S. at 317.

60. *Id*. at 318.

61. *Id*. at 313.

> radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the [use tax] collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions.[62]

In short, tax obligations resulting from small connections with the taxing state troubled the Court, as did the potential for such obligations to spread across the country if North Dakota's law was upheld. However, the underlying nature of the Court's concerns remained somewhat obscure after *Quill*. Perhaps the administrative costs to an interstate taxpayer of complying with tax regimes were at the core of the concerns,[63] or perhaps the Court was anxious about the overall tax burden that might fall to interstate taxpayers if the personal nexus standard was loosened.[64] The Court would provide no further guidance until *Wayfair*.[65]

2. Transactional Nexus

Transactional nexus has a longer, though perhaps quieter, history in the case law than personal nexus. The best place to start when uncovering the transactional nexus requirement is with the 1944 companion cases of *McLeod v. J.E. Dilworth Co.*[66] and *General Trading Co. v. State Tax Commission of Iowa*.[67] In these cases, the Supreme Court considered nearly identical fact patterns: an out-of-state vendor sold to residents of the taxing state, and the products sold were delivered into the state from out of state by common carrier.[68] In the Court's view, the only relevant difference was that in *Dilworth*, Arkansas demanded the vendor collect a sales tax imposed on the sales transactions involving Arkansas residents,[69] and in *General Trading Co.*, Iowa

62. *Id.* at 313 n.6.

63. *See id.*; Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 759–60 (1967).

64. *See Quill*, 504 U.S. at 314–16 ("Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation."); *Bellas Hess*, 386 U.S. at 759 ("And if the power of Illinois to impose use tax burdens upon National 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.").

65. *See* Holderness, *supra* note 17, at 315–16 (observing that the Supreme Court rejected certiorari in all challenges to the physical presence rule after *Quill* and until *Wayfair*).

66. 322 U.S. 327 (1944).

67. 322 U.S. 335 (1944).

68. *Dilworth*, 322 U.S. at 328; *General Trading Co.*, 322 U.S. at 337.

69. *Dilworth*, 322 U.S. at 327 ("We are asked to reverse a decision of the Supreme Court of Arkansas holding that the Commerce Clause precludes liability for the sales tax of that State upon the transactions to be set forth.").

demanded the vendor collect a use tax imposed on the in-state use of the products originally sold in Minnesota.[70]

Because the states imposed different taxes, the cases reached different results. Though personal nexus arguably existed with respect to each out-of-state vendor, Arkansas could not require the vendor to collect its sales tax,[71] but Iowa was permitted to require the vendor to collect its use tax.[72] Transactional nexus was at the core of these decisions; in *Dilworth*, Arkansas simply lacked a sufficient connection with the sales it sought to tax because they were consummated outside of the state (i.e., there was no local sale for Arkansas to tax), whereas in *General Trading Co.*, Iowa had such a connection with the in-state use of the products sold.[73] It did not matter to the Court that sales and use taxes are complementary and often reach the same economic result.[74]

70. *General Trading Co.*, 322 U.S. at 336 ("The question now presented is, in short, whether Iowa may collect, in the circumstances of this case, such a use tax from General Trading Company, a Minnesota corporation, on the basis of property bought from Trading Company and sent by it from Minnesota to purchasers in Iowa for use and enjoyment there."). Although sales taxes and use taxes are formally imposed on separate transactions, they have largely been thought of as economically equivalent taxes on consumption. *See, e.g.*, Holderness, *supra* note 17, at 347; Charles E. McLure Jr., *State/Local Taxes on Interstate Commerce: Legitimacy and Fairness*, 93 TAX NOTES 7703, ¶¶ 9–16 (2001). The use tax is often framed as merely a backstop to the sales tax, necessary only because of the historically limited jurisdictional reach of sales taxes. *See* RICHARD D. POMP, STATE AND LOCAL TAXATION, at 6-39 to 6-44 (9th ed., 2019); *see also* Robert C. Brown, *The Future of Use Taxes*, 8 LAW & CONTEMP. PROBS. 495, 504 (1941); Paul J. Hartman, *Sales Taxation in Interstate Commerce*, 9 VAND. L. REV. 138, 165 (1956).

71. *Dilworth*, 322 U.S. at 330 ("For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.").

72. *General Trading Co.*, 322 U.S. at 338 (observing "the right of Iowa . . . to exact a use tax from purchasers on mail order goods forwarded into Iowa from without the State").

73. *Compare Dilworth*, 322 U.S. at 330 ("We would have to destroy both business and legal notions to deny that under these circumstances the sale—the transfer of ownership—was made in Tennessee."), *with General Trading Co.*, 322 U.S. at 338 ("The tax is what it professes to be—a non-discriminatory excise laid on all personal property consumed in Iowa. The property is enjoyed by an Iowa resident partly because the opportunity is given by Iowa to enjoy property no matter whence acquired. The exaction is made against the ultimate consumer—the Iowa resident who is paying taxes to sustain his own state government."); *see also* Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 363 (1941) ("The fact that under Iowa law the sale is made outside of the state does not mean that the power of Iowa 'has nothing on which to operate.' The purchaser is in Iowa and the tax is upon use in Iowa. The validity of such a tax, so far as the purchaser is concerned, 'has been withdrawn from the arena of debate.'" (citations omitted) (first quoting Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 (1940); and then quoting Henneford v. Silas Mason Co., 300 U.S. 577, 583 (1937))).

74. *Dilworth*, 322 U.S. at 330 ("A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds.").

In what would turn out to be a highly influential opinion to the *Quill* Court,[75] Justice Rutledge penned a partial dissent, partial concurrence that addressed both the *Dilworth* and *General Trading Co.* cases.[76] In his opinion, Justice Rutledge argued there was no room for a nexus inquiry under the dormant Commerce Clause.[77] In his view, issues of state tax jurisdiction were due process concerns, and the dormant Commerce Clause should be setting rules of tax priority between multiple states that have jurisdiction over the activity taxed.[78] Therefore, he believed both Arkansas and Iowa had nexus with the consumption they sought to tax through their respective sales tax and use tax, and he rejected the opposing outcomes of the *Dilworth* and *General Trading Co.* cases as based on formalistic distinctions.[79] Justice Rutledge argued the dormant Commerce Clause would provide a remedy only once interstate consumption was subject to higher cumulative tax burdens than intrastate consumption, and the remedy would be to prioritize the market state's right to tax over that of the origin state.[80]

By articulating different motivations behind the requirements of the Due Process Clause and the dormant Commerce Clause in the state tax context and analyzing those requirements separately, Justice Rutledge's opinion laid groundwork for the splitting of the due process and dormant Commerce Clause analyses in *Quill*.[81] However, when the *Quill* Court made that split, it failed to also adopt Justice Rutledge's position that the dormant Commerce Clause did not contain a nexus requirement. Instead, the *Quill* Court appeared to incorporate the transactional nexus requirement into the dormant Commerce Clause analysis by claiming, "[W]e will sustain a tax against a Commerce Clause challenge so long as the 'tax . . . is applied to an activity with a substantial nexus with the taxing State . . . .'"[82]

75. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 305–06 (1992) (quoting Justice Rutledge's opinion before proceeding to "[h]eed[] Justice Rutledge's counsel, [and] consider each constitutional limit in turn.").

76. Justice Rutledge's opinion was filed in the case of *International Harvester Co. v. Department of Treasury*, which was a third companion case to *Dilworth* and *General Trading Co*. 322 U.S. 340 (1944).

77. *Id*. at 356–58 (Rutledge, J., dissenting in part, concurring in part) (arguing that both the origin states and market states in the *Dilworth* and *General Trading Co.* cases should have jurisdiction to tax under the due process clause, and that the dormant Commerce Clause is concerned with more substantive effects of the taxes at issue).

78. *Id*. at 359.

79. *Id*. at 352 ("The only other difference is in the terms used by Iowa and Arkansas, respectively, to describe their taxes . . . . Other things being the same, constitutionality should not turn on whether one name or the other is applied by the state.").

80. *Id*. at 361 ("If in this case it were necessary to choose between the state of origin and that of market for the exercise of exclusive power to tax, or for requiring allowance of credit in order to avoid the cumulative burden, in my opinion the choice should lie in favor of the state of market rather than the state of origin.").

81. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 305–06 (1992).

82. *Id*. at 311.

Dilworth and *General Trading Co.* offer a rare source for discerning the demands of the transactional nexus requirement because usually there is no controversy around whether transactional nexus exists. For example, no transactional nexus issue existed in *Quill* because the activity taxed clearly took place in the taxing state.[83] The development of the transactional nexus doctrine has thus been subtler than that of the personal nexus doctrine, as only a few cases have offered sparse additional insight into the transactional nexus requirement.

In the 1951 case, *Norton Co. v. Department of Revenue of Illinois*,[84] the taxpayer was a manufacturer based in Massachusetts that had established an office and warehouse in Illinois.[85] The taxpayer made local retail sales out of the Illinois office and also made mail order sales to Illinois residents out of its Massachusetts establishments.[86] The taxpayer argued those mail order sales could not be included in its Illinois tax base because they were made in interstate commerce.[87] Though the idea that interstate commerce cannot be subject to state taxation has since been abandoned, the Court denied the taxpayer's challenge because the Illinois office performed multiple functions in the state relating to the mail order sales.[88]

In reaching its decision and important to the transactional nexus concept, the Court observed, "Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable."[89] The Court cited *Dilworth* for this position. Further, the Court stated that when a taxpayer "has gone into the State to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on some Illinois sales only by showing that particular transactions are dissociated from the local business and interstate in nature."[90] Though the *Norton* Court couched its analysis in terms of whether an activity was local or interstate in nature, the decision indicates that an activity must have some local connection to a state before the state can tax it—transactional nexus is required.

In the 1989 case *Goldberg v. Sweet*,[91] the Court considered whether Illinois could impose an excise tax on telecommunications that originated or

83. *See id.* at 301 ("This case . . . involves a State's attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased *for use within the State*." (emphasis added)).

84. 340 U.S. 534 (1951).

85. *Id*. at 535.

86. *Id*. at 536.

87. *Id*. at 535–36.

88. *Id*. at 538–39.

89. *Id*. at 537.

90. *Id*.

91. 488 U.S. 252 (1989).

terminated in the state and were charged to a service address in the state.[92] Although the Court initially dismissed transactional nexus concerns as moot,[93] it later returned to the question with brief, but somewhat illuminating, dicta as it discussed concerns about multiple taxation:[94]

> We doubt that States through which the telephone call's electronic signals merely pass have a sufficient nexus to tax that call. We also doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call.
>
> We believe that only two States have a nexus substantial enough to tax a consumer's purchase of an interstate telephone call. The first is a State like Illinois which taxes the origination or termination of an interstate telephone call charged to a service address within that State. The second is a State which taxes the origination or termination of an interstate telephone call billed or paid within that State.[95]

While the Court did not expand on why it held the nexus beliefs it articulated, this dicta demonstrates that the transactional nexus aspect demands some local hook for the activity taxed beyond its simple beginning, end, and location. The importance of a local billing or service address to a telephone call is unclear, but such an address may indicate to the Court's satisfaction that tax compliance is not too burdensome because some familiarity exists between the local taxpayers and the taxing state's tax system. Alternatively, the administrative near-impossibility of taxing telecommunications based on the location of the signals may have caused the Court to fear that if a state like Illinois was not permitted to tax the telecommunications, no state would be able to, effectively shielding the interstate activities from state taxation and setting the clock back on the state taxation of interstate commerce.[96]

In 1995 in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[97] the Supreme Court considered whether Oklahoma could impose its sales tax on the full value of bus tickets sold in Oklahoma for interstate travel.[98] Relying on *Goldberg* and earlier cases, the Court had no difficulty proclaiming that Ok-

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92. *Id*. at 254–57.

93. *Id*. at 260 ("As all parties agree that Illinois has a substantial nexus with the interstate telecommunications reached by the Tax Act, we begin our inquiry with apportionment, the second prong of the *Complete Auto* test.").

94. *Id*. at 262–63.

95. *Id*. at 263 (citations omitted) (first citing United Air Lines, Inc. v. Mahin, 410 U.S. 623, 631 (1973); then citing Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292, 302–04 (1944) (Jackson, J., concurring); and then citing Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753 (1967)).

96. Thanks to Professor Pomp for bringing this concern to my attention. *See infra* note 170 for cases rejecting state tax immunity for interstate commerce.

97. 514 U.S. 175 (1995).

98. *Id*. at 177.

lahoma had "'nexus' aplenty" with the sales, thus no transactional nexus controversy existed.[99] *Jefferson Lines* advanced the transactional nexus doctrine by clarifying that the inquiry is not a means of prioritizing different states' tax claims; rather, it is a simple threshold connection question.[100]

Although transactional nexus issues have not surfaced at the Supreme Court level with much frequency, numerous lower courts have addressed the transactional nexus requirement, often citing to *Dilworth*.[101] Thus, the transactional nexus requirement was alive and well, though underdeveloped and undertheorized, pre-*Wayfair*.[102]

Heading into *Wayfair* then, states and taxpayers were faced with a dysfunctional physical presence rule for personal nexus and a conclusory transactional nexus standard that had created highly formalistic distinctions regarding state tax jurisdiction. Hopes were high that the Supreme Court would introduce more coherence into the substantial nexus doctrine by abandoning the physical presence rule and the formalism in the transactional nexus doctrine. As detailed in the next section, *Wayfair* partially delivered on these hopes by delivering a narrow opinion which discarded the physical presence rule but left the greater dormant Commerce Clause nexus doctrine unsettled.

B. Wayfair*: Substantial Nexus at a Crossroads*

As the evolutions of the personal nexus and the transactional nexus doctrines demonstrate, the dormant Commerce Clause's substantial nexus jurisprudence is, at a minimum, complex. Much of the complexity was created

99. *Id*. at 184 (quoting D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33 (1988)).

100. *Id*. ("[T]he taxpayer does not deny Oklahoma's substantial nexus to the in-state portion of the bus service, but rather argues that nexus to the State is insufficient as to the portion of travel outside its borders. This point, however, goes to the second prong of *Complete Auto* . . . ."). The full dormant Commerce Clause test relied on in *Quill* derives from the *Complete Auto* case and is referred to as the "*Complete Auto* test." The second prong of the test demands that a tax be fairly apportioned to the amount of activity occurring in the taxing state. *See infra* note 155 and accompanying text for a full description of the *Complete Auto* test.

101. *See, e.g.*, Gen. Motors Corp. v. City & Cty. of Denver, 990 P.2d 59, 66 (Colo. 1999); TA Operating Corp. v. Dep't of Revenue, 767 So. 2d 1270, 1275 (Fla. Dist. Ct. App. 2000); World Book, Inc. v. Dep't of Treasury, 590 N.W.2d 293, 297–98 (Mich. 1999); Crutchfield Corp. v. Testa, 88 N.E.3d 900, 908 (Ohio 2016); Koch Fuels, Inc. v. State (*ex rel*. Okla. Tax Comm'n), 862 P.2d 471, 476–77 (Okla. 1993); Travelscape, LLC v. S.C. Dep't of Revenue, 705 S.E.2d 28, 37 (S.C. 2011); State v. Dorhout, 513 N.W.2d 390, 393 (S.D. 1994); Chi. Bridge & Iron Co. v. State Tax Comm'n, 839 P.2d 303, 308 (Utah 1992); Irwin Nats. v. Dep't of Revenue, 382 P.3d 689, 693 (Wash. Ct. App. 2016); Travelocity.com LP v. Wyo. Dep't of Revenue, 329 P.3d 131, 148 (Wyo. 2014).

102. *See* sources cited *supra* note 101 and accompanying text; *see also* Gamage & Heckman, *supra* note 17, at 490 ("Together, [*Dilworth* and *General Trading Co.*] established a dichotomy between sales and use taxes that remains in effect to this day: purchases that occur within a state may be subject to sales taxation while purchases from remote vendors may only be subject to use taxation.").

by undertheorized expressions of the need for the substantial nexus requirement, which led to analytically unsatisfying conclusions about when such nexus existed.

As this Section explains, 2018's *Wayfair* decision brought a measure of coherence to the personal nexus doctrine but failed to address transactional nexus issues or the substantial nexus doctrine more broadly. In so doing, the case brought the substantial nexus doctrine into the twenty-first century but left it at a crossroads: the doctrine can either collaps into the due process personal jurisdiction standard, or it can be strengthened into a coherent standard that addresses the concerns of the dormant Commerce Clause. The next Part argues for the latter path by developing a robust theory of the dormant Commerce Clause nexus requirement to guide the doctrine forward.

1. A Vague Personal Nexus Standard

Wayfair was a case about the physical presence rule for personal nexus.[103] The case came about in an interesting manner. In response to a concurrence by Justice Kennedy in a 2015 case in which the Justice offered a scathing critique of the physical presence rule,[104] South Dakota passed a law which explicitly disregarded the rule for purposes of sales tax collection obligations in the state.[105] Instead, the South Dakota law imposed a sales tax collection obligation on any vendor who collected gross receipts of more than $100,000 from sales to South Dakotans or who made more than 200 individual sales to South Dakotans in the prior year, whether or not the vendor had a physical presence in the state.[106] Remote vendors were thus targeted for new sales tax collection obligations.

A handful of those remote vendors—Wayfair, Overstock, and Newegg.com—refused to comply with the South Dakota law and challenged

103. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2087–88 (2018).

104. Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124, 1134–35 (2015) (Kennedy, J., concurring). Justice Kennedy was far from alone in his critique of the physical presence rule. *See, e.g.*, Holderness, *supra* note 17, at 331–39 (critiquing the physical presence rule's ability to target undue burdens on interstate commerce); Pomp, *supra* note 17, at 1145–46; Swain, *supra* note 20, at 361–64.

105. S.D. CODIFIED LAWS § 10-64-2 (2018); s*ee also id.* § 10-64-1 (providing legislative findings supporting a law disregarding the physical presence rule including "the general growth of online retail" eroding the state's sales tax base and "the [falling] costs of [use tax] collection . . . [g]iven modern computing and software options," and noting the "argument [for requiring remote sellers to collect use taxes] has grown stronger, and the cause more urgent, with time," given these findings).

106. *Id*. § 10-64-2.

its constitutionality.[107] The South Dakota courts agreed with the remote vendors,[108] and the South Dakota Department of Revenue offered little resistance.[109] Instead, the Department focused its efforts on convincing the United States Supreme Court to overturn the long standing physical presence rule.[110] Thus, the briefings and decisions along the way to the Supreme Court were narrowly focused on whether South Dakota's law unconstitutionally imposed tax on people lacking personal nexus with the state.[111] To win, the state needed to prove that anyone falling under its statute had personal nexus with the state.

Although the State achieved its narrow goal and the Supreme Court discarded the physical presence rule,[112] the *Wayfair* decision left the personal nexus doctrine (and the greater substantial nexus doctrine) in a vague state.[113] Narrowly read, *Wayfair* stands only for the proposition that a taxpayer's physical presence is not necessary to establish personal nexus with the taxing state.[114] Broader readings hint at how the Court views the role of both aspects of the substantial nexus requirement more generally but do not provide clarity.[115]

After abandoning the physical presence rule, the *Wayfair* Court proclaimed that personal nexus "is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction,"[116] echoing the due process personal jurisdiction standard.[117] For this proposition, the Court only cited to dicta from *Polar Tankers, Inc. v. City*

107. *See* State v. Wayfair, Inc., 229 F. Supp. 3d 1026 (D.S.D. 2017).

108. State v. Wayfair Inc., 901 N.W.2d 754, 760–61 (S.D. 2017) (holding Section 10-64-2 of the South Dakota Codified Laws unconstitutional), *vacated sub nom.* South Dakota v. Wayfair, 138 S. Ct. 2080 (2018).

109. *Id*. at 760 ("The State filed a response to the motion for summary judgement agreeing with Sellers' statement of material facts. The State further agreed that the court would have to grant Sellers' motion for summary judgment based upon *Bellas Hess* and *Quill* and indicated its intention to pursue review of the issue by the United States Supreme Court.").

110. *Id*.

111. *See, e.g.*, *id*. at 759–60 (discussing the procedural posture of the case and the briefings and motions of the parties).

112. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

113. *See* sources cited *supra* note 15.

114. *See* Thimmesch et al., *Substantial Nexus*, *supra* note 15, at 447 ("The Court's ruling was very narrow, though, holding only that the physical presence rule is no longer the governing standard for purposes of determining when a taxpayer has the substantial nexus required under the Court's *Complete Auto Transit Inc. v. Brady* formulation.").

115. *Id*. at 448.

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

117. The reference to the "substantial privilege of carrying on business" in the taxing jurisdiction had been used by the Supreme Court in the state tax jurisprudence before *Wayfair*, but only in discussions of due process limitations on state tax actions. *See* Mobil Oil Corp. v. Comm'r of Taxes of Vt., 445 U.S. 425, 437 (1980); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444–45 (1940).

of Valdez,[118] which was not decided on dormant Commerce Clause grounds and, in any event, involved oil tankers that were physically present in the taxing jurisdiction.[119] *Polar Tankers Inc.* provides little guidance for determining when personal nexus exists if the taxpayer is not physically present in the taxing state.

The *Wayfair* Court might have expanded on this "substantial privilege" standard when deciding that Wayfair had satisfied it, but the Court only offered the following explanation:

> Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State. The Act applies only to sellers that deliver more than $100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis. This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota. And respondents are large, national companies that undoubtedly maintain an extensive virtual presence. Thus, the substantial nexus requirement of *Complete Auto* is satisfied in this case.[120]

Rather than explain what it means to avail oneself of the substantial privilege of carrying on business in a jurisdiction, the Court simply declared that Wayfair had done so because of the quantity of its business with South Dakotans and the size and national scope of its business. The Court may be correct, but how should smaller vendors read this opinion? What if Wayfair sold only one $150,000 piece of furniture to a South Dakotan? Or what if Wayfair sold $1.00 trinkets to 200 separate South Dakotans? The *Wayfair* opinion did not adequately answer these questions because it failed to articulate a meaning behind the "substantial privilege of carrying on business" phrase in the dormant Commerce Clause context.[121]

However, *Wayfair* did not leave the personal nexus standard and the substantial nexus doctrine totally rudderless. The *Wayfair* Court invoked dormant Commerce Clause concerns when it clarified that compliance costs weigh heavily in the substantial nexus analysis:

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118. 557 U.S. 1, 11 (2009).

119. *See* Fatale, *supra* note 15, at 868; Pomp, *supra* note 15, at 29.

120. *Wayfair*, 138 S. Ct. at 2099 (citation omitted).

121. *See* Calhoun & Kolarik, *supra* note 15, at 130 ("Post-*Wayfair*, the new substantial nexus test turns on whether a taxpayer has availed itself of the substantial privilege of carrying on business in the taxing jurisdiction at issue. In keeping with tradition, the Court left the minimum threshold of this sufficiency test undefined, for lower courts to determine. Because the substantial nexus analysis is fact-specific, the only existing guidance for determining the sufficiency of the economic and virtual contacts that satisfy this test are the particular South Dakota contacts of the businesses involved in the *Wayfair* litigation.").

> The *Quill* majority expressed concern that without the physical presence rule "a state tax might unduly burden interstate commerce" by subjecting retailers to tax collection obligations in thousands of different taxing jurisdictions. But the administrative costs of compliance, especially in the modern economy with its Internet technology, are largely unrelated to whether a company happens to have a physical presence in a State. . . . In other words, under *Quill*, a small company with diverse physical presence might be equally or more burdened by compliance costs than a large remote seller. The physical presence rule is a poor proxy for the compliance costs faced by companies that do business in multiple States.[122]

The Court further homed in on its concern with tax compliance costs by raising, with seeming approval, various features of the South Dakota law: The thresholds protected small sellers, retroactive application of the law was forbidden, and South Dakota was a member of the Streamlined Sales and Use Tax Agreement,[123] which meant the state's sales tax system had been simplified by adopting common statutory language and administrative practices with other member states.[124]

Even so, the Court raised those "features [of South Dakota's tax system] that appear designed to prevent discrimination against or undue burdens upon interstate commerce" only after claiming "[t]he question remains whether some other principle in the Court's Commerce Clause doctrine might invalidate the Act."[125] Although the *Wayfair* Court was clearly concerned with the compliance burdens placed on interstate taxpayers, the Court failed to tie those concerns directly to its due-process-esque personal nexus standard. *Wayfair* implied a need for the dormant Commerce Clause personal nexus inquiry while simultaneously seeming to collapse the personal nexus standard into a due process standard which does not target that need.

2. A Lack of Transactional Nexus

For all the disruption it brought to the personal nexus doctrine, *Wayfair* did little with respect to the transactional nexus doctrine. As noted, the decision and the parties focused on the personal nexus issue. However, the South Dakota law at issue in *Wayfair* required out-of-state vendors to collect tax on

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122. *Wayfair*, 138 S. Ct. at 2093 (citation omitted) (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.16 (1992)).

123. *Id*. at 2099–2100.

124. *See About Us*, STREAMLINED SALES TAX GOVERNING BOARD, INC., https://www.streamlinedsalestax.org/about-us/about-sstgb (last visited June 4, 2019); *see also* Wayfair, 138 S. Ct. at 2099–2100.

125. *Wayfair*, 138 S. Ct. at 2099.

sales to South Dakota residents.[126] Under *Dilworth*, South Dakota likely lacks transactional nexus with those sales and thus has no jurisdiction over them, regardless of its jurisdiction over the vendors themselves.[127] Thus, a transactional nexus issue lurked behind the *Wayfair* litigation.[128]

The parties to the *Wayfair* litigation did not raise the lurking transactional nexus issue,[129] and the Court effectively ignored the issue by claiming without support that "[a]ll concede that taxing the sales in question here is lawful"[130] and "[a]ll agree that South Dakota has the authority to tax these transactions."[131] While it is true that the use of the sold products would be taxable, the sales themselves should not be. This lack of attention to the transactional nexus issue is concerning—the issue threatened to immunize those out-of-state sales from taxation by South Dakota[132]—and open to interpretation.

A broad reading of *Wayfair* in this context may indicate that the formalism of past jurisprudence is a bygone relic. The Court's description of everyone as agreeing the sales were taxable and its cavalier references to both sales and use taxes as sales taxes throughout the opinion suggest the Court viewed sales and use taxes as equivalent taxes,[133] at least in the context of the personal nexus discussion. As personal nexus is not concerned with the activity taxed, but rather with the taxpayer, this equivalence should be uncontroversial—the potential taxpayers of both taxes are the consumer and the

126. S.D. CODIFIED LAWS § 10-64-2 (2018) ("Notwithstanding any other provision of law, any seller . . . shall remit *the sales tax* . . . ." (emphasis added)); *see* Hayes R. Holderness & Matthew C. Boch, *Did South Dakota Neglect Transactional Nexus in Its Bill to Kill Quill?*, DAILY TAX REPORT: STATE, Dec. 6, 2017, at 1; Richard D. Pomp, Wayfair*: Its Implications and Missed Opportunities*, 58 WASH. U. J. L. & POL'Y 1 (2019).

127. *See supra* note 71; *see also* Holderness & Boch, *supra* note 126, at 4 ("[B]y limiting the scope of the new economic nexus rule to sales taxes, South Dakota has put up an additional hurdle in the way of the victory it desires. The state may find that even if it wins on the physical presence issue, it will remain unable to tax the proceeds from sales of products delivered into the state by common carrier, and additional legislation will be necessary.").

128. *See* Holderness & Boch, *supra* note 126; Pomp, *supra* note 126; Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 975–76.

129. *See* Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976.

130. *Wayfair*, 138 S. Ct. at 2087.

131. *Id*. at 2092.

132. Thus, there being no taxable transactions to collect tax on, Wayfair would have no actual tax collection obligation. *See* Holderness & Boch, *supra* note 126.

133. *See* Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976. *See generally Wayfair*, 138 S. Ct. at 2080.

vendor.[134] The Court's failure to go further and distinguish the taxes on transactional nexus grounds might be viewed as a repudiation of the *Dilworth/General Trading Co.* dichotomy.[135]

On the other hand, a more conservative reading of the *Wayfair* decision indicates that the case is properly viewed solely as a personal nexus case, leaving intact the transactional nexus jurisprudence and the *Dilworth/General Trading Co.* dichotomy.[136] The parties did not raise or brief the transactional nexus issue, and the Court did not raise it *sua sponte* during any of the proceedings.[137] The issue is not directly mentioned in the decision.[138] Referring to use taxes as sales taxes is a common colloquial practice.[139] Lower court decisions have continued to rely on the historical transactional nexus doctrine,[140] and *Wayfair*'s indirect references to any transactional nexus issues in the case do not engage with that historical doctrine. As with the personal nexus doctrine, *Wayfair* leaves the transactional nexus doctrine in a vague state: Does it remain controlled by formalistic distinctions, or has a more substantive analysis been allowed to creep in?[141] The operation of South Dakota's law and taxpayer certainty depends on the answer to this question.

3. *The* Wayfair *Crossroads*

By shaking the traditional personal nexus analysis apart and failing to address transactional nexus concerns, the *Wayfair* case leaves the substantial nexus doctrine at a crossroads. *Wayfair*'s personal nexus standard is vague and reminiscent of the due process personal jurisdiction standard and does

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134. Holderness, *supra* note 17, at 320–21 (describing sales tax and use tax collection regimes); Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976 ("Read in its entirety, *Wayfair* suggests that the Court viewed the difference in the taxes as a difference in who remits them—sales taxes being collected and remitted by vendors and use taxes being paid directly by consumers.").

135. *See* Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976 (considering, through rejecting, this implied repudiation of the *Dilworth*/*General Trading Co.* dichotomy).

136. *See Wayfair*, 138 S. Ct. at 2088 ("The Court granted certiorari here to reconsider the scope and validity of the physical presence rule mandated by those cases."); *see also* Gamage & Heckman, *supra* note 17, at 490; Holderness & Boch, *supra* note 126; Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976.

137. *See supra* note 129.

138. *See generally Wayfair*, 138 S. Ct. 2080.

139. *See* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 12.01 (3d ed. 2001) (observing that the term "sales tax" is often used to describe a large variety of taxes, including the use tax); Andrew J. Haile, *Sales Tax Exceptionalism*, 4 COLUM. J. TAX L. 136, 141 n.12 (2013); Thimmesch et al., *Sales Tax Formalism*, *supra* note 15, at 976 ("Justice Anthony M. Kennedy's opinion explicitly noted that the South Dakota statute imposed a sales tax collection obligation, but the reference seems to have been more colloquial than technical.").

140. *See supra* note 101.

141. *See* Holderness & Boch, *supra* note 126, at 6 ("If certiorari is granted, though, the transactional nexus problem would be an opportunity for the Court to revisit and refresh its relatively dated transactional nexus jurisprudence.").

not clearly address the Court's concern for the burden that compliance costs associated with state taxes might impose on interstate commerce.[142] Likewise, the Court's casual dismissal of any transactional nexus concerns lurking in the case leaves the traditional formalistic transactional nexus standard in doubt. By avoiding the transactional nexus issues, the Court also passed up an opportunity to clarify the relationship between the personal and transactional nexus aspects going forward.

As a result of all this vagueness and uncertainty, courts, states, and taxpayers will have to navigate the crossroads at which *Wayfair* has placed the substantial nexus doctrine. The dormant Commerce Clause nexus standard could remain vague and collapse into the due process personal jurisdiction standard, or it could strengthen into a coherent standard that protects interstate commerce in earnest from unduly burdensome state tax actions. The former path could lead to uncertain and burdensome tax obligations for interstate taxpayers, counselling in favor of the latter path. As the next Part explains, a threshold nexus requirement has the unique ability to support the United States' system of interstate commerce by protecting against unduly burdensome tax compliance costs. Failing to realize this ability would leave interstate commerce exposed to harmful state taxes; to avoid this possibility, the next Part guides the substantial nexus doctrine towards a coherent standard by developing the compliance burden theory of dormant Commerce Clause nexus and the standard that follows from that theory.

II. SOUND DORMANT COMMERCE CLAUSE NEXUS

As the discussion in Part I indicates, the dormant Commerce Clause's substantial nexus requirement has generated much controversy and confusion over the course of its existence. Much of the controversy stems from the Supreme Court's failure to articulate a clear purpose for the requirement,[143] leaving people to question the role the requirement has in preventing state tax actions from placing undue burdens on interstate commerce. Indeed, many commentators have questioned whether the nexus concept has any role to play in the dormant Commerce Clause context, or whether nexus is more appropriately considered only in the due process personal jurisdiction context.[144]

142. *Wayfair*, 138 S. Ct. at 2099–2100 (approving the South Dakota law and describing how it eased compliance burdens on taxpayers); *see also id.* at 2093 ("The *Quill* majority expressed concern that without the physical presence rule 'a state tax might unduly burden interstate commerce' by subjecting retailers to tax-collection obligations in thousands of different taxing jurisdictions. But the administrative costs of compliance, especially in the modern economy with its Internet technology, are largely unrelated to whether a company happens to have a physical presence in a State." (citation omitted) (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992)).

143. *See supra* Part I. *But see supra* note 17 (observing that commentators have proposed theoretical justifications for the substantial nexus requirement).

144. *See* sources cited *supra* note 42.

This Part develops a theory—the compliance burden theory—that explains why nexus does have an important role to play in the dormant Commerce Clause context. To develop the compliance burden theory, this Part considers the types of burdens a state tax might impose on interstate commerce and the ability of a threshold nexus requirement to address those burdens. As the analysis demonstrates, such a requirement is uniquely situated to protect interstate commerce from undue burdens caused by tax compliance costs.[145]

This Part then develops a coherent dormant Commerce Clause nexus standard by relying on the compliance burden theory. This standard focuses on whether tax compliance costs would compel someone engaged in interstate commerce to avoid doing business in the taxing state. The compliance burden theory and the nexus standard that follows demonstrate dormant Commerce Clause nexus doctrine can and should avoid collapsing into due process personal jurisdiction doctrine.

A. *The Dormant Commerce Clause and Undue Burdens on Interstate Commerce*

One of the more important restraints on state actions, tax or otherwise, is the dormant Commerce Clause doctrine. As explained by the Supreme Court, the dormant Commerce Clause doctrine exists to prevent the "economic Balkanization" of the states by prohibiting state actions that discriminate against or unduly burden interstate commerce.[146] The Court has found that facially discriminatory state actions are categorically unconstitutional under the dormant Commerce Clause,[147] so the most challenging legal issues arise in assessing when a state action that is not facially discriminatory—like imposing a general sales tax—nevertheless places an undue burden on interstate commerce. Generally, a balancing test—referred to as the "*Pike* balancing test"—is used to address these issues: a state action is deemed to unduly burden interstate commerce when the burdens placed on interstate commerce outweigh the state's interest in taking the action.[148]

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145. *See* Gamage & Heckman, *supra* note 17, at 497–503 (reaching a similar conclusion).

146. *E.g.*, *Wayfair*, 138 S. Ct. at 2089, 2091; Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 180 (1995).

147. *See, e.g.*, City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978) (observing "a virtually *per se* rule of invalidity" for laws that facially discriminate against interstate commerce).

148. The Supreme Court has adopted "a two-tiered approach to analyzing state economic regulation under the Commerce Clause." Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 578–79 (1986). When a regulatory measure "has only indirect effects on interstate commerce and regulates evenhandedly," the Court applies a balancing analysis, looking to "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits." *Id.* at 579 (citing Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

However, the *Pike* balancing test has not found a clear home in the state tax jurisprudence despite the Court's recognition that a tax levied on interstate commerce has the potential to unduly burden that commerce.[149] Indeed, Chief Justice John Marshall famously described the power to tax as entailing "the power to destroy"; taken to an extreme, a state tax could destroy interstate commerce through death by taxation.[150] The *Pike* balancing test's absence from the state tax cases likely is a result of the difficulties in quantifying a state's significant interest[151] in exercising the tax power,[152] a power that often has been described as fundamental.[153]

Deviating from the *Pike* balancing test, the modern state tax doctrine instead relies on the *Complete Auto* test—derived from the 1977 *Complete Auto* case—to guide the analysis of the burden that a state tax might impose on interstate commerce in a qualitative manner.[154] In full, the *Complete Auto* test requires that a "tax [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" before the dormant Commerce Clause is satisfied.[155] This Article focuses on the nexus concept embedded in the first prong of the test, but

149. *E.g.*, Quill Corp. v. North Dakota, 504 U.S. 298, 312–13 (1992).

150. *See* McCulloch v. Maryland, 17 U.S. 316, 431 (1819) ("That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance, in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied.").

151. *E.g.*, Commonwealth Edison Co. v. Montana, 453 U.S. 609, 616 (1981) ("[T]his Court has acknowledged that 'a State has a significant interest in exacting from interstate commerce its fair share of the cost of state government.'" (quoting Washington Revenue Dep't v. Ass'n. of Wash. Stevedoring Cos., 435 U.S. 734, 748 (1978))).

152. Fatale, *supra* note 15, at 873–74 (detailing the difficulty of applying the *Pike* balancing test to tax matters); Thimmesch, *supra* note 20, at 109–10 (articulating the difficulty of measuring a state's interest in imposing taxes).

153. *See, e.g.*, Arkansas v. Farm Credit Servs. of Cent. Ark., 520 U.S. 821, 826 (1997) ("The power to tax is basic to the power of the State to exist."); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (referring to taxation as "the most basic power of government"); State Bd. of Tax Comm'rs of Ind. v. Jackson, 283 U.S. 527, 537 (1931) ("The power of taxation is fundamental to the very existence of the government of the States."); Tyler v. United States, 281 U.S. 497, 503 (1930) ("The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions.").

154. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2091 (2018); *see also* Thimmesch, *supra* note 20, at 107–08 ("*Pike* balancing is the Court's way of determining when state regulations, in the parlance of its precedential case, simply 'go too far.' That is where *Pike* seems to diverge from *Complete Auto*, because the Court does not exercise a similarly broad oversight function in its tax cases. It does not strike down state taxes because they are too high or because they result in cumulative tax burdens. Rather, states are free to tax as they see fit as long as their taxes are non-discriminatory and are fairly apportioned. The one exception, of course, is that states cannot go 'too far' in *who* they impose those burdens on." (footnotes omitted)).

155. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992) (alterations in original) (quoting Complete Auto Transit Inc. v. Brady, 430 U.S. 274, 279 (1977)).

the other prongs become relevant when analyzing the role of a threshold nexus requirement in preventing undue burdens on interstate commerce.

B. The Compliance Burden Theory of Dormant Commerce Clause Nexus

Broadly speaking, three aspects of a state tax can create burdens on interstate commerce: the tax rate; the tax base; and the tax compliance costs. A tax rate that becomes too high, a tax base that is incorrectly measured, or tax compliance costs that become too heavy might lead to undue burdens. As the following subsections demonstrate, the nexus concept—that threshold connection between the taxing state and the interstate commerce taxed—offers weak protections against potential undue burdens resulting from tax rates and tax bases but offers strong protections against such burdens resulting from tax compliance costs. Thus, protecting interstate commerce from the undue burdens of tax compliance costs should drive the dormant Commerce Clause nexus doctrine.

1. The Potential Undue Burdens of Too High Tax Rates

When thinking of an unduly burdensome tax, one might first suspect that the tax rate is too high. However, a high tax rate, if duly-enacted though a state's legitimate political process, is not inherently problematic, as the Supreme Court has indicated.[156] Because a state's interest in exercising its tax power is strong and difficult to quantify, it is difficult to apply the traditional *Pike* balancing test to determine whether the tax unduly burdens interstate

156. *See* West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 200 (1994) ("Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because '[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse.'" (alteration in original) (quoting Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 n.17 (1981))). Justice Ginsburg most recently articulated a political process argument in a dissent in *Comptroller of Treasury of Maryland v. Wynne*, stating:

> Residents, moreover, possess political means, not shared by outsiders, to ensure that the power to tax their income is not abused. "It is not," this Court has observed, "a purpose of the Commerce Clause to protect state residents from their own state taxes." The reason is evident. Residents are "insider[s] who presumably [are] able to complain about and change the tax through the [State's] political process." Nonresidents, by contrast, are not similarly positioned to "effec[t] legislative change." As Chief Justice Marshall, developer of the Court's Commerce Clause jurisprudence, reasoned: "In imposing a tax the legislature acts upon its constituents. This is in general a sufficient security against erroneous and oppressive taxation." The "people of a State" can thus "res[t] confidently on the interest of the legislator, and on the influence of the constituents over their representative, to guard them against . . . abuse" of the "right of taxing themselves and their property."

135 S. Ct. 1787, 1814–15 (2015) (Ginsburg, J., dissenting) (alterations in original) (citations omitted) (first quoting Goldberg v. Sweet, 488 U.S. 252, 266 (1989); and then quoting McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 428 (1818)); *see also* Gamage & Heckman, *supra* note 17, at 496.

commerce.[157] However, the type of balancing that *Pike* demands—comparing the state's interest in acting with the burden placed on individuals—is unnecessary when the tax is self-imposed; the taxpayer-voters have decided the tax is worth imposing, presumptively making the burdens imposed not undue.

Of course, the dormant Commerce Clause is concerned with undue burdens *on interstate commerce*. This interstate commerce aspect introduces the possibility that the political process may fail to accurately balance the state's interest and the burdens of the state tax; the state tax may fall on an out-of-state taxpayer who is not involved in the state's political process and thus not be self-imposed.[158] Alternatively, the interstate income of state residents might be subject to higher tax rates than intrastate income.[159] Interstate commerce may become unduly burdened as a result of either.[160] These scenarios are not difficult to imagine; for example, Virginians might elect to impose a one hundred percent tax rate on the income of Marylanders earned in Virginia. Marylanders would presumably stop their Virginia activities facing such a tax, and interstate commerce would have been impermissibly chilled. Alternatively, Virginians might impose a higher tax on income earned by Virginians in Maryland to encourage Virginians to work solely in Virginia.

A threshold nexus requirement could address this problem, though not in a completely satisfying manner. A nexus standard could protect any interstate taxpayer from a state tax until the taxpayer's connection with the state is large enough that it would be allowed to vote or otherwise participate in the political system.[161] Once the interstate taxpayer has a political voice in the taxing state, the political protections against high tax rates could be relied on.

Difficulties of comprehensibly articulating such a standard aside,[162] a major problem for relying on the nexus requirement in this way is that the interstate taxpayers' political voice might not overcome that of a majority of intrastate taxpayers, threatening to expose the interstate commerce to higher

157. *See supra* note 152.

158. *See West Lynn Creamery*, 512 U.S. at 200 ("However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy."); *see also* Zelinsky, *supra* note 17, at 51 (observing that "the temptation to tax nonvoters is politically irresistible").

159. *See generally Wynne*, 135 S. Ct. at 1787.

160. *See id*. at 1815 (Ginsburg, J., dissenting) ("This Court has not shied away from striking down or closely scrutinizing state efforts to tax residents at a higher rate for out-of-state activities than for in-state activities (or to exempt from taxation only in-state activities).").

161. *See* Zelinsky, *supra* note 17, at 3 ("From [a political process] vantage, the Commerce Clause concept of tax nexus is best understood as a rough, but serviceable, proxy for the taxpayer's standing in the political process.").

162. *See id*. at 55–59 (addressing the difficulties of a political voice standard for substantial nexus).

tax rates.[163] In the above example, native Virginians might easily drown out the political influence of Marylanders who have the ability to participate in Virginia's political process. Alternatively, Virginians working solely intrastate could elect to tax other Virginians who work interstate at higher rates. Unless the dormant Commerce Clause were to require states to afford out-of-staters or those working out-of-state more political influence than pure in-staters—an absurd proposition—a nexus standard based on political voice would fail to effectively protect interstate commerce from too high tax rates.

Therefore, to ensure interstate commerce is appropriately protected from unduly high tax rates, the in-state voters should be relied on to reach the appropriate balance. This can be done by prohibiting interstate commerce from being taxed more heavily than intrastate commerce. Such a rule would allow in-state voters to be relied on to prevent unduly burdensome tax rates from being imposed on both intrastate and interstate commerce,[164] regardless of the connection the interstate commerce has with the state. Local Virginians would be unable to subject Marylanders or interstate Virginians to higher taxes than the local Virginians are willing to bear.

The Supreme Court has recognized the strength of such a non-discrimination rule in this context and has not sought to impose limits on the size of state tax rates on interstate commerce in the modern jurisprudence.[165] Instead, the third prong of the *Complete Auto* test prevents states from specifically targeting interstate commerce for higher tax burdens by forbidding states from treating interstate commerce more harshly than intrastate commerce.[166] Thus, a threshold nexus standard is neither necessary nor best suited to address the potential undue burdens on interstate commerce of too high tax rates.

2. The Potential Undue Burdens of a Distorted Tax Base

Continuing to think of unduly burdensome taxes, one might next suspect that a distorted tax base could create harmful results. Although the in-state political process can be relied on to reach a constitutional tax rate on inter-

163. *See id.* at 52–53 (discussing the "chief problem with this approach . . . that interstate taxpayers' political remedies do not always protect them from excessive tax burdens").

164. *See supra* note 156.

165. In historical jurisprudence, all taxes on interstate commerce were forbidden at various times. For descriptions of the evolution of the jurisprudence, see Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 179–84 (1995); Complete Auto Transit Inc. v. Brady, 430 U.S. 274, 279–87 (1977); *see also* POMP, *supra* note 70, at 1-1 to 1-21.

166. *E.g.*, Comptroller of Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1794 (2015) ("Under our precedents, the dormant Commerce Clause precludes States from 'discriminat[ing] between transactions on the basis of some interstate element.' This means, among other things, that a State 'may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.'" (citations omitted) (first quoting Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 332 n.12 (1977); and then quoting Armco Inc. v. Hardesty, 467 U.S. 638, 642 (1984))).

state commerce, that political process may fail when considering the construction of the tax base. The political process can ensure the same bases are subject to tax regardless of whether the bases are part of intrastate or interstate commerce, but the multijurisdictional nature of interstate commerce introduces the complexity that the entire tax base may not be connected with the taxing state.

A state tax might therefore burden interstate commerce by attributing more of the interstate tax base commerce to its jurisdiction than is appropriate, effectively engaging in the taxation of extraterritorial activities.[167] This sort of activity represents a potential indirect means of taxing interstate commerce more heavily than intrastate commerce and thus chilling the interstate commerce. For instance, Arizona might impose an income tax which applies to all income earned in the state. It is often difficult to source income to only one place;[168] for example, the income a data hosting service earns performing services out of its California office for Arizona clients arguably has both California and Arizona sources. If Arizona fully included any income that has at least a partial Arizona source in the state's income tax base, that tax base would be overstated at the expense of interstate commerce.

A threshold nexus requirement could be used to protect against this type of potentially burdensome action but only in a highly ineffective manner. The requirement could prevent a state from imposing tax on interstate commerce until such time as the interstate taxpayer or activity has such a large connection with the state that sourcing any amount of the activity taxed to the state would not be *unduly* burdensome. For instance, suppose there is

167. *See Jefferson Lines*, 514 U.S. at 184–85 ("The difficult question in this case is whether the tax is properly apportioned within the meaning of the second prong of *Complete Auto*'s test, 'the central purpose [of which] is to ensure that each State taxes only its fair share of an interstate transaction.' This principle of fair share is the lineal descendant of *Western Live Stock*'s prohibition of multiple taxation, which is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." (alteration in original) (citation omitted) (quoting Goldberg v. Sweet, 488 U.S. 252, 260–61 (1989))); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) ("[W]e will strike down the application of an apportionment formula if the taxpayer can prove 'by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportions to the business transacted . . . in that State," or has "led to a grossly distorted result."' (alterations in original) (citations omitted) (first quoting Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931), and then quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274 (1978))); *Moorman Mfg. Co.*, 437 U.S. at 276–81 (addressing concerns that Iowa attributed too much of an interstate company's income to the state through the use of a single sales factor apportionment formula).

168. *See, e.g.*, Catherine A. Battin et al., *Demystifying the Sales Factor: Market-Based Sourcing*, 72 ST. TAX NOTES 403, 403 (2014) ("The key problem faced by most service providers is determining where the market for their services is located. Depending on the state, the market may be where the benefit of the service is received by the customer, where the service is received, where the customer is located, or where the service is delivered. Those varying interpretations of the market may produce dramatically different results and create complexities and uncertainties." (footnotes omitted)).

some tolerable margin of error for states in determining their share of the tax base such that one state might claim more of the base than it technically should—say the claimed tax base must be within ten percentage points of the "true" base.[169] In such a case, the substantial nexus standard could protect against the undue burden of overstated tax bases by preventing a state from taxing interstate commerce until at least ninety percent of that commerce occurred in the state (assuming the high end of the range of acceptable tax bases is one hundred percent of the tax base).

This solution would be too restrictive on states by effectively protecting most interstate commerce from state taxation, a position the Supreme Court has rejected.[170] The potential tax base problems are better solved through a system of apportionment—requiring the states to divide up interstate tax bases—or a system of tax prioritization[171]—ranking the authority of the states to impose tax on the interstate commerce. Either system could ensure that no more than one hundred percent of the interstate commerce is subject to tax, though an apportionment system would be more respectful of each individual states' tax power by not conditioning any one state's authority on another's.

Indeed, to address these concerns, the Supreme Court has adopted an apportionment system. The second prong of the *Complete Auto* test requires that any state tax on interstate commerce be fairly apportioned according to the amount of activity in the state.[172] Therefore, in theory, a state should be unable to tax one hundred percent of an activity that takes place in more than one state; the state should only be allowed to impose tax on that portion of

169. *See Container Corp.*, 463 U.S. at 184 (observing a deviation of "approximately 14%" would not violate the fair apportionment requirement whereas a deviation of "more than 250%" would). Query how one would determine the appropriate baseline against which to make such a comparison; the Court has not provided clear guidance other than to say that using the accounting method of the taxpayer will not suffice on its own. *Id.* at 182–84.

170. *See, e.g.*, D. H. Holmes Co. v. McNamara, 486 U.S. 24, 30–31 (1988) ("*Complete Auto* abandoned the abstract notion that interstate commerce 'itself' cannot be taxed by the States. We recognized that, with certain restrictions, interstate commerce may be required to pay its fair share of state taxes."); Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975) ("It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business.'" (quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938))); Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 461–62 (1959) ("[I]t is axiomatic that the founders did not intend to immunize [interstate] commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State.").

171. Justice Rutledge argued as early as 1944 that the dormant Commerce Clause doctrine should be setting such rules of tax priority among the states. *See supra* note 80.

172. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992) ("[W]e will sustain a tax against a Commerce Clause challenge so long as the 'tax . . . [2] is fairly apportioned . . . .'" (second alteration in original)).

the activity that takes place in the state.[173] In this way, interstate commerce that has no connection with the taxing state should be protected from the state's tax; the in-state tax base would be nothing.[174]

A state tax might also burden interstate commerce by measuring the tax base by something wholly unrelated to the activities in the state,[175] another potential indirect means of taxing interstate commerce more heavily than intrastate commerce. For example, Colorado could impose a "nature tax" on visitors to its state parks for the privilege of visiting those parks but measure the tax by the income of the taxpayer, which might create a tax inordinately large in relation to the taxpayer's activities in the state.

A threshold nexus requirement could protect against such harm by again requiring that the interstate commerce have such a large connection with the state that using any tax base would not be unduly burdensome, though such a threshold would likely be too restrictive on states.[176] Instead, the political process protections discussed earlier should prevent the use of this tactic to target out-of-state taxpayers, and the anti-discrimination prong of the *Complete Auto* test would adequately protect interstate commerce.[177]

For its part, the state tax jurisprudence may have recognized the ability of the political process to protect against these kinds of distorted tax bases. Technically, the fourth prong of the *Complete Auto* test prohibits tax bases that are unrelated to the activity in the state, ensuring the state tax is fairly related to whatever is occurring in the state.[178] However, the application of this prong is so forgiving to states—almost any tax base will be found to be

173. *See Container Corp.*, 463 U.S. at 169 ("The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed."). In practice, the constitutional apportionment standards leave a lot of room for state-by-state interpretation, which has created a web of overlapping and underlapping rules that do not perfectly divide the tax base. *See State Taxation: The Role of Congress in Developing Apportionment Standards: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 3–4 (2010) (statement of John A. Swain, Professor, University of Arizona, James E. Rogers College of Law); Cara Griffith, *The Complexities of Apportionment and the Question of Uniformity*, 56 ST. TAX NOTES 725 (2010).

174. The Due Process Clause also meaningfully restricts states' ability to tax things outside of their territories by demanding that there be "some minimum connection" between the taxing state and the thing taxed. *See Quill*, 504 U.S. at 306–08 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)). In this way, the Due Process Clause addresses concerns about extraterritorial state taxation. *See* Holderness, *supra* note 13, at 402–04 (discussing prohibitions on extraterritorial state taxation).

175. *See* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 625–26 (1981).

176. *See supra* note 170.

177. *See supra* notes 156–166 and accompanying text.

178. *See Commonwealth Edison*, 453 U.S. at 626 ("[T]he fourth prong of the *Complete Auto Transit* test imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of state tax burden.'" (quoting W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1983)).

fairly related to whatever is occurring in the state—that it effectively passes the question to the political process.[179]

Thus, a threshold nexus standard is also ill-suited and unnecessary to address the potential undue burdens on interstate commerce of distorted tax bases.

3. *The Potential Undue Burdens of Tax Compliance Costs*

Finally, one might suspect that a tax could become unduly burdensome if the costs to comply with the tax were too large. Tax compliance costs include things such as the labor required to ensure taxes are correctly paid, the capital investments in software and computing capacity to run tax compliance systems, the ability to access funds to pay the tax, and—importantly—the costs and risks associated with handling audits by state revenue departments.[180] Significantly, compliance costs tend to be relatively flat; they are roughly as burdensome on the first bit of activity taxed as they are on the last.[181]

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179. *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 199 (1995) ("The fair relation prong of *Complete Auto* requires no detailed accounting of the services provided to the taxpayer on account of the activity being taxed, nor, indeed, is a State limited to offsetting the public costs created by the taxed activity. If the event is taxable, the proceeds from the tax may ordinarily be used for purposes unrelated to the taxable event."); *Commonwealth Edison*, 453 U.S. at 628 (analyzing a state tax under the forth prong of the *Complete Auto* test and observing that "questions about the appropriate level of state taxes must be resolved through the political process"); *see also* Edward A. Zelinsky & Brannon P. Denning, Debate, *The Future of the Dormant Commerce Clause: Abolishing the Prohibition on Discriminatory Taxation*, 155 U. PA. L. REV. PENNUMBRA 196, 205 (2007) ("Courts have heretofore been so reluctant to [apply] the 'fairly related' prong of *Complete Auto* [that it] has become a dead letter.").

180. *See* U.S. GOV'T. ACCOUNTABILITY OFF., GAO-18-114 SALES TAXES: STATES COULD GAIN REVENUE FROM EXPANDED AUTHORITY, BUT BUSINESSES ARE LIKELY TO EXPERIENCE COMPLIANCE COSTS, 15–27 (2017) [hereinafter GAO REPORT] (detailing compliance costs for sales and use tax collection); Holderness, *supra* note 17, at 331; Ralph B. Tower, *Back to the Future? The Post-*Wayfair *Consumer Use Tax*, 89 ST. TAX NOTES 879 (2018) (detailing the challenges of use tax compliance under different regimes). The costs of addressing the risk of inadvertent non-compliance and addressing potential non-compliance on audit tend to multiply the otherwise relatively straightforward compliance costs. *See* GAO REPORT, *supra*, at 20–27; Julia S. Bragg & Robert J. Tuinstra, Jr., *Managing State and Local Tax Risks*, 57 ST. TAX NOTES 361 (2010) (detailing the various risks for taxpayers associated with state and local tax compliance); Gamage & Heckman, *supra* note 17, at 510 ("[C]ompensation for compliance costs must include compensation for intangible costs such as executives' time and the risk of being subject to penalties for inadvertent non-compliance.").

181. *See* DONALD BRUCE & WILLIAM F. FOX, SMALL BUS. ADMIN., AN ANALYSIS OF INTERNET SALES TAXATION AND THE SMALL SELLER EXEMPTION 35–36 (2013) (surveying studies of compliance costs and observing, "These findings indicate that there may be some economies of scale in terms of compliance costs, echoing Bradford's (2004) survey of the literature. As Bradford notes, however, the apparent economies of scale may be based on the relatively fixed nature of compliance costs."); *see also* GAO REPORT, *supra* note 180, at 15–27; Gamage & Heckman, *supra* note 17, at 504–09 (analyzing hypothetical tax compliance costs based on reports of compliance costs and observing that costs are "much higher as a percentage of sales for small vendors than for large vendors," demonstrating that such costs rise more slowly than the benefits of sales activity);

As an example of how tax compliance costs might unduly burden interstate commerce, suppose it costs a New York vendor $475 for compliance software that enables it to correctly collect and remit Massachusetts sales tax. If the New York vendor makes only $50 per sale into Massachusetts, it would presumably forgo making any sales into the state until it makes at least ten sales, thereby making enough profit to cover its compliance costs. The compliance costs would chill the New York vendor's willingness to engage in interstate commerce until the vendor's activity in the state is profitable enough to cover the compliance costs. Here, a threshold nexus requirement shines and other dormant Commerce Clause guardrails falter.

A threshold nexus requirement can protect against the potential undue burden of tax compliance costs on interstate commerce by ensuring a state cannot impose tax (and the associated compliance costs) until the commerce has enough of a connection with the state such that the benefit of that connection to the taxpayer outweighs the burden of the compliance costs. In short, nexus with the taxing state would not exist until the interstate taxpayer has made enough money to cover the compliance costs of the state tax system. In the above example, the nexus requirement could protect the New York vendor's first nine sales from Massachusetts sales tax. In this way, the nexus requirement can ensure that interstate commerce is not exposed to unduly burdensome tax compliance costs, costs that would chill the interstate commerce.

Because of the flat nature of compliance costs,[182] other dormant Commerce Clause protections are ill-suited to address the burden of tax compliance costs as they focus on the structure and scope of the tax itself. An apportionment system would technically assign a small portion of interstate activity to a state if there is only a tiny amount of the activity occurring in the state, which would require the taxpayer to bear full compliance costs to pay a small amount of tax. Those costs cannot be apportioned like the tax base; they must be borne in full by someone. The anti-discrimination principle requires only that the state not treat interstate commerce more harshly than intrastate commerce. If a state chooses, through its political system, to impose taxes with high compliance costs on intrastate commerce, then the prong would not prevent the imposition of those same costs on interstate commerce.[183] Thus, a threshold nexus requirement is uniquely situated to address the potential burden of tax compliance costs on interstate commerce.

Thimmesch, *supra* note 20, at 111 ("[A] firm's costs will likely be highest in its first year of operating in a state, but they should be reduced thereafter. A firm utilizing software to manage many of these burdens might find their costs to be more stable.").

182. *See supra* note 181.

183. The anti-discrimination prong does not work in reverse; it does not demand that intrastate commerce be treated the same as interstate commerce. Intrastate commerce is the sole domain of

C. The Compliance Burden Theory and Cumulative Tax Burdens

The above analysis leads to the compliance burden theory of dormant Commerce Clause nexus: the nexus requirement should exist to prevent unduly burdensome tax compliance costs from being placed on interstate commerce. The Supreme Court has never explicitly offered this justification for its articulated "substantial nexus" requirement, but as discussed, its decisions addressing the personal nexus requirement have threads of concerns about tax compliance costs.[184] For example, in *Wayfair*, the Court discussed how the physical presence rule failed to protect small vendors from burdensome "administrative costs of compliance."[185]

Recognizing the dormant Commerce Clause nexus requirement is uniquely situated to protect against unduly burdensome tax compliance costs raises an important question: should each state's tax compliance costs be considered in isolation, or should the nexus requirement focus on the cumulative compliance costs borne by a multistate taxpayer?[186] Because the dormant Commerce Clause jurisprudence exists to prevent individual states from acting to unduly burden interstate commerce, it is not adequately equipped to address the cumulative effects of all states' actions. Addressing those cumulative effects instead demands political balancing and tradeoffs that Congress has been tasked with under its Commerce Clause authority.[187] Simply put, in the absence of Congressional action, individual states' interests in exercising their tax powers over interstate commerce are not dependent on what other states do. As such, the compliance costs of each tax regime must be viewed in isolation.

The state taxation jurisprudence has implicitly recognized this conclusion. The Supreme Court has been loath to invalidate one state's tax action under the dormant Commerce Clause when an interstate taxpayer suffers from alleged undue burdens from the accumulation of many states' tax regimes; instead, the Court has demanded clear proof that the challenged tax regime, not the other states', is the actual source of the undue burdens, a

the taxing state, and federal law will not upset the state's rules for intrastate commerce in this context. *See* Goldberg v. Sweet, 488 U.S. 252, 266 (1989) ("It is not a purpose of the Commerce Clause to protect state residents from their own state taxes.").

184. *See supra* Section I.A.1.

185. *See* South Dakota v. Wayfair, 138 S. Ct. 2080, 2093 (2018).

186. This question has long lingered in the substantial nexus area. For example, in their pre-*Wayfair* analysis of the substantial nexus requirement, Professors Gamage and Heckman considered the burdens on interstate commerce created by aggregate tax compliance costs from multiple jurisdictions. *See* Gamage & Heckman, *supra* note 17, at 500–01.

187. *See* Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 760 (1967) ("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.").

nearly impossible task in practice.[188] Additionally, the *Quill* Court failed to adopt Justice Rutledge's position that the dormant Commerce Clause should be setting rules of tax priority between taxing states that have due process nexus with the interstate commerce taxed, despite the fact that the Court adopted Justice Rutledge's suggested split of the Due Process Clause and dormant Commerce Clause analyses of state tax actions.[189] Setting rules of tax priority would have accounted for cumulative tax burdens; instead, the *Quill* Court left the issue in Congress' hands.[190] Until Congress says otherwise, each individual state's tax power is not dependent on any other state's actions.

It is true that *Quill* and *Bellas Hess* both expressed concern about the potential of cumulative tax burdens on interstate taxpayers to support the use of the physical presence rule for personal nexus.[191] However, *Wayfair* should be read to dismiss those concerns in its focus on the taxpayer's connection with the taxing jurisdiction alone. Indeed, the *Wayfair* Court specifically addressed those concerns and claimed that "[o]ther aspects of the Court's doctrine can better and more accurately address any potential [cumulative] burdens on interstate commerce, whether or not *Quill*'s physical presence rule is satisfied."[192]

Although the Court did not expand on what those other aspects might be, to the extent the dormant Commerce Clause jurisprudence does anything to address cumulative tax burdens on interstate commerce, it does so mainly through the apportionment prong of the *Complete Auto* test.[193] In theory, apportionment ensures that no cumulative tax burdens exist on interstate commerce by preventing states from taxing more than their fair share of the multistate tax base.[194] Therefore, courts should address the potential impact

188. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 192–93 (1983) ("If California's method of formula apportionment 'inevitably' led to double taxation, that might be reason enough to render it suspect. But since it does not, it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation." (citation omitted)); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 276–81 (1978) (refusing to hold Iowa's apportionment formula unconstitutional because it differed from other states' formulas and may have contributed to cumulative tax burdens on interstate commerce).

189. Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992) ("Heeding Justice Rutledge's counsel, we consider each constitutional limit in turn.").

190. *Cf. id*. at 318 ("[The Commerce Clause] aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions." (footnote omitted)).

191. *See supra* notes 56 and 62.

192. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2093 (2018).

193. *See supra* notes 167–173 and accompanying text.

194. *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995) (explaining that the apportionment standard looks "to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State" and "the threat of real

of cumulative tax burdens on interstate commerce after dormant Commerce Clause nexus exists with the taxing state—that is to say, after establishing that the tax compliance costs imposed by the taxing state are not unduly burdensome on interstate commerce.

In sum, the compliance burden theory holds that a threshold nexus inquiry for state tax power is appropriate under the dormant Commerce Clause because such an inquiry is uniquely capable of protecting interstate commerce from the undue burdens of state tax compliance costs. The theory focuses on individual state tax burdens; it is not concerned with the cumulative tax compliance costs to which a multistate taxpayer might be subjected. Relying on these conclusions, the next Section develops a theoretically-sound dormant Commerce Clause nexus standard.

D. A Theoretically Sound Dormant Commerce Clause Nexus Standard

Understanding the compliance burden theory allows for the development of a theoretically-sound dormant Commerce Clause nexus standard. The nexus standard must take the costs associated with tax compliance into account, as well as the benefits the taxpayer receives from engaging in interstate commerce in the taxing state. This standard taps into many of the concerns expressed by the *Wayfair* Court and ensures that those concerns drive the nexus analysis.

*1. A Post-*Wayfair *Nexus Standard*

The fundamental nature of the state tax power indicates that the states should have a strong interest in efficient and effective tax administration,[195] which may demand that taxpayers bear many of the costs of tax compliance. However, imposing those costs on interstate commerce threatens to inappropriately chill that commerce.[196] Therefore, the standard for dormant Commerce Clause nexus should follow the greater dormant Commerce Clause doctrine and engage in balancing similar to the *Pike* balancing test to determine when the state's interest in imposing tax compliance costs is unduly burdensome on interstate commerce.[197] Traditional *Pike* balancing may be difficult in the case of evaluating the state tax burden itself,[198] but the balancing becomes more straightforward when examining the tax compliance costs.

multiple taxation (though not by literally identical statutes) may indicate a State's impermissible overreaching"); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) ("The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed.").

195. *See supra* note 153.

196. *See supra* Section II.B.3.

197. *See supra* note 148.

198. *See supra* note 154.

The nexus standard that follows from the compliance burden theory provides that dormant Commerce Clause nexus exists when the benefits the taxpayer receives from conducting interstate commerce in the state exceed the tax compliance costs imposed on the taxpayer. Simply put, if the interstate commerce is profitable despite the tax compliance costs,[199] then the nexus standard should be satisfied. If not, dormant Commerce Clause nexus should not be found. This standard can be expressed formulaically as:

Dormant Commerce Clause Nexus ⇔ Benefit to Taxpayer of Activity in State > Taxpayer Compliance Costs

This standard sends a clear message to states that compliance costs are important. That said, the standard should not be terribly imposing on states. Reasonable minds can disagree on how much the benefit to the taxpayer should exceed the tax compliance costs, but at a minimum that benefit should equal the costs to avoid the complete interruption of interstate commerce. In any event, because tax compliance costs are relatively flat costs to the taxpayer, dormant Commerce Clause nexus concerns should quickly fade away as the interstate taxpayer increases its beneficial activities in the state.

The proposed nexus standard does not separate out personal nexus and transactional nexus concerns, at least not directly. Instead, it focuses on the compliance costs placed on the *taxpayer* as they relate to the interstate *activity* in the taxing state. The reason for this approach is that the two concerns become significantly intertwined under the compliance burden theory. The burden of tax compliance costs must fall to a taxpayer, so personal nexus may seem the more relevant concern. If the taxpayer's presence in the state is not beneficial enough to justify taking on the burden of those costs, dormant Commerce Clause nexus does not exist.

However, the relevant presence of the taxpayer is based on the activities being conducted in and taxed by the state. Transactional nexus turns out to be the most pertinent concern because the tax compliance costs are specific to the activity taxed. If those compliance costs would drive the taxpayer to stop that activity in the state, dormant Commerce Clause nexus is not established. Because of the prominence of the transactional nexus aspect under the compliance burden theory, a coherent dormant Commerce Clause nexus standard can develop in the jurisprudence even if the standard for personal nexus remains vague or collapses into the due process personal jurisdiction

199. As Professors Gamage and Heckman observed before the *Wayfair* case, "Being exempt from state sales and use taxes is sufficiently important to major e-commerce vendors such as Amazon that these vendors can be expected to end most affiliations that would deem them to have a physical presence within key customer states." Gamage & Heckman, *supra* note 17, at 485. This observation recognizes that remote vendors were offered a significant competitive advantage over local vendors under the physical presence rule regime. The proposal in this Article would only permit remote vendors to avoid tax collection when the costs of doing so would be prohibitively expensive for the taxpayer. *Id*.

standard.[200] All that is needed is the development of the transactional nexus standard in line with the proposed standard.

In short, a theoretically-sound dormant Commerce Clause nexus standard must consider the specific interstate activity taxed and how tax compliance costs burden that activity. Personal nexus should exist when transactional nexus exists, and even if other activities could establish personal nexus,[201] transactional nexus requires that each activity taxed be analyzed separately. The Court was correct to frame the first prong of the *Complete Auto* test in terms of transactional nexus,[202] and the *Quill* Court's focus on personal nexus was unnecessary.[203]

2. Assessing the Proposed Nexus Standard

In addition to fulfilling the goals of the dormant Commerce Clause by protecting interstate commerce from unduly burdensome tax compliance costs, the proposed nexus standard would prove beneficial in a number of ways. First, by using a more focused dormant Commerce Clause nexus standard, the analysis of state tax jurisdiction can appropriately adapt to changing economies, business practices, and tax systems. For example, if interstate services are more profitable than interstate sales of consumer goods, then a smaller connection with the services would be necessary to overcome the burden of tax compliance costs. If businesses become more adept at complying with complex tax systems, again, a smaller connection

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200. *Cf.* Thimmesch, *supra* note 20, at 116 ("The Court's best option in *Wayfair* is to repeal the physical-presence rule and to not replace it."). Many commentators have argued that it would be appropriate for the personal nexus standard to collapse into the due process nexus standard. *See* source cited *supra* note 42.

201. Certain case law indicates that the personal nexus and transactional nexus inquiries may be totally separate from each other. *See* Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 561 (1977) ("[T]he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate 'some definite link, some minimum connection, between [the State and] the *person* . . . it seeks to tax.'" (second alteration in original) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954))). If personal nexus continues to evolve as a separate line of doctrine from transactional nexus, then it would be possible for a taxpayer to have nexus with the state but for the activity taxed not to have a connection with the state. For example, an online bookseller could have its headquarters in Washington State, establishing personal nexus, yet the transactional nexus doctrine would prevent Washington State from taxing the bookseller's sales made at its retail store in New York.

202. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992) (laying out the *Complete Auto* test as "we will sustain a tax against a Commerce Clause challenge so long as the 'tax *[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.'" (alterations in original) (emphasis added) (quoting Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977))).

203. *Cf.* Thimmesch, *supra* note 42, at 188–91 (2012) (discussing the "[g]ratuitous [e]levation of the Commerce Clause over the Due Process Clause").

with taxing states would be necessary. As tax systems simplify, their compliance costs fall, also requiring smaller connections.

Second, the proposed standard would allow states the flexibility to expand their tax jurisdiction by absorbing the compliance costs of their tax systems.[204] The idea of states absorbing the compliance costs of their tax systems may seem fanciful at first glance, but states already do this to varying degrees. For example, many states provide "vendor discounts" to vendors that collect sales and use taxes, whereby the vendor is permitted to retain a percentage of the taxes collected in order to offset the administrative burden of collecting and remitting.[205] Additionally, member states of the Streamlined Sales and Use Tax Agreement provide free compliance software to certain vendors.[206]

Third, the proposed nexus standard would also bring the tax jurisprudence more in line with other areas of dormant Commerce Clause jurisprudence,[207] reducing variation between different areas of law.[208] Outside of the state tax arena, the *Pike* balancing test is used to resolve conflicts between states and multijurisdictional people and activities.[209] Although, in practice, the *Pike* balancing test is highly deferential to states,[210] the test seeks to balance the costs imposed by the state on interstate commerce against the state's

204. Pre-*Wayfair*, Professors Gamage and Heckman proposed allowing states to move past the physical presence rule if they fully absorbed the compliance costs of their tax systems. *See* Gamage & Heckman, *supra* note 17, at 503–12.

205. For a list of states providing vendor discounts, see FED'N OF TAX ADM'RS, STATE SALES TAX RATES AND VENDOR DISCOUNTS (2019), https://www.taxadmin.org/assets/docs/Research/Rates/vendors.pdf.

206. *See Certified Service Providers About*, STREAMLINED SALES TAX GOVERNING BOARD, INC., https://www.streamlinedsalestax.org/certified-service-providers/certified-service-providers-about (last visited June 4, 2019).

207. *See* Adam B. Thimmesch, *The Unified Dormant Commerce Clause*, 91 TEMPLE L. REV. (forthcoming 2019) (arguing that the state tax dormant Commerce Clause jurisprudence is well on its way to convening with the non-tax dormant Commerce Clause jurisprudence and that that coming together should be formally completed).

208. *See* Thimmesch, *supra* note 20, at 116, 120–21; Hayes Holderness, *The Workability of Pike Balancing for State and Local Tax Collection Obligations*, SURLY SUBGROUP (Apr. 4, 2018), https://perma.cc/W752-J4AE. *But see* Fatale, *supra* note 15, at 872 (claiming that "the Court has been retreating from *Pike* for several decades, even in the regulatory context from which that standard derives"); Hellerstein & Appleby, *supra* note 15, at 292 ("[I]t has been argued that the Court has implicitly repudiated a *Pike* balancing analysis in dormant commerce clause cases . . . .").

209. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2090–91 (2018).

210. *See* Hellerstein & Appleby, *supra* note 15, at 292; Thimmesch, *supra* note 20, at 108 ("The Court has not struck down a state statute applying [*Pike*] balancing since the 1980s. The Roberts Court has generally been unwilling to even engage in balancing." (footnote omitted)).

interest in acting,[211] as would the proposed dormant Commerce Clause nexus standard.[212]

This is not to claim that finding that balance will not present challenges. If there was value to the physical presence rule, it was the value that comes with generally applicable bright-line rules; they are typically easier to apply than more fluid standards.[213] A primary criticism of the proposed nexus standard might be that it would require intensive evidence gathering and complicated calculations to determine when tax compliance costs become too burdensome.[214] Indeed, some commentators argue that the application of a balancing test in this context is prohibitively difficult.[215] However, these arguments are based on the difficulty of sorting out the cumulative burdens that tax compliance costs from multiple jurisdictions might place on interstate commerce; admittedly, teasing out each jurisdiction's contribution to the cumulative burden would be a prohibitively difficult task.[216]

As discussed though, the compliance burden theory instructs that the dormant Commerce Clause nexus standard must focus on the compliance costs imposed by each taxing jurisdiction in isolation, not in aggregate.[217] This focus simplifies the balancing analysis: compliance costs and taxpayer benefits are easier to calculate when only considering one taxing jurisdiction at a time. Taxpayers should be able to show fairly accurately their anticipated costs of compliance with the individual state tax regime and the expected profitability of their activities in the taxing state.

Even so, as a practical matter, the proposed standard would likely lead to lawmakers and taxpayers resorting to proxies such as the average profit margin of the particular activity taxed to simplify the analysis, forsaking a

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211. Brown-Forman Distillers Corp. v. New York State Liquor Auth., 467 U.S. 573, 579 (1986) (observing that when a regulatory measure "has only indirect effects on interstate commerce and regulates evenhandedly," the Court applies a balancing analysis, looking to "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits" (citing Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970))).

212. Professor Thimmesch argues that the substantial nexus concept generally should be understood to serve the same function as *Pike* balancing. *See* Thimmesch, *supra* note 20, at 106–08.

213. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 315 (1992) ("Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges . . . . This artificiality, however, is more than offset by the benefits of a clear rule. 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." (citations omitted)).

214. *See* Fatale, *supra* note 15, at 873–74 (detailing the difficulty of applying the *Pike* balancing test to tax matters); Thimmesch, *supra* note 20, at 109–12 (discussing the difficulties of a balancing test as a substantial nexus standard).

215. *See, e.g.*, Gamage & Heckman, *supra* note 17, at 512–13. In Professors Gamage and Heckman's view, the solution to the difficulty of balancing in this context is to only find substantial nexus in those taxing jurisdictions that fully absorb the tax compliance costs imposed on interstate commerce. *Id*. at 506–07, 513.

216. *See supra* note 188 and accompanying text.

217. *See supra* Section II.B.3.

truly pure application of the standard.[218] Such proxies would provide clarity and simplicity generally, and the standard would serve as a safety valve for seriously aggrieved taxpayers wishing to bring individual challenges to nexus determinations.

Such challenges could be costly for states and taxpayers but should be rare. Given the low hurdle the proposed nexus standard should present, taxpayers should only raise challenges when they have clear and compelling evidence of their compliance costs and benefits, and states could adopt conservative proxies to head off most challenges. States could also avoid placing tax obligations on people not directly connected to the activity taxed because such obligations are more difficult to comply with than obligations placed on people directly connected with the activity taxed.[219] Finally, states that wish to avoid dormant Commerce Clause nexus controversies could always simplify their taxes and assume the compliance costs associated with them.[220] In other words, the states would control their dormant Commerce Clause nexus destinies under the proposed standard.

Although the standard is proposed in a neutral effort to bring clarity and reason to the dormant Commerce Clause nexus requirement, the standard might be criticized as promoting a pro-state or anti-taxpayer agenda. This criticism fails to consider whether the pre-*Wayfair status quo* struck an appropriate balance between states and taxpayers. The pre-*Wayfair* personal nexus rules were a thorn in most states' sides, as the multitude of efforts to undermine the rules demonstrate.[221] The traditional transactional nexus rules impose unnecessarily formalistic restrictions on certain state tax actions.[222] Loosening these rules in an effort to more accurately track whether state tax systems place undue burdens on interstate commerce is likely to broaden

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218. These sorts of administrative shortcuts are common in state and local tax jurisprudence, as the cost of arriving at absolutely accurate measures is often prohibitive. For example, the apportionment formulas states use to meet the fair apportionment requirement of the *Complete Auto* test are recognized not to be absolutely accurate; instead the formulas rely on measures like a taxpayer's property, payroll, and sales in the taxing state to reasonably approximate the taxpayer's taxable activity (i.e., income) in the state. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) (observing that the fair apportionment prong would be violated only if "the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,'" before observing that the three-factor property, payroll, and sales formula had "met our approval, [and had] become . . . something of a benchmark against which other apportionment formulas are judged'" (quoting Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931))). The *Container Corp.* Court indicated that a deviation from the absolutely accurate tax base of "approximately 14%" would not be "out of all appropriate proportion" whereas a deviation of "more than 250%" would be. *Id*. at 181, 184.

219. *See infra* note 253 and accompanying text.

220. *See* Gamage & Heckman, *supra* note 17, at 503–12 (discussing this option and how states might assume tax compliance costs).

221. *See* Holderness, *supra* note 13, at 414–19 (surveying efforts to overturn the physical presence rule).

222. *See supra* Section I.A.2.

state tax authority.[223] But according to the compliance burden theory, that authority should have been broader all along; prior doctrine was inappropriately anti-state, and cleaning up the doctrine would place taxpayers and states in a sounder balance.

In sum, the compliance burden theory underlying the dormant Commerce Clause nexus requirement leads to fairly narrow protections against undue burdens on interstate commerce.[224] Properly understood, the dormant Commerce Clause nexus requirement simply carves out an amount of interstate activity that may cross a state's line and not be subject to the state's taxing power: that amount of interstate activity that would not continue if the taxpayer were made to bear the costs of tax compliance. Adopting such a standard would bring clarity to a murky area of law and allow for the appropriate amount of flexibility needed for state taxes to adapt to changing tax and business practices over time.

III. BRINGING DORMANT COMMERCE CLAUSE NEXUS DOCTRINE IN LINE WITH THEORY

The crossroads created by the *Wayfair* decision offers the opportunity to clarify and stabilize the protections of the dormant Commerce Clause nexus requirement. Failing to do so, say by allowing the nexus standard to completely collapse into the due process personal jurisdiction standard, would open the door to unprincipled expansions of state tax power and uncertain tax obligations that may burden interstate commerce. Such a failure may particularly burden the activities of small businesses and of entities that facilitate the commerce of others, such as online marketplaces similar to Amazon Marketplace, payment intermediaries like MasterCard, and common carriers such as FedEx.

This Part details how the compliance burden theory and the proposed nexus standard can be unambiguously incorporated into existing substantial nexus doctrine by focusing on the resolution of three post-*Wayfair* issues that may be soon litigated. Though the term "substantial nexus" may be troublesome in its current state,[225] it does offer an expedient way to establish the protections of the proposed standard in the case law. Courts and state tax lawyers have been using the term for decades, and the Supreme Court seems unwilling to completely abandon it, as *Wayfair* demonstrates. Rather than let it fester in limbo, "substantial nexus" should be infused with meaning. That

223. *See* Thimmesch, *supra* note 20, at 117–19 (discussing the effects of loosening the substantial nexus standards).

224. This standard achieves goals proposed by economists for appropriate nexus standards. *See* Charles E. McLure Jr., *The Nuttiness of State and Local Taxes—And the Nuttiness of Responses Thereto*, 25 ST. TAX NOTES 841, 845 (2002) ("Nexus (duty to collect tax) should depend on having *either* a substantial physical presence or a non-*de minimis* amount of sales in a state . . . .").

225. *See supra* notes 39–42 and accompanying text.

said, the proposed standard need not find a home in the "substantial nexus" term; if that term were abandoned, there would still be a need to evaluate the burden tax compliance costs place on the interstate taxpayer.

The three post-*Wayfair* issues considered below include the constitutionality of imposing sales and use tax collection obligations on someone other than the vendor or the customer, the vitality of the formalism of the traditional transactional nexus doctrine, and the necessity of substantial nexus at both the state and local level when local taxes are imposed. The key to appropriately developing the substantial nexus doctrine through these issues is to recognize the prominence of transactional nexus in the analysis and to adopt a coherent transactional nexus standard, regardless of how *Wayfair*'s "substantial privilege of carrying on business"[226] personal nexus standard is interpreted.

A. *Nexus Between Taxpayer and Activity Taxed: The Case of Marketplace Collection Obligations*

South Dakota's win in *Wayfair* has predictably been embraced by the states, as demonstrated by a rush of legislative activity to align statutory personal nexus rules with the decision.[227] Many states (including South Dakota) are going further than the original South Dakota model, which requires vendors who collected gross receipts of more than $100,000 from sales to South Dakotans or who made more than 200 individual sales to South Dakotans in the prior year to collect the state's sales tax.[228] These states are extending tax collection obligations to marketplaces that facilitate sales between vendors and customers, like Amazon Marketplace, eBay, and Etsy.[229] These laws cover entities that allow third-party vendors to use their platform to reach customers.

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226. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

227. *See* Roxanne Bland, South Dakota v. Wayfair: *The Fallout*, 90 ST. TAX NOTES 621, 621 (2018) ("After the U.S. Supreme Court's June ruling in *South Dakota v. Wayfair* jettisoned the rule equating physical presence with substantial nexus for purposes of requiring remote vendors selling into a state to collect that state's sales tax, many sales tax states rushed to draft new economic nexus standards to drop into their tax codes." (footnote omitted)); Pomp, *supra* note 126 (detailing states' post-*Wayfair* legislative efforts).

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

229. *See, e.g.*, H.R. 470, 2018 Leg., Reg. Sess. (Ala. 2018); S. 417, 2018 Gen. Assemb., Reg. Sess. (Conn. 2018); S. 2417, 2018 Gen. Assemb., Reg. Sess. (Iowa 2018); H.R. 366, 2018 Gen. Assemb., Reg. Sess. (Ky. 2018); H.R. 1019, 56th Leg., 2d Spec. Sess. (Okla. 2018); S. 2, 2018 Legis. Assemb., 93d Spec. Sess. (S.D. 2018); H.R. 2163, 65th Leg., Reg. Sess. (Wash. 2018); H.R. 1, 90th Leg., 1st Spec. Sess. (Minn. 2017); H.R. 542, 2017 Gen. Assemb., Reg. Sess. (Pa. 2017); H.R. 5175, 2017 Gen. Assemb., Reg. Sess. (R.I. 2017); *see also* TOMMY HOYT, ET AL., MULTISTATE TAX COMM'N, REPORT OF WAYFAIR IMPLEMENTATION & MARKETPLACE FACILITATOR WORK GROUP 4 (2018), https://perma.cc/UHQ4-TXK7 [hereinafter, MTC, WHITE PAPER]; Jad Chamseddine, *2019: The Year of Marketplace Legislation*, 90 ST. TAX NOTES 1096, 1096 (2018); Lauren Loricchio, *States Want Marketplace Facilitators to Collect Tax for Small Sellers*, 90 ST. TAX NOTES 749, 749 (2018); Shanske et al., *supra* note 15, at 112.

These marketplace collection laws often place a tax collection obligation on the marketplace once sales made through its platform pass the same thresholds that apply to the individual vendors.[230] Such an obligation can attach on a collective basis, so once enough sales are made on the platform, regardless of who the vendor is, the marketplace becomes responsible for tax collection. For example, South Dakota's marketplace collection law requires the marketplace to collect the state's sales tax if the marketplace "[f]acilitates the sales of two or more marketplace sellers that, when the sales are combined, are subject to [the South Dakota law at issue in *Wayfair*], even if the marketplace sellers are not separately or individually subject to [that law]."[231]

A clear policy behind these marketplace collection laws is to push tax collection obligations to the most consolidated levels possible, on the belief that economies of scale at such levels will smooth the collection of taxes.[232] One marketplace could collect and remit taxes instead of thousands of individual vendors. In theory, this state of affairs could ease the administrative burden on a state to receive taxes collected and to audit tax collectors.[233] In addition, the laws will predictably expand the number of sales on which tax is collected because the marketplaces will be collecting tax on sales made by vendors who are individually not subject to collection obligations.[234] As others note, this expansion increases fairness of treatment between vendors;[235] the states also figure to collect more taxes through these laws.[236] It is not difficult to imagine states playing with the idea of extending these types of laws to cover additional entities that facilitate the commerce of others, such as payment intermediaries and common carriers.[237]

230. *E.g.*, S.D. CODIFIED LAWS § 10-65-5.

231. *Id*.

232. *See* MTC, WHITE PAPER, *supra* note 229, at 3 ("In order to increase sales/use tax collection compliance levels, several states are imposing requirements on marketplace facilitators to collect and remit the sales/use tax on their marketplace sales."); Chamseddine, *supra* note 229, at 1096 ("The trend is happening mainly because it is more fruitful for states to require collection by marketplace providers. 'It makes a lot more sense for states to have marketplace platforms or facilitators registered and collecting rather than having to deal with hundreds or thousands of marketplace sellers individually,' said Marshall Stranburg, deputy executive director of the Multistate Tax Commission.").

233. *See* MTC, WHITE PAPER, *supra* note 229, at 3; Chamseddine, *supra* note 229, at 1096.

234. *See* Loricchio, *supra* note 229, at 749.

235. Shanske et al., *supra* note 15, at 112.

236. Chamseddine, *supra* note 229, at 1096 ("States that don't expand their remote sales tax collection requirements to marketplaces could 'miss out on a huge chunk' of revenue, according to Richard Cram, also of the MTC.").

237. *C.f.* Rifat Azam & Orly Mazur, *Cloudy with a Chance of Taxation*, 22 FLA. TAX REV. 500 (2019) (arguing for requiring payment intermediaries to collect excise taxes on cloud computing transactions that they facilitate).

Given the loosening of the personal nexus standard in *Wayfair*, these marketplace collection laws may pass constitutional muster,[238] but they should not be guaranteed success given the compliance costs they will place on the marketplaces and the indirect benefits the marketplaces may receive from the taxing states. Take the example of Etsy, which vendors located around the country use to connect with customers.[239] Assume there are one hundred vendors using Etsy that sell into South Dakota and their sales collectively satisfy the state's statutory personal nexus rule. South Dakota's law would require Etsy to collect the sales taxes imposed on the transactions that occur on its platform as long as the constitutional substantial nexus standard is met with respect to Etsy.[240]

Current personal nexus doctrine appears not to obstruct South Dakota's efforts significantly. If Etsy is purposefully exploiting the state's marketplace, say by supporting vendors in the state or selling into the state and deriving income therefrom, then it will have exposed itself to personal nexus with the state.[241] A court might follow *Wayfair*'s lead and declare personal nexus to exist because it thinks Etsy has purposefully "availed itself of the substantial privilege of carrying on business" in the state.[242] However, this analysis should give states and Etsy pause; personal nexus might not exist if the substantial nexus standard is allowed to advance past *Wayfair*'s vague expression.[243]

Under the proposed substantial nexus standard,[244] if the compliance costs of collecting the sales tax imposed on the marketplace rendered the marketplace's activities in the state unprofitable, personal nexus would not exist (i.e. Etsy would not have availed itself of the substantial privilege of carrying on business in the state). One challenge under the proposed standard would lie in determining the profitability of the marketplace's facilitation of

238. *See* Shanske et al., *supra* note 15, at 112. *But see* Calhoun & Kolarik, *supra* note 15, at 135 ("Nor is it clear whether a state may compel the marketplace facilitator to collect and remit use tax for its client, the remote seller.").

239. *See About*, ETSY, https://www.etsy.com/about (last visited Oct. 13, 2019) (describing the Etsy platform).

240. *See* S.D. CODIFIED LAWS § 10-65-5 (2018).

241. *See supra* Section I.A.1.

242. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

243. *Wayfair* may have cut off the path to such advancement of the personal nexus standard when it indicated that some other aspect of the dormant Commerce Clause should address tax compliance costs. *See id.* ("The question remains whether some other principle in the Court's Commerce Clause doctrine might invalidate the Act."). Even if the path to advancing the personal nexus standard is cut off, substantial nexus doctrine can still align with theory through the development of the transactional nexus standard, which is the more important of the two aspects of the substantial nexus requirement. *See supra* note 200 and accompanying text.

244. *See supra* Part II.C.1 (developing the proposed substantial nexus standard, which can be stated formulaically as: Dormant Commerce Clause Nexus ⇔ Benefit to Taxpayer of Activity in State > Taxpayer Compliance Costs).

sales in the state. The other challenge would be determining the compliance costs imposed on the marketplace by the taxing state.

At first glance, it is not clear that any given marketplace would derive benefit from the taxing state simply by facilitating other vendors' sales. The analysis would first need to determine if the marketplace's activities outside of the taxing state could be attributed to the state. This analysis would likely depend on the arrangement between the marketplace and its vendors: what does the marketplace do for its vendors and what does it earn from each vendor for those services, particularly with respect to the taxing state? If the marketplace actively promotes its platform in the state and collects fees based on a per-transaction basis, this task may be relatively straightforward; if the marketplace is more passive or general fees are collected, then the task may become harder. This analysis should be expected to separate active marketplaces like Etsy from more passive ones like Craigslist.[245]

Issues exist on the compliance costs side of the analysis as well. There is an important difference between the vendor who is asked to collect taxes on their own sales and the marketplace that is asked to collect taxes on someone else's sales. The vendor has direct knowledge of the transaction, direct access to the information required to accurately collect taxes, and direct access to the funds needed to pay the tax; the marketplace does not.[246] The marketplace would have to retrieve that information from the individual vendors and may have to pay the taxes out-of-pocket and seek redress through costly measures such as legal suits against vendors or customers.[247]

245. Craigslist does not engage in the same level of promotion of third-party sellers on its platform as Etsy does. *Compare Terms of Use*, CRAIGSLIST, https://www.craigslist.org/about/terms.of.use (last updated Aug. 16, 2019) (describing the Craigslist platform), *with About*, ETSY, https://www.etsy.com/about (last visited Oct. 13, 2019) (describing the Etsy platform).

246. This is not to say that the marketplace could not easily acquire such information from the vendors, but in the first instance, the marketplace does not have that information and must incur some cost to retrieve it. *See infra* notes 250–253 and accompanying text.

247. For example, the South Dakota marketplace collection law treats the sales from the vendor as sales for resale, placing the burden on the marketplace to collect from the ultimate consumer. S. 2, 2018 Legis. Assemb., 93d Spec. Sess. (S.D. 2018). A major source of compliance costs in the sales and use tax area is determining which sales are exempt from tax, which includes the collection and verification of exemption certificates from tax-exempt purchasers such as businesses that are not purchasing goods at retail. *See, e.g.*, Britt C. Dobbins & Wendy M. Leonard, *Compliance Strategies Regarding Resale and Other Sales Tax Exemption Certificates*, 12 J. MULTISTATE TAX'N. & INCENTIVES 14, 17–23 (2003) (discussing common issues associated with exemption certificates); Dick Eppleman, *Tax Practitioners and State Auditors Focus on Managing Sales Tax Exemption Certificate*, 16 J. MULTISTATE TAX'N. & INCENTIVES 26, 29 (2007) (detailing compliance burdens associated with exemption certificates); Cara Griffith, *Streamlining Versus "Amazon" Laws: The Remote Seller Dilemma*, 55 ST. TAX NOTES 351, 354 (2010) ("Determining how to handle tax-exempt sales, sales tax holidays, and product taxability coding can be a daunting task, particularly for small and midsize businesses. It has been estimated that sales tax exemptions account for 60 percent of the cost of compliance for small businesses."). As the tax collector becomes further removed from the purchaser, it may be more and more costly to obtain and verify those certificates.

The marketplace's indirect connection to the transactions at issue is most concerning for the increased costs of addressing audit risks; the marketplace may need to rely on vendors for information necessary to comply with the state tax law, and vendor errors could increase the marketplace's costs of interacting with a state taxing authority.[248] By taking these costs into account, the personal nexus standard would reflect an understanding that the taxpayer's connection to the activity taxed matters.[249] In the case of the marketplace collection laws, collecting tax on other people's sales may burden a marketplace too much, such that it forbids vendors from making sales into the taxing state using its platform. However, where the state's market is important enough to the marketplace, the compliance costs should not present a significant hurdle to South Dakota's efforts.

This observation highlights that the personal nexus inquiry need not impose a high burden on states.[250] Etsy could demand that its vendors transmit transaction information to Etsy in a reasonable manner.[251] If all marketplaces did this, Etsy would not suffer market share because of the action and much of the harm might dissipate. Sifting through many different vendors' transactions may be costlier than only dealing with one's own sales, but the statutory thresholds could be adjusted to account for this discrepancy.

The important point is the personal nexus standard should take into account how the state tax system affects different taxpayers, bringing the standard closer in line with the traditional *Pike* balancing test and better fulfilling the goals of the dormant Commerce Clause doctrine.[252] The taxpayer's connection with the activity taxed is an important indicator of the burden of compliance costs, and as that connection becomes weaker and less direct, the demands of personal nexus should be expected to increase.[253] The personal nexus of entities that facilitate the commerce of others, like marketplaces, payment intermediaries, and common carriers, necessitate a close look under the proposed standard.

248. *See* Holderness, *supra* note 17, at 334–39 (detailing the impact that the relationship between the taxpayer and the activity taxed can have on the burden placed on the taxpayer to collect taxes); *see also* Paul Jones, *Etsy Releases List of States Where It Collects Sales Taxes*, TAX ANALYSTS (Jan. 23, 2019) ("[Etsy] said collecting sales and use tax for multiple taxing jurisdictions using different rules is complicated and difficult, and urged sellers to support its effort to lobby lawmakers to back federal legislation that would standardize rules. 'Our experience [] [in Washington and Pennsylvania] . . . has shown us how hard it is to properly classify the 50 million handmade, craft, and vintage goods . . . into taxable item categories,' Etsy said." (third alteration in original)).

249. *See* Holderness, *supra* note 17, at 334–39 (arguing that even under the physical presence regime, the dormant Commerce Clause demanded some connection between the taxpayer and the activity taxed).

250. *See supra* note 224 and accompanying text.

251. *See, e.g.*, Jones, *supra* note 248 (detailing Etsy's sales tax collection efforts).

252. *See supra* notes 146–148 and accompanying text (discussing the *Pike* balancing test and the goals of the dormant Commerce Clause).

253. *Cf.* Holderness, *supra* note 17, at 334–39.

The above analysis highlights a second point about the proposed substantial nexus standard: transactional nexus is the prominent concern, not personal nexus. In the above example, though the analysis is framed as developing the personal nexus standard, recognizing the importance of the relationship between the taxpayer and the activity taxed would wed the personal nexus standard to the transactional nexus standard. When the compliance costs imposed by the sales tax would cause the interstate sales activity to cease, transactional nexus with the taxing state should not exist. And Etsy, as the taxpayer, should also lack personal nexus with the taxing state when those interstate sales would cease. To be clear, Etsy would not have to stop interacting with the taxing state; it would just be protected from tax obligations until its activities were profitable enough to cover the tax compliance costs.

Thus, a theoretically-sound substantial nexus standard could do away with the personal nexus inquiry,[254] but given the prominence of the inquiry in the *Wayfair* case, courts are not primed to abandon the personal nexus aspect of the substantial nexus doctrine. The above approach to personal nexus would at least bring the doctrine closer in line with theory but has the potential to fail to prevent undue burdens on interstate commerce when the taxpayer has a large presence in the state unrelated to the activity taxed.[255] For example, Washington State would likely find personal nexus with Seattle-based Amazon.com for almost any kind of tax, regardless of the specific compliance costs associated with the tax. Some case law even indicates that a taxpayer's nexus with a state need not be related to the transaction taxed by the state, though this case law appears to be grounded in the Due Process Clause rather than the dormant Commerce Clause.[256] Thus, the above approach to personal nexus might not provide the appropriate protections

254. *See supra* note 200.

255. Given historical practice and the lack of clear guidance from the *Wayfair* Court, courts should be expected to find personal nexus where the taxpayer has a high amount of activity in the taxing state, particularly where the taxpayer has a physical presence in the state. Even the *Wayfair* Court was taken in by the amount of activity in the state, simply stating that such amount of activity met the substantial nexus standard without deeper explanation. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018). However, a prominent practitioner has suggested that a taxpayer could challenge a finding of substantial nexus based on its physical presence in the taxing state, arguing that after *Wayfair*, physical presence alone is not enough to establish personal nexus. *See* Amy Hamilton, *What Will the First Post-*Wayfair *Litigation Look Like?*, 90 ST. TAX NOTES 609, 609–10 (2018) (discussing comments of Leah Robinson).

256. *See* Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 561 (1977). In determining that the taxpayer's nexus did not depend on the activity taxed by the state, the *National Geographic Society* Court claimed that the test was "simply whether the facts demonstrate 'some definite link, some minimum connection, between [the State and] the *person* . . . it seeks to tax'" and cited to the *Miller Brothers* case for support. *Id*. (alteration in original) (quoting Miller Bros. v. Maryland, 347 U.S. 340, 344–45 (1954)). This language used by the Court parallels due process standards for nexus, not those of the dormant Commerce Clause, and *Miller Brothers* is best viewed as a due process case, as argued earlier. *See supra* note 55; *see also* Holderness, *supra* note 17, at

against undue burdens on interstate commerce,[257] but developing the transactional nexus standard as described in the next Section can ensure those protections exist.

B. Ghosts of Transactional Nexus: The Ongoing Vitality of Sales and Use Tax Formalism

As noted, the issue in *Wayfair* was personal nexus, but the South Dakota statute has a lurking transactional nexus issue.[258] That issue results from the fact that the South Dakota statute only requires remote vendors to collect sales taxes; there is no obligation to collect use taxes.[259] In fact, South Dakota doubled down on its disregard for this issue by passing a marketplace collection bill that also only applies to the collection of sales taxes.[260] If South Dakota lacks transactional nexus with out-of-state sales—as the pre-*Wayfair* jurisprudence suggests that it does[261]—then any attempt to require vendors to collect those sales taxes should fail. In contrast, it is clear under the jurisprudence that South Dakota could require vendors to collect use taxes on the products that they sell into the state for use there, making the limited scope of the South Dakota statutes a seemingly incredible foot-fault for the state.[262] States like South Dakota who impose only sales tax collection obligations on remote sellers have left themselves vulnerable to legal challenge.[263]

If *Wayfair* is read to reject this transactional nexus formalism, then a transactional nexus challenge to a law like South Dakota's would fail. However, the *Wayfair* Court's cavalier approach to the transactional nexus issue makes reliance on such a reading risky. Even so, accepting that *Wayfair* did not directly dismantle the historical formalism created by transactional nexus doctrine does not require accepting that the decision did not provide the tools for dismantling that formalism in the future. Should a remote vendor challenge a sales-tax-only collection regime, the courts would have to confront the transactional nexus issue head on.

334–38 (arguing that *National Geographic Society* is not controlling for dormant Commerce Clause purposes).

257. *See* Hellerstein & Appleby, *supra* note 15, at 291–92.

258. *See supra* note 128.

259. *See* S.D. CODIFIED LAWS § 10-64-2 (2018).

260. *See* S. 2, 2018 Legis. Assemb., 93d Spec. Sess. (S.D. 2018).

261. *See supra* Section I.A.2.

262. *See* Holderness & Boch, *supra* note 126. Although there is an easy legislative fix to this problem—expanding the statutes to cover the collection of use taxes, the experience in South Dakota has shown that some states may be unaware of the gravity of the issue or unwilling to address it. *See* Pomp, *supra* note 126.

263. *See* Holderness & Boch, *supra* note 126.

Under current doctrine, the states would likely lose such a challenge of their efforts to tax out-of-state sales.[264] However, *Wayfair* provides courts with the basis to explicitly abandon the formalistic distinction between sales taxes and use taxes by bringing the transactional nexus standard in line with the compliance burden theory. *Wayfair* began this task in the personal nexus context, and that alignment should be continued in the transactional nexus context.

A court approaching the transactional nexus issue should recognize *Wayfair*'s concern with compliance costs and establish that the compliance costs associated with the particular activity taxed cannot be allowed to cause the activity to cease in the state. There is no place in this analysis for categorical declarations that transactional nexus does or does not exist with respect to a particular form of taxation.[265] Indeed, the Supreme Court has demanded that the substance rather than the form of a tax control its constitutionality; to determine the substance of a tax, the Court asks upon whom or what the tax is economically imposed.[266] Although sales taxes and use taxes are formally imposed on separate transactions, they have largely been thought of as economically equivalent taxes on consumption.[267]

Therefore, the only proper room for difference in the jurisdictional reach of sales taxes and use taxes (or any taxes) under the dormant Commerce Clause should result from differences in their compliance costs, as the proposed standard recognizes. Any concerns that loosening the transactional nexus standard would allow states to tax transactions beyond their borders are more appropriately addressed by due process protections against extraterritoriality and the requirements of the apportionment prong of the *Complete Auto* test rather than by the substantial nexus prong.[268]

264. *See supra* Section I.A.2. *McLeod v. J.E. Dilworth Co.* prohibits a state from imposing a sales tax on sales consummated outside of the state. 322 U.S. 327, 330 (1944).

265. *See supra* notes 201–203 and accompanying text.

266. *See* Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1977) (rejecting formalistic labels as controlling the constitutionality of a state tax and instead looking to economic realities of the tax); *see also* Comptroller of Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1795 (2015) ("We see no reason why the distinction between gross receipts and net income should matter, particularly in light of the admonition that we must consider 'not the formal language of the tax statute but rather its practical effect.'" (quoting *Complete Auto*, 430 U.S. at 279)); Walter Hellerstein et al., *Commerce Clause Restraints on State Taxation After* Jefferson Lines, 51 TAX L. REV. 47, 49 (1995). As Professors Gamage and Heckman note, "[w]ho bears a tax or subsidy is a function of the relative price elasticities of supply and demand and is not fixed by who has a legal obligation to pay the tax." Gamage & Heckman, *supra* note 17, at 486 n.18; *see also* Hellerstein et al, *supra*, at 54, 54 n.42.

267. *See, e.g.*, Holderness, *supra* note 17, at 347; McLure, *supra* note 70, at ¶¶ 9–16. Because the use tax is often framed as merely a backstop to the sales tax, *see* POMP, *supra* note 70, at 6-39 to 6-43, the substantial nexus jurisprudence before *Wayfair* had pushed use taxes into the shadow of sales taxes, and the transactional nexus standard for use taxes was not extended to sales taxes, which would have alleviated many of the formalism concerns in this area. *See* Holderness, *supra* note 17, at 345–55 (tracing how use taxes were unnecessarily pushed into the shadow of sales taxes for nexus purposes).

268. *See supra* notes 167–174 and accompanying text.

Breathing life into the transactional nexus standard as proposed would result in a theoretically-sound, substantial nexus standard regardless of what the courts do with the personal nexus doctrine. The proposed standard would ensure the compliance costs associated with each tax are considered and would protect taxpayers from undue costs related to small amounts of interstate activity in a state.

C. Over 10,000 Taxing Jurisdictions: Substantial Local Nexus

A final post-*Wayfair* issue to consider is whether substantial nexus will be required at the local level as well as the state level.[269] Many localities impose their own taxes—Chief Justice Roberts noted in his *Wayfair* dissent that "[o]ver 10,000 jurisdictions levy sales taxes"[270]—and these local taxes conform to state-level taxes in varying degrees.[271] Additionally, some localities administer their own taxes, whereas others rely on the state to administer their taxes.[272] Thus, a real possibility exists that a local-level tax could impose significant additional compliance costs on an interstate taxpayer or activity, such that the taxpayer might avoid conducting activities in the locality.[273] This result would seem to violate the demands of the compliance burden theory.

However, localities come into existence differently than states. The states are creations of the people and have divested some of their powers to the federal government including, as relevant here, the power to regulate interstate commerce.[274] Localities are creations of the states and often are viewed as mere extensions of the state.[275] In other words, by creating a locality, the state merely decentralizes some of its operations in favor of various

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269. *See* Joe Crosby et al., Wayfair*: The Present and Future of State Taxes*, 90 ST. TAX NOTES 1073, 1076–77 (2018) ("[O]ne other question that follows on *Wayfair* is whether we will see localities attempting to use *Wayfair*-like authority to reach outside their borders, even outside the state they're in, and impose local business licensing or other types of imposition on companies that are making sales into the locality."); Sarah Horn et al., *One by One, Most States Responded to* South Dakota v. Wayfair *in 2018*, RIA STATE & LOCAL TAX UPDATE, Dec. 12, 2018, at 4, 2018 WL 6546893 (RIA) (discussing the confusion brought about as a result of the *Wayfair* decision, including when a business must collect local taxes).

270. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2103 (2018) (Roberts, J., dissenting).

271. *See* POMP, *supra* note 70, at 6-44 to 6-46.

272. *See id.*

273. *See* Bland, *supra* note 227, at 623–24 (discussing concerns about the impact of a complex web of local taxes on Colorado's efforts to implement a South Dakota-style nexus statute).

274. *See* RICHARD BRIFFAULT & LAURIE REYNOLDS, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 7–8 (8th ed. 2016).

275. *Id*. at 8–9; Richard Briffault, *Our Localism: The Structure of Local Government Law* (pt.1), 90 COLUM. L. REV. 1, 7–8 (1990) (discussing the role of the local government in relation to the state).

goals.[276] With the source of local power in mind, it becomes unclear whether local-level substantial nexus is needed once state-level substantial nexus exists.

Although current substantial nexus doctrine does not provide a clear answer to the issue, the problem is not as troubling as it might appear. As a practical matter, the local-level substantial nexus question is currently trivial. The South Dakota model for statutory substantial nexus provisions—which most states have followed[277]—imposes thresholds designed to protect small vendors from being subject to the state's tax obligations.[278] As such, these thresholds likely do not come close to the constitutional line for substantial nexus; any person or activity exceeding the thresholds likely established constitutional substantial nexus long before the thresholds were met. This statement may not be true in all instances, but on the assumption that the states will continue with the South Dakota model and not draw close to the constitutional line for substantial nexus, it seems unlikely that the added compliance burdens of local taxes would trigger constitutional concerns; the statutes will protect interstate commerce more than the dormant Commerce Clause.

If the proposed substantial nexus standard is implemented, then the issue of local-level substantial nexus becomes a non-issue. The substantial nexus standard would permit those tax obligations that do not overwhelm the interstate commerce with compliance costs, such that the taxpayer would cease the activity in the taxing jurisdiction. This standard necessitates a tax-by-tax examination in order to determine whether the appropriate substantial nexus exists in each case.

Therefore, a vendor asked to collect a local tax would have grounds to challenge that specific locality's action if the tax's compliance burden was too high. Alternatively, and to the same practical effect, if one views the locality simply as an extension of the state, then the state would lack substantial nexus with the taxpayer or activity when the local taxes increased the compliance burdens above the constitutional line. Substantial nexus at the state level could be restored by eliminating the local tax in that instance or by reducing the differences between the state- and local-level taxes and the complexities those differences create. In other words, if a state feels that its ability to impose taxes is impaired on substantial nexus grounds because of the complexity of local taxes, the state can rein in those local taxes.

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276. BRIFFAULT & REYNOLDS, *supra* note 274, at 9–16; *see also* Yishai Blank, *Localism in the New Global Legal Order*, 47 HARV. INT'L L.J. 263, 270–77 (2006) (discussing various goals localities are argued to achieve).

277. *See supra* note 227.

278. S.D. CODIFIED LAWS § 10-64-2 (2018) (imposing thresholds of $100,000 of gross revenue from sales into the state or 200 separate sales into the state before statutory personal nexus exists); *see* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) ("[T]he Act applies a safe harbor to those who transact only limited business in South Dakota.").

IV. CONCLUSION

The *Wayfair* decision brought the dormant Commerce Clause nexus doctrine into the twenty-first century and thus was one of the most impactful in the field of state and local taxation since the *Quill* case it partially overturned. As a result of its abandonment of the historical physical presence rule for personal nexus, *Wayfair* might be read to have pushed the dormant Commerce Clause's nexus requirement towards the Due Process Clause's personal jurisdiction requirement. Alternatively, the case could be read to have begun the work of establishing a nexus doctrine that more coherently addresses the concerns of the dormant Commerce Clause.

This Article has argued for the latter reading and continues the work of *Wayfair* by fully developing the compliance burden theory of dormant Commerce Clause nexus and the standard that follows from that theory. The Article also has mapped out the path for incorporating this theoretically-sound nexus standard into the jurisprudence through future litigation spurred by unanswered questions from *Wayfair*. Ensuring the dormant Commerce Clause nexus doctrine continues to come into alignment with theory will prevent the protections of the doctrine from withering away and will ensure that interstate commerce—particularly that conducted by small businesses and online mar ketplaces—is not subjected to undue burdens from state tax compliance costs. With a little help, *Wayfair* can be the beginning of the way forward for the dormant Commerce Clause nexus doctrine, not the end.