

Minutes of Teleconference of Task Force III  
(July 7, 1997 at 2:00pm, EDT)

I Identified parties present:

June Zivley (Co-Leader)	Kaye Caldwell (Co-Leader)
H. Beau Baez	Merle Buff
René Y. Blocker	Annabelle Canning ( <i>sp?</i> )
Dennis Fox	
Alan Friedman (Facilitator)	
Paull Mines (Reporter)	Kendall Houghton
Dale Vettel	Art Rosen
Larry O’Nan, Charlotte Quarles	Delores Whiskeyman
George Sorenson, Martha Mote, Jerry Carlton	
Marshall Stranburg	
June Summers	
Mark Wainwright	

II No public comments were made.

III **Common carrier definition as it pertains to NBH’s recognized safe harbor of contact limited to U.S. mail and common carrier:** The viewpoints expressed included—

1. *Trap for unwary tax planner.* A written comment from Peter Bloom was read that described the distinction between common carriers and private contract carriers an unjustified trap for the unwary tax planner. No valid distinction exists between common carrier and private contract carrier; an out-of-state seller should be able to use all unaffiliated carriers without changing the seller’s nexus consequences.
2. *Relationship and control.* Distinction between common carrier and private contract carrier is valid even today, thirty years after the NBH decision. The determination essentially focuses on determining whether the relationship between the out-of-state seller and the carrier is sufficient to conclude that the out-of-state seller has a physical presence in the taxing State arising from the carrier’s representational role. The element of control over a contract carrier is far different from that over a common carrier. One may safely conclude that a private contract carrier is the representative of the out-of-state seller.

3. *Functional analysis.* No difference in nexus consequences should follow if the function performed by a contract carrier is no different from the functions performed by common carriers or the U.S. Postal Service. Therefore, as the functions performed by common carriers and/or U.S. Postal Service have expanded, so must the safe harbor afforded by *NBH* to out-of-state sellers who use private contract carriers.
4. *Checklist of permitted activities.* It would be clearer to list the activities that a private contract carrier could do without leaving the common carrier safe harbor, e.g., pure shipment and delivery by a contract carrier is permitted? This listing should contemplate permitted activities that exceed pure shipment and delivery; really anything a common carrier normally does today should be a permitted activity by a private contract carrier.
5. *Checklist approach is irrelevant.* Establishing a list of permitted activities by a private contract carrier is irrelevant to the pertinent inquiry: What is the nature of the relationship between the carrier and the out-of-state seller and does that relationship justify calling the carrier a representative of the seller for purposes of "market enhancement"?
6. *What is a common carrier?* The modern understanding of a common carrier is one that is more expansive than what the U.S. Supreme Court understood as a common carrier in 1967 when it decided *NBH*. The admitted safe harbor of contact limited to U.S. mail and common carrier necessarily picks up the new activities now undertaken by the modern common carrier.
7. *Learning from financial institution apportionment rule.* The approach taken in defining a financial institution for purposes of the income apportionment rule developed by the MTC is a useful lesson here. All competitors should be treated alike. This approach would be translated here to mean that private contract carriers should not be placed at a disadvantage vis à vis common carriers.
8. *Private contract carrier/common carrier distinction is bright line.* While treating the use of a private contract carrier as outside of the *NBH/Quill* safe harbor may appear artificial at the edges, that observation does not negate the benefits of the bright line understanding that can be preserved by distinguishing between common carriers and private contract carriers. There is obviously some point where everyone would admit the use of a contract carrier is the same as having a representative in the taxing State

for market enhancement activities. Consistent with the U.S. Supreme Court's jurisprudential objective it is better to limit the clearly established safe harbor to common carriers and conclude the use of private contract carriers is outside the safe harbor.

**IV. Illustrating tension between safe harbor of *NBH/Quill* and "physical presence test."** The task force desired to see the precise statements of the U.S. Supreme Court that raises the described tension between the safe harbor of *NBH/Quill* (contact limited to U.S. mail and common carrier) and the descriptive "physical presence test." Please find attached excerpts taken from *Quill* that illustrate this tension.

**V. Basing physical presence upon temporary presence of employees engaged in market enhancement activities.** The viewpoints expressed included—

1. *Too restrictive limitation.* It is too restrictive to require employees temporarily in the State to be engaged in market enhancement activities before physical presence may be found. One thousand, non-marketing employees temporarily in the State should create physical presence and, more importantly, nexus.
2. *Market enhancement limitation makes sense.* We see examples where there are a large number of employees in the taxing State and still do not contend that the out-of-state seller has physical presence in the taxing State. In one case 100 employees may come into the State for training on a newly purchased telephone system without that temporary presence constituting physical presence. The market enhancement limitation makes sense. But there can be circumstances where application of the market enhancement limitation is a harder *pharmaceutical* to swallow, e.g., 10 employees in the taxing State for 6 months scouring the taxing State for possible sources of supply.
3. *List activities that are non-market enhancement.* The phrase "significantly associated with the out-of-state seller's ability to establish and maintain the market" ("market enhancement"), although admittedly based upon U.S. Supreme Court lore, is not a clearly understood principle. It would be better to list activities that employees temporarily in the State may do in the taxing State without those activities rising to the level of market enhancement activities. Alternatively, there could be a profusion of examples that show the permitted activities that do not result in physical presence. Examples of temporary presence in the State that were noted with the observation that physical presence should not be created were (i) employee lobbyist, (ii) executive

retreat, (iii) board of directors meeting, and (iv) employee buyer for the out-of-state seller. [Reporter's note: The Reporter agreed to supply a *first-cut* (hardly exhaustive) list for possible consideration of the Task Force. See list of permitted activities undertaken by employees temporarily in taxing state that do not constitute market enhancement.]

4. *Need to attract subscribing States.* To retain the requirement of market enhancement activities for employees temporarily in the taxing State will drive too many States away from wanting to consider the Guideline. It would be preferable to deal with a small quantitative number of employees temporarily in the taxing State without this temporary presence constituting physical presence under the *de minimis* rules.

**VI. Basing physical presence upon presence of representatives and/or property of representatives where the presence is tied to market enhancement activities.** The viewpoints expressed included—

1. *How physical presence based on presence of representatives differs from physical presence based upon presence of employees.* There is a difference in the stated rules that govern the determination of physical presence based upon the presence of employees as opposed to the presence of representatives. The permanent presence of an employee in the taxing State establishes physical presence regardless of the activity undertaken by the employee. See II.C.1., lines 110-111. The permanent presence of a representative in the taxing State only establishes physical presence if the presence is tied to market enhancement activity. See II.C.5., lines 239-245. For temporary presence of employees and representatives, the presence must be tied to market enhancement activity to establish physical presence. See II.C.1., lines 111-116; II.C.5., lines 239-245. [Basing physical presence on the use of property of a representative in the taxing State also requires that the representative's property be tied to market enhancement activity. See II.C.6.]
2. *Wait to see how "representative is defined."* Many of the task force members were reluctant to express any opinion on the use of the market enhancement limitation without first knowing how the term "representative" was ultimately defined. [Review of the definition of representative was assigned to another task force, Task Force IV. This task force, Task Force III, requested that it be kept apprised on the developments of the definition of representative.

**VII Defining “permanent,” “temporary,” and “significantly associated with the ability of the out-of-state seller to establish or maintain the market.”** The viewpoints expressed included—

1. *Is one year too long?* The one year period contemplated by the definition of permanent (see II.F.9.) is too long.
2. *Permanence should be tied to function.* Permanence is sometimes tied to function and is less temporal. Is a mail order seller of high quality pears permanently present in Oregon if it sends in an employee crew of pickers once each pear-picking season for one month?
3. *Clarify “significantly associated . . . maintain the market with examples.* The phrase “significantly associated with the ability of the out-of-state seller to establish or maintain the market” needs to be clarified with a listing of examples of what the phrase actually means. [The Reporter agreed to supply a *first-cut* (hardly exhaustive) listing of functions that constitute market enhancement activities. See attached list.]

**VIII Future Meeting.** The next meeting of the task force is set for July 14, 1997, at 2:00pm, Eastern Daylight Time. Participants need to call (703) 736-7307 and ask to participate in the Multistate Tax Commission call moderated by Paull Mines.

In preparation for this next teleconference, participants will reflect on the issues that have been discussed with a view to determining at the next task force whether any areas under discussion are open to consensus agreement. For those areas for which consensus is not possible, the participants should be prepared to state concisely the reason for not reaching consensus.

Excerpts from *Quill* Illustrating Tension Between Safe Harbor of Contacts Limited to U.S. Mail and Common Carrier and Physical Presence Requirement

This case, like *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), 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. In *Bellas Hess* we held that a similar Illinois statute violated the Due Process Clause of the Fourteenth Amendment and created an unconstitutional burden on interstate commerce. **In particular, we ruled that a “seller whose only connection with customers in the State is by common carrier or the United States mail” lacked the requisite minimum contacts with the State.** *Id.*, at 758.

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Equally important, in the court's view, were the changes in the “legal landscape.” With respect to the Commerce Clause, the court emphasized that *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), rejected the line of cases holding that the direct taxation of interstate commerce was impermissible and adopted instead a “consistent and rational method of inquiry [that focused on] the practical effect of [the] challenged tax.” *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 443 (1980). **This and subsequent rulings, the court maintained, indicated that the Commerce Clause no longer mandated the sort of physical-presence nexus suggested in *Bellas Hess*.**

**Similarly, with respect to the Due Process Clause, the North Dakota court observed that cases following *Bellas Hess* had not construed “minimum contacts” to require physical presence within a State as a prerequisite to the legitimate exercise of state power.** The State Court then concluded that “the Due Process requirement of a ‘minimal connection’ to establish nexus is encompassed within the *Complete Auto* test” and that the relevant inquiry under the latter test was whether “the state has provided some protection, opportunities, or benefit for which it can expect a return.” 470 N.W.2d, at 216.

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The Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,” *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954), and that the “income attributed to the State for tax purposes must be rationally related to ‘values connected with the taxing State.’ ” *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978) (citation omitted). Here, we are concerned primarily with the first of these requirements. Prior to *Bellas Hess*, we had held that that requirement was satisfied in a variety of circumstances involving use taxes. For example, the presence of sales personnel in the State, or the maintenance of local retail stores in the State, justified the exercise of that power because the seller's local

activities were “plainly accorded the protection and services of the taxing State.” *Bellas Hess*, 386 U.S., at 757. The furthest extension of that power was recognized in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), in which the Court upheld a use tax despite the fact that all of the seller's in-state solicitation was performed by independent contractors. **These cases all involved some sort of physical presence within the State, and in *Bellas Hess* the Court suggested that such presence was not only sufficient for jurisdiction under the Due Process Clause, but also necessary. We expressly declined to obliterate the “sharp distinction ... 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 a part of a general interstate business.”** 386 U.S., at 758. [footnotes omitted].

**Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State.** As we explained in *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985):

“Jurisdiction in these circumstances may not be avoided merely because the defendant did not *physically* enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, **it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are ‘purposefully directed’ toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.**” *Id.*, at 476 (emphasis in original) (bold face added).

Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has “fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.” *Shaffer v. Heitner*, 433 U.S., at 218 (STEVENS, J., concurring in judgment). In “modern commercial life” it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: the requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. **Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of**

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

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While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases. Under *Complete Auto*'s four-part test, 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.” 430 U.S., at 279. ***Bellas Hess* concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the “substantial nexus” required by the Commerce Clause.**

Thus, three weeks after *Complete Auto* was handed down, we cited *Bellas Hess* for this proposition and discussed the case at some length. **In *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 559 (1977), we affirmed the continuing vitality of *Bellas Hess*' “sharp distinction . . . between mail-order sellers with [a physical presence in the taxing] 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.”** We have continued to cite *Bellas Hess* with approval ever since. For example, in *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989), we expressed “doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. See *National Bellas Hess* . . . (receipt of mail provides insufficient nexus).” See also *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 33 (1988); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S., at 437; *National Geographic Society*, 430 U.S., at 559. For these reasons, we disagree with the State Supreme Court's conclusion that our decision in *Complete Auto* undercut the *Bellas Hess* rule.

The State of North Dakota relies less on *Complete Auto* and more on the evolution of our due process jurisprudence. **The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process “minimum contacts” test, then that corporation also meets the Commerce Clause “substantial nexus” test.** We disagree. Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies.

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**The State Supreme Court reviewed our recent Commerce Clause decisions and concluded that those rulings signalled a “retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach”** and thus supported its decision not to apply *Bellas Hess*. 470 N.W.2d, at 214 (citing *Standard Pressed Steel Co. v. Department of Revenue of Wash.*, 419 U.S. 560 (1975), and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987)). Although we agree with the State Court's assessment of the evolution of our cases, we do not share its conclusion that this evolution indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law.

**First, as the State Court itself noted, 470 N.W.2d, at 214, all of these cases involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* or compel that it be overruled.** Second, and more importantly, although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established “bright-line” tests. **Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.**

*Complete Auto*, it is true, renounced *Freeman* and its progeny as “formalistic.” But not all formalism is alike. *Spector*'s formal distinction between taxes on the “privilege of doing business” and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood “only as a trap for the unwary draftsman.” *Complete Auto*, 430 U.S., at 279. In contrast, the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. 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* followed the latter approach and created a safe harbor for vendors “whose only connection with customers in the [taxing] State is by common carrier or the United States mail.” Under *Bellas Hess*, such vendors are free from state-imposed duties to collect sales and use taxes.** [footnote omitted].

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\* \* \* Second, unlike the *Attleboro* rule, we have, in our decisions, frequently relied on the *Bellas Hess* rule in the last 25 years, see *supra*, at 11, and we have never intimated in our review of sales or use taxes that *Bellas Hess* was unsound. Finally, again unlike the *Attleboro* rule, the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizeable industry. The “interest

in stability and orderly development of the law” that undergirds the doctrine of *stare decisis*, see *Runyon v. McCrary*, 427 U.S. 160, 190-191 (1976) (STEVENS, J., concurring), therefore counsels adherence to settled precedent.

**In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes.** To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law. For these reasons, we disagree with the North Dakota Supreme Court's conclusion that the time has come to renounce the bright-line test of *Bellas Hess*.

First-Cut (hardly exhaustive) List of Functions of Employees  
*Temporarily* in Taxing State Without Constituting Market  
Enhancement Activities

1. Temporary presence to consult with business advisors and professionals (visits with lawyers, accountants, insurance brokers or agents, investment bankers, commercial bankers, credit card companies).
2. Temporary presence to meet with suppliers (printers, manufacturers, fabricators, assemblers, further-processors, engineers, designers).
3. Temporary presence to conduct on-site photography sessions for securing photos to may or may not thereafter be used in catalogue that will eventually be mailed to customers, including customers in the State.
4. Temporary business visits to the State that are not for purposes to establishing contact with, or planning for others to establish contact with, customers and/or potential customers (executive retreat, board of directors or shareholder meeting, award trips to excelling sales personnel, recreational trips, seminar or conference for training, speech to trade group meeting).
5. Temporary presence for purposes of recruiting or interviewing potential employees.
6. Temporary presence for purposes on influencing legislative process of State.

## Illustrating “Significantly Associated with Ability of Out-of-State Seller To Establish and Maintain Market”

The following illustrate market enhancement activities that trigger physical presence for employees temporarily in the taxing State and for representatives in the taxing State (temporarily or permanently). In preparing this hardly exhaustive list, it must be recalled that the approved phrase talks of activities “significantly associated with the ability . . . ,” not activities that do in fact establish and maintain the market. So here are the illustrations—

1. Solicitation and marketing directed to persons in the taxing State, including market research for sales to be made into the taxing State.
2. Product fulfillment activities, including delivery, distribution, installation, training, testing, and consultation.
3. Repair services that are on behalf of the out-of-state seller.
4. Customer adjustment services, including handling of complaints and returns.
5. Other activities that involve contact with persons who are customers and/or potential customers where the contact is made with the person in his/her capacity as a customer.