VIRGINIA TAX REVIEW

VOLUME 21, NUMBER 4 SPRING 2002

FEDERALISM AND STATE BUSINESS ACTIVITY TAX NEXUS: REVISITING PUBLIC LAW 86-272

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The author acknowledges helpful comments on drafts of this paper by Thomas A. Barnico of the Massachusetts Attorney General's Office, Peter D. Enrich of Northeastern University Law School, Walter Hellerstein of the University of Georgia Law School, Thomas J. Chappell of Arthur Andersen, LLP, and Donald Twomey of the Massachusetts Department of Revenue. The author dedicates this article to his wife, Stacy, and his mother and father, Grace and Mike.

INTRODUCTION

"First, [Public Law 86-272] is, as we have stated, [a law] which will foster a direct invasion of the statutory rights of the States, rights which they now legally exercise. The States are hard pressed for tax revenues, without which they must

> become powerless wards of the National Government. By what reason and for just what specific purpose should Congress interfere with State assessment of taxes on profits realized within a State, in the absences of positive proof that such assessments were, in fact, interfering with or obstructing interstate commerce? Sufficient justification, we respectfully submit, is lacking."[1]

Current congressional attempts to appropriately restrict state *sales and use* taxes on Internet transactions have led, perversely, to congressional proposals to expand a forty-three year old federal statute, Public Law 86-272, which bars state *income* tax under certain circumstances.[2] In particular, Public Law 86-272 prohibits the states from imposing a net income based tax on a business when that business limits its contacts with the state to the solicitation of sales of tangible personal property, where this property is delivered from outside the state.[3]

Public Law 86-272 was enacted in 1959, 171 years after the ratification of the U.S. Constitution, and was the first federal statute to impose general restrictions upon the states' power to tax.[4] Responding to intense business lobbying, Congress quickly deliberated the Act and passed it in just over six months, giving the states very little input.[5]

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[1] Senators Albert Gore Sr. and Eugene McCarthy, expressing their minority views on Public Law 86-272, 73 Stat. 555 (2001) (codified at 15 U.S.C. §§ 381-384) [hereinafter Public Law 86-272 or the Act]. *See* S. REP. NO. 86-658, at 11-12 (1959) (Gore & McCarthy minority view).

[2] The recent congressional proposals would reenact Public Law 86-272 with broader prohibitions on state taxation. *See* New Economy Fairness Act, S. 664, 107th Cong. (2001); The Internet Tax Fairness Act, H.R. 2526, 107th Cong. (2001). Senate 664 is in essence a refiled version of a bill filed in the year 2000. *See* New Economy Simplification Act, S. 240, 106th Cong. (2000). *See generally* Doug Sheppard, *No Kinder, Gentler Internet Tax Battle in 2001*, 22 STATE TAX NOTES (TA) 1068, 1074 (Dec. 31, 2001) (discussing the three federal bills).

[3] *See* 15 U.S.C. §§ 381-384.

[4] *See* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 4.23[3] (3d ed. 2000). *See also* Kathryn L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 182 (1997) ("Congress has introduced bills regulating state and local taxation as far back as 1934 yet did not actually enact any legislation limiting the States' power to tax interstate commerce until 1959.").

[5] One commentator referred to Public Law 86-272 as "a piece of hasty, hysteria legislation...pressured through the Federal Congress by a highly organized and certainly skillfully handled group of trade organizations." Robert L. Roland, *Public Law 86-272: Regulation or Raid*, 46 VA. L. REV. 1172, 1172 (1960). *See also* Paul J. Hartman, *Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 1008 (1962) (stating that "[e]ven those who in the main favor congres-

Congress passed Public Law 86-272 as a "temporary" or "stop-gap" measure,[6] but has not revisited the Act in the forty-three years since its enactment. The new congressional proposals force state tax practitioners to finally turn and revisit Public Law 86-272. As this article demonstrates, upon reexamination, it is apparent that Public Law 86-272 is not only arbitrary in its application, enormously costly to the states, and functioning at odds with its initial purpose; but it is also likely unconstitutional.[7] For these reasons, this article argues that Congress should not broaden Public Law 86-272, but rather should repeal it. In the absence of a congressional repeal, the Supreme Court should strike down the Act.

Public Law 86-272 was originally intended primarily to protect smaller companies from having to comply with the states' allegedly burdensome income tax laws.[8] However, almost before the ink on the Act was dry, a federal subcommittee charged with its review concluded that it did not serve this purpose, but instead benefited larger companies.[9] This disparity has become greater with the passage of time as larger businesses have utilized tax planning to accord themselves the benefits of the Act. Further, since Public Law 86-272 benefits primarily larger companies and not smaller companies, it has the unintended effect of actually disadvantaging smaller companies relative to their larger competitors.[10]

Public Law 86-272 was also intended to maintain the jurisdictional rules that existed forty-three years ago prior to the Supreme Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*,[11] holding that in-state persons soliciting sales could establish tax-

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sional intervention have criticized the technical draftsmanship exhibited in the act and the abbreviated procedure used in its adoption").

[6] *See* S. REP. No. 86-658, at 4 (1959).

[7] *See* Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological, Constraints, and Tax Laws*, 52 TAX L. REV. 269, 395 (1997) (arguing that Public Law 86-272 makes no economic sense and should be repealed, not expanded).

[8] *See generally* S. REP. No. 86-658, at 2-4.

[9] *See, e.g.*, 1 SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE, HOUSE JUDICIARY COMM., STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. NO. 88-1480, at 428 (1964) [hereinafter Willis Report] ("Insofar as the supporters of the statute believed that the law would be beneficial primarily to small businesses, they appear to have been mistaken.").

[10] *See* McLure, *supra* note 7, at 387 (stating that Public Law 86-272 is unfair to local merchants and distorts interstate commerce by favoring it at the expense of intrastate commerce).

[11] 358 U.S. 450 (1959).

ing jurisdiction on the part of their employer.[12] Congress enacted Public Law 86-272 in large part because it believed that the Court's decision in *Portland Cement* was equivocal and inconsistent with the Court's prior law.[13] However, the Court has repeatedly reaffirmed its commitment to the rule of law stated in *Portland Cement*,[14] whereas the logic behind Public Law 86-272 has become antiquated.

Although the federal benefit to be derived from Public Law 86-272 is questionable, there is no doubt that the Act is enormously costly to the states both in terms of the tax revenues forgone[15] and in terms of the Act's considerable administrative costs. States incur significant administrative costs as a result of the Act because the Act's application turns upon the meaning of several terms, none of which the Act defines.[16] Hence, the states have been forced to defend literally hundreds of lawsuits in state courts and tribunals concerning the meaning of the federal terminology.[17] Ironically, while Congress primarily intended

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[12] *See* Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 223 (1992); Heublein, Inc. v. South Carolina Tax Comm'n, 409 U.S. 275, 280 (1972).

[13] For example, House Report 936 stated that, despite *Portland Cement*, "it may be argued that the Supreme Court has not yet decisively disposed of the precise question of whether solicitation alone is a sufficient activity for the imposition of a State income tax upon an out-of-State business...." *See* H.R. REP. NO. 86-936, at 2 (1959).

[14] *See* Tyler Pipe Indus. v. Washington Dep't of Revenue, 483 U.S. 232 (1987) (applying the "solicitation" nexus standard in the context of an income tax); Standard Pressed Steel Co. v. Dep't of Revenue of Wash., 419 U.S. 560 (1975) (same); Scripto, Inc. v. Carson, 362 U.S. 207 (1960) (applying the "solicitation" nexus standard in the context of a sales tax). *See also* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 285 (1977) (favorably citing *Portland Cement* in a case that established the Court's current four-part test for evaluating the validity of a state tax under the dormant Commerce Clause).

[15] An affidavit filed by the Massachusetts Department of Revenue in a 1997 case stated that, for the fiscal years 1993 and 1994, the Department assessed taxes or sent notices of intention to assess in 1,580 cases in which taxpayers invoked Public Law 86-272, representing taxes that totaled $29,578,207. *See* Brief for the Commisioner at 41, Nat'l Private Truck Council, Inc. v. Comm'r of Revenue, 688 N.E.2d 936 (Mass. 1997) (SJC-07478).

[16] These terms are "solicitation," "delivery," "tangible personal property," and "office." *See* 15 U.S.C. § 381. The term "independent contractor" has also generated litigation because, although the term is defined, the definition is confusing. *See* 15 U.S.C. § 381(d).

[17] Although the Supreme Court endeavored to define one of the ambiguous terms, "solicitation," in *Wrigley*, 505 U.S. 214 (1992), this definition remains ambiguous. *See, e.g.*, Paul E. Guttormsson, Note, *Gumming Up the Works: How the Supreme Court's Wrigley Opinion Redefined 'Solicitation of Orders' Under the Interstate*

to benefit smaller businesses with the Act, the states have been forced to defend litigation under Public Law 86-272 against some of the largest businesses in the United States.[18]

The current congressional attempts to restrict state *sales and use* taxes on Internet transactions by expanding Public Law 86-272 both bring to the forefront and amplify the stated concerns with Public Law 86-272. The proposed congressional bills would create a "business activity" nexus standard for the purpose of state taxation. This standard would take the single safe harbor established under Public Law 86-272, expand upon it, and add seven to nine more safe harbors.[19]

Commerce Tax Act (15 U.S.C § 381), 1993 WIS. L. REV. 1375, 1392 (1993). *Wrigley* comically illustrates the deficiencies in Public Law 86-272 as a jurisdictional statute. The opinion was rendered by a 6-3 vote. The dissent disagreed with the majority's construction of the term "solicitation" and claimed that, in any event, the majority misapplied its test to the facts. 505 U.S. at 243-44 (Kennedy, J., dissenting). In contrast, the majority claimed that the standard that the dissent advocated was "amorphous" and potentially subject to taxpayer manipulation. *See id.* at 229 n.5. The majority decision noted, in a bit of understatement, that despite the fact that "Congress' primary goal [in enacting Public Law 86-272] was to provide clarity that would remove the uncertainty created by [*Portland Cement*], experience has proved the § 381 minimum standard to be somewhat less than entirely clear." *See id.* at 223 (quotation marks omitted).

[18] *See, e.g.*, Tyson Foods, Inc. v. Dep't of Revenue, 726 N.E.2d 12 (Ill. Ct. App. 2000); Johnson & Johnson Consumer Prods. v. Comm'r of Revenue, Nos. 7057-67, 2000 WL 1886617 (Minn. Tax Dec. 26, 2000); Hallmark Mktg. Corp. & Affiliates v. Dep't of Revenue, 2000 WL 33225374 (Or. Tax Magistrate Div. Oct. 9, 2000); Amgen, Inc. v. Comm'r of Revenue, 693 N.E.2d 175 (Mass. 1998); Gillette Co. v. Dep't of Treasury, 497 N.W.2d 595 (Mich. Ct. App. 1993); Nat'l Tires, Inc. v. Comm'r, 1996 WL 729880 (Mass. App. Tax Bd. Nov. 27, 1996); E & J Gallo Winery v. Comm'r, 1996 WL 729879 (Mass. App. Tax Bd. Nov. 19, 1996); Phillip Morris, Inc. v. Dep't of Revenue, 1990 WL 19738 (Or. Tax Mar. 1, 1990); United States Tobacco Co. v. Commonwealth, 386 A.2d 471 (Pa. 1978), *cert. denied*, 439 U.S. 880 (1978).

[19] *See supra* note 2 (referencing the three federal bills). Each of the three bills provides that a person is not subject to tax in a state unless it has a "substantial physical presence" in the state. The bills do not define this term, but rather set forth either eight or ten types of activities that do not meet this test. In each bill, the activities include (1) the "presence or use of intangible personal property in the state"; (2) the "use of any service provider for the transmission of communications"; and (3) the "affiliation with a person located in the state" other than an agent whose activities constitute a "substantial physical presence." *See* Sheppard, *supra* note 2. *See also* Doug Sheppard, *Internet Freedom, Business Tax Nexus Combined in U.S. Reps' Bill*, 21 STATE TAX NOTES (TA) 270 (July 23, 2001) [hereinafter Sheppard, *Internet Freedom*]; Michael Mazerov, *Should New Limits on State Corporate Profits Taxes Be A Quid Pro Quo For the States' Ability to Tax Internet Sales?*, 21 STATE TAX NOTES (TA) 889 (Sept. 17, 2001).

Whereas Congress intended for Public Law 86-272 to benefit manufacturing and mercantile corporations, the proposed business activity nexus rules would apply to all forms of U.S. commercial activity.[20] By one estimate, the proposed business activity nexus statutes would cost the states $9 billion in forgone tax revenues in the first year alone.[21] In fact, substantial increases in tax planning and state litigation would likely make these statutes even more costly.[22]

Although Congress should repeal Public Law 86-272, Congress likely will not do so since the nature of the national political process—as revealed in the enactment of Public Law 86-272—creates great temptation for Congress "to provide constituents with tax giveaways in the form of prohibitions on state taxation."[23] On the other hand, as reflected by the forty-three year long history of this "stop-gap" legislation, the political process provides very little incentive for Congress to eliminate a state tax benefit when it has become outmoded.[24] Indeed, the very existence of the federal bills proposing an extension of Public Law 86-272 reveals the nature of the political process. As in the enactment of Public Law 86-272, the proposed nexus statutes are touted as necessary to protect smaller businesses.[25] But also as in the case of

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[20] Public Law 86-272 was directed at manufacturing and mercantile businesses at a time when these businesses accounted for "a very major part of the private activity in the United States." *See* H.R. REP. NO. 88-4180, at 16 (1964).

[21] *See* Doug Sheppard, *What's in a Number? The Debate Over the MTC's Nexus Bill Revenue Impact Estimate*, 22 STATE TAX NOTES (TA) 198 (Oct. 15, 2001).

[22] *See id.* at 198 (Executive Director of the Multistate Tax Commission Dan Bucks commenting that "[t]he task of estimating the impact of H.R. 2526 or S.664 is very difficult because essentially what they do is legalize expanded methods of tax avoidance or income shifting").

[23] *See* Tracy A. Kaye, *Show Me the Money: Congressional Limitations on State Tax Sovereignty*, 35 HARV. J. ON LEGIS. 149, 178 (1998).

[24] Professor Kathryn Moore recently performed an empirical study of over 200 federal bills that were introduced to regulate state and local taxation over a twenty-five-year period. *See* Moore, *supra* note 4, at 182 (1997). Professor Moore concluded that a federal bill regulating this taxation will generally only be enacted when the legislation either (1) personally benefits the members of Congress; (2) represents a compromise between the states and taxpayers and is part of broader legislation; or (3) "benefits a specific, well-defined interest group that orchestrates an extensive campaign with limited opposition." *Id.* at 172. Public Law 86-272 represents this third type of legislation, whereas the potential repeal of the Act is not contemplated under any of these three categories.

[25] *See* Dean Andal, *A Uniform Jurisdictional Standard: Applying the Substantial Physical Presence Standard to E-Commerce*, 17 STATE TAX NOTES (TA) 1536, 1538-40 (Dec. 6, 1999). Mr. Andal's proposal became the New Economy Tax Simplification Act, S. 2401, 106th Cong. (2000), which was then effectively refiled in 2001 as the New Economy Tax Fairness Act, S. 664, 107th Cong. (2001). *See* Doug

Public Law 86-272, the persons who make these claims are generally representatives of the largest companies in the United States.[26] Further, just like Public Law 86-272, the proposed business activity nexus statutes are touted as necessary to maintain jurisdictional clarity—this time purportedly by codifying rather than overriding an outstanding Supreme Court precedent.[27] However, the Supreme Court precedent on which the proposed statutes are based has been the source of extensive state court litigation.[28]

Even in the absence of the repeal of Public Law 86-272, it is this author's view that Public Law 86-272 is unconstitutional under the Supreme Court's contemporary view of federalism. For similar reasons, it is this author's view that the proposed business activity nexus statutes, if enacted, would also be unconstitutional.

This Article consists of six parts. Part I provides an overview of the Supreme Court's constitutional analysis concerning the federal commerce power and relates this analysis to state taxation in general and Public Law 86-272 in particular. Part II evaluates in detail the Court's historical approach to the interaction between the Commerce Clause and the Tenth Amendment. Part III evaluates how the Court's

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Sheppard, *U.S. Senators Propose to Codify Nexus Standards for Sales, Income Tax*, 18 STATE TAX NOTES (TA) 1364 (Apr. 17, 2000); Doug Sheppard, *U.S. Senators Reintroduce Bill to 'Codify' Nexus Standards*, 20 STATE TAX NOTES (TA) 1260 (Apr. 9, 2001). *See also* Lee A. Sheppard, *Business Taxpayers Resist Nexus in Courts and Congress*, 18 STATE TAX NOTES (TA) 1623 (May 8, 2000) (discussing S. 2401).

[26] *See, e.g.*, Doug Sheppard, *Where Will Congress End Up on the Internet Issue?*, 20 STATE TAX NOTES (TA) 1953, 1954 (June 4, 2001) (referencing comments of representatives of Microsoft and AOL); Sheppard, *Internet Freedom, supra* note 19, at 270 (referencing the support of the Walt Disney Company); Doug Sheppard, *Dorgan Optimistic Internet Tax Issue Can Be Solved*, 20 STATE TAX NOTES (TA) 960, 961 (Mar. 19, 2001) (referencing comments of a representative of Federated Department Stores Inc.).

[27] The precedent is *Quill Corp. v. North Dakota*, and the focus is the "physical presence" jurisdictional standard that was referenced in that case in the context of the states' sales and use tax collection duties. *See* 504 U.S. 298, 314, 317 (1992). The claim is made that the *Quill* physical presence standard applies to income taxes as well as sales and use taxes and that this clear rule should be codified by federal legislation. *See, e.g.*, Andal, *supra* note 25; Sheppard, *supra* note 21, at 200 (comments of Douglas Lindholm, the Executive Director of the Committee on State Taxation (COST)).

[28] *See, e.g.*, Kmart Props., Inc. v. Taxation & Revenue Dep't, No. 21140 (N.M. Ct. App. Nov. 27, 2001), *reprinted in* 2001 STATE TAX TODAY 233-18 (Dec. 4, 2001); Gen. Motors Corp. v. City of Seattle, 25 P.3d 1022 (Wash. Ct. App. 2001). *See generally* Michael T. Fatale, *State Tax Jurisdiction and the Mythical Physical Presence Constitutional Standard*, 54 TAX. LAW. 105 (2000).

current approach would apply in the context of state taxation. Part IV evaluates Public Law 86-272 and its history. Part V considers the constitutionality of the Act in light of the Court's current rules concerning the Tenth Amendment. Part VI concludes that Public Law 86-272 should be held unconstitutional and further concludes that, because the proposed business activity nexus statutes substantially resemble Public Law 86-272, these statutes also, if enacted, should be struck down.

I. OVERVIEW OF SUPREME COURT'S FEDERAL COMMERCE POWER ANALYSIS

The Supreme Court has never evaluated the constitutionality of Public Law 86-272. The statute was enacted pursuant to the Commerce Clause at a time when it was generally concluded that this clause placed practically no limit on congressional power.[29] For example, the Court had previously applied the Commerce Clause to uphold the ability of Congress to regulate the amount of wheat grown by a farmer for in-home consumption.[30] In addition, shortly after the enactment of Public Law 86-272, the Court applied the Commerce Clause to uphold the "moral legislation" set forth in the Civil Rights Act of 1964 as applied to hotels and restaurants.[31] While each of these federal statutes arguably possessed only a remote connection to "interstate" commerce, the Court applied a very liberal standard of review. The Court determined that Congress possessed the "plenary power" to determine whether an activity impacted interstate commerce and to determine the means by which this activity should be regulated.[32]

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[29] *See* Peter M. Shane, *Federalism's 'Old Deal': What's Right and Wrong with Conservative Judicial Activism*, 45 VILL. L. REV. 201, 203 (2000) (stating that from 1937 to 1964 the answer to the law school question as to what Congress could regulate under this clause was "anything it wants").

[30] *See* Wickard v. Filburn, 317 U.S. 111, 118, 125 (1942).

[31] *See* Katzenbach v. McClung, 379 U.S. 294 (1964) (concerning the regulation of a restaurant); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964) (concerning the regulation of a motel). *Heart of Atlanta* acknowledged the intent of the legislation to address a "moral and social wrong." 379 U.S. at 257.

[32] *See, e.g.*, *Wickard*, 317 U.S. at 124 ("The power of Congress over interstate commerce is plenary and complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed in the Constitution...."); *Heart of Atlanta*, 379 U.S. at 261-62 ("How obstructions in commerce may be removed—what means are to be employed—is within the sound and exclusive discretion of the Congress.").

Although the cases decided in the mid-part of the 20th Century suggest that Congress has broad ability to regulate the activities of private citizens under the Commerce Clause, the states are not the equivalent of private citizens under the U.S. Constitution.[33] Rather, the Constitution recognizes that the states are separate sovereigns that stand on equal footing with the federal government in many respects.[34] Further, the Constitution specifically protects the rights and powers of the states pursuant to the Tenth Amendment.[35] Significantly, it was not until almost twenty years after the enactment of Public Law 86-272 that the Court began to delineate the restrictions on federal power that apply when Congress seeks to regulate not the activities of private citizens, but rather the "States as *States*."[36] This process is ongoing to this day.

The cases that evaluate federal regulation of the states under the Commerce Clause have largely pertained to congressional attempts to regulate the states where the states act like private citizens, and in particular like commercial entities.[37] For example, a series of cases have

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[33] *See* New York v. United States, 326 U.S. 572, 588 (1946) (Stone, C.J., concurring) (explaining that unlike the states, "private citizens do not own State-houses or public school buildings or receive tax revenues...").

[34] *See* Printz v. United States, 521 U.S. 898, 918 (1997) ("It is incontestible that the Constitution established a system of 'dual sovereignty.'") (quoting Gregory v. Ashcroft, 501 U.S. 452, 457 (1991)); New York v. United States, 505 U.S. 144, 162 (1992) ("The preservation of the States, and the maintenance of their governments, are as much within the design and care of the Constitution as the preservation of the Union and the maintenance of the National government.") (quoting Texas v. White, 7 Wall. 700, 725 (1869)). *See also* THE FEDERALIST NO. 39, at 285 (James Madison) (B. Wright ed., 1961) (stating that the states possess a "residuary and inviolable sovereignty") (quoted in *Printz*, 521 U.S. at 919, and Alden v. Maine, 527 U.S. 706, 714 (1999)).

[35] The Tenth Amendment provides that, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X. This Amendment "expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system." *See* Fry v. United States, 421 U.S. 542, 547 (1975). *See also Printz*, 521 U.S. at 919 (stating that the Tenth Amendment makes "express" that there is "residual state sovereignty").

[36] *See* Nat'l League of Cities v. Usery, 426 U.S. 833, 837 (1976) (emphasis added), *rev'd by* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985).

[37] *See* Reno v. Condon, 528 U.S. 141 (2000) (addressing a federal law regulating the states along with private parties as a "supplier" or "reseller" of personal information contained in the records of state motor vehicle departments). *See also* South Carolina v. Baker, 485 U.S. 505 (1988) (addressing a federal law regulating the states collectively with private parties as the issuers of bonds).

involved amendments to the Fair Labor Standards Act (FLSA), pursuant to which Congress has sought to require the states, when acting as employers, to abide by the same wage and hour restrictions that generally apply to private employers.[38] Although the states clearly act analogously to private employers, the Court has struggled with the extent to which Congress can similarly regulate the states.[39]

The cases involving FLSA reveal that the Court applies a higher level of scrutiny when Congress seeks to regulate the states with private citizens, as opposed to private citizens alone. In a 1985 case, *Garcia v. San Antonio Metropolitan Transit Authority*, the Court stated that the inquiry in the former context is whether the national "political process" failed in the enactment of the statute.[40] However, the Court has never defined exactly what this standard means, and at least since 1988 in *South Carolina v. Baker*,[41] has not applied it. Instead, the Court's more recent cases suggest that the appropriate inquiry in a Tenth Amendment case involving a statute of general applicability is a balancing of the federal benefits to be obtained by the legislation against the burdens that the legislation imposes upon the states.[42] These recent cases suggest that Garcia's political process standard is merely one component of the Court's larger balancing inquiry.[43]

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[38] *See Alden*, 527 U.S. 706. *See also Garcia*, 469 U.S. 528, *rev'g Nat'l League of Cities*, 426 U.S. 833, *rev'g* Maryland v. Wirtz, 392 U.S. 183 (1968). FLSA had been previously upheld under the Commerce Clause as applied to private employers. *See* United States v. Darby, 312 U.S. 100 (1941). *Cf. New York*, 326 U.S. at 582 (concluding that federal legislation could tax New York State on its revenues derived from the sale of mineral water since the tax was one of general application and was not applied to the "State as a State").

[39] *Alden*, 527 U.S. 706, *Garcia*, 469 U.S. 528, and *Usery*, 426 U.S. 833, were each decided by a 5-4 vote. As noted in the preceding footnote, the Court has reversed itself twice in the state cases involving FLSA, and at least one commentator has suggested that the Court's most recent case involving this statute, *Alden*, effectively overrules its prior 1985 decision in *Garcia*. *See* Judith Olans Brown & Peter D. Enrich, *Nostalgic Federalism*, 28 HASTINGS CONST. L. Q. 1, 19 (2000).

[40] 469 U.S. 528, 554.

[41] 485 U.S. 505.

[42] *See Printz*, 521 U.S. at 932 (stating that a balancing approach is appropriate where the Court is "evaluating whether the incidental application to the States of a federal law of general applicability excessively interfered with the functioning of state governments"); *New York*, 505 U.S. at 177 (stating that the Court will weigh "the strength of federal interests in light of the degree to which such laws would prevent the State from functioning as a sovereign"). *See also Baker*, 485 U.S. at 529 (Rehnquist, C.J., concurring) (suggesting that *Baker* was based upon a balancing analysis).

[43] *See Condon*, 528 U.S. 141 (upholding a federal statute of general applicability

The Court's scrutiny is at its apex when Congress regulates the states, not under a law of general applicability, but "as states" because "in providing for a stronger central government...the Framers explicitly chose a Constitution that confers upon Congress the power to regulate individuals, not States."[44] Hence, there may be times when the congressional burdens imposed upon the states are so great that the benefits to interstate commerce are irrelevant.[45] One unique concern in cases in which Congress seeks to regulate the states as states is the extent to which the federal regulation may distort the citizenry's sense as to which sovereign, the state or federal government, is accountable for the regulation.[46]

In recent years, the Court's concern with federal intrusions on state power has caused it to scrutinize situations in which Congress has regulated the activities of private citizens in "an area of traditional state concern."[47] These recent cases, *Morrison* and *Lopez*, have brought the Court full circle and have rejected the idea that Congress has "plenary" power under the Commerce Clause even as to activities conducted by private citizens.[48] In cases that do not involve either the "channels" or "instrumentalities" of interstate commerce, *Morrison* and *Lopez* conclude that Congress may regulate private activity under the Commerce Clause only when this activity "substantially affects" interstate commerce.[49] Further, the Court has determined that it will adjudicate

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by analogy to the Court's prior decision in *Baker*, 485 U.S. 505, without any mention of the political process standard).

[44] *See Printz*, 521 U.S. at 920 (quoting *New York*, 505 U.S. at 166). *See also New York*, 505 U.S. at 166 ("The allocation of power contained in the Commerce Clause...authorizes Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce.").

[45] *See Printz*, 521 U.S. at 932 (stating that this "balancing analysis" is inappropriate when the "whole *object* of the law [is] to direct the functioning of the state executive") (emphasis in original).

[46] *See Alden*, 527 U.S. at 751 ("'The Constitution thus contemplates that a State's government will represent and remain accountable to its own citizens.' When the Federal Government asserts authority over a State's most fundamental political processes, it strikes at the heart of the political accountability so essential to our liberty and republican form of government.") (quoting *Printz*, 521 U.S. at 920).

[47] *See* United States v. Lopez , 514 U.S. 549, 580 (1995) (Kennedy, J., concurring). *See also* United States v. Morrison, 529 U.S. 598 (2000).

[48] *See Morrison*, 529 U.S. at 613 (stating that "'if we were to accept the Government's arguments, we are hard pressed to posit any activity by an individual Congress is without power to regulate'") (quoting *Lopez*, 514 U.S. at 564).

[49] *See Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558-59.

when this standard is met rather than deferring to Congress.[50] The Court's "substantial effects" test is consistent with the balancing standard that the Court applies to direct federal regulation of the states because the Court will ultimately determine whether a federal regulation represents a sufficiently strong federal interest.[51]

None of the Court's recent Tenth Amendment cases evaluates federal restrictions on state taxation. However, because this type of regulation pertains to the states as states, it would be subject to the Court's highest scrutiny.[52] Further, the states' sovereign interest in the right of taxation is substantial. Even Alexander Hamilton, who was a strong proponent of federal power, recognized that "the individual States would, under the proposed Constitution, retain an independent and uncontrollable authority to raise revenue to any extent of which they may stand in need, by every kind of taxation, except duties on imports and exports."[53] The Court has consistently echoed similar sentiments, dating back to the time of Justice John Marshall:

> [T]hat the power of taxation is one of vital importance; that it is retained by the states; that it is not abridged by the grant

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[50] *See Morrison*, 529 U.S. at 614 ("'Whether particular operations affect interstate commerce sufficiently to come under the constitutional power of Congress to regulate them is ultimately a judicial rather than a legislative question, and can be settled finally only by this Court.'") (quoting *Lopez*, 514 U.S. at 557 n.2 (quoting *Heart of Atlanta*, 379 U.S. at 273 (Black, J., concurring)). *See also Morrison*, 529 U.S. at 616 ("Under our written Constitution...the limitation of congressional authority is not solely a matter of legislative grace.").

[51] *Lopez*, 514 U.S. at 578 (Kennedy, J., concurring) (explaining that the Court will "intervene when one or the other level of Government has tipped the scales too far").

[52] *See* Gregory v. Ashcroft, 501 U.S. 452, 463 (1991) (Ashcroft stating that the Court will carefully consider federal intrusion with a state decision that "lies at 'the heart of a representative government'") (quoting Bernal v. Fainter, 467 U.S. 216, 221 (1984) (citations omitted)).

[53] THE FEDERALIST NO. 33, at 248 (Alexander Hamilton) (B. Wright ed., 1961). Hamilton also stated that:

> Though a law, therefore, laying a tax for the use of the United States would be supreme in its nature, and could not legally be opposed or controlled, yet a law for abrogating or preventing the collection of a tax laid by the authority of the State (unless upon imports and exports), would not be the supreme law of the land, but an usurpation of power not granted by the Constitution.

Id. at 247. The author notes that Hamilton attended his alma mater, Columbia University, and was a member of the class of 1778, although he did not graduate because he left to take part in the Revolutionary War.

> of similar power to the government of the Union; that it is to be concurrently exercised by two governments; [these] are truths that have never been denied.[54]

Public Law 86-272 should be struck down as unconstitutional under the Court's Tenth Amendment balancing test because the statute provides very little benefit in terms of protecting interstate commerce, but at the same time is enormously costly to the states.[55] Taxpayers criticize the states and state courts for rendering inconsistent interpretations of the federal terminology,[56] but this confusion inheres in the Act and merely begs the question whether the states should be made to perform this function at all.[57] Further, Public Law 86-272 distorts political accountability between the federal and state governments because it permits federal legislators to take credit for a huge business tax break, while at the same time holding state officials accountable for the arbitrary application of the Act.[58] Also, the political

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[54] McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 425 (1819). *See also* McKesson v. Div. of Alcoholic Beverages & Tobacco, 496 U.S. 18, 37 n.19 (1990) ("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible.") (quoting Dows v. City of Chicago, 78 U.S. 108, 110 (1871)).

[55] Applying a balancing analysis to the Act is consistent with the Court's analysis in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280 (1978) (stating in dicta that Congress can prescribe uniform rules concerning the computation of income to be taxed by the states presuming that "due consideration is given to the interests of all affected States"). *See also* Archie Parnell, *Constitutional Considerations of Federal Control Over the Sovereign Taxing Authority of the States*, 28 CATH. U. L. REV. 227, 245 (1979) (arguing that the "better view...is that the question of the extent to which Congress may limit the states' taxing power should be analyzed by balancing competing and legitimate constitutional powers").

[56] *See, e.g.*, Phillip M. Tatarowicz, *State Judicial and Administrative Interpretations of U.S. Public Law 86-272*, 38 TAX LAW. 293, 293 n.5 (1985) ("[S]tate courts have developed varying interpretations" and "[t]he result is lack of uniformity and the absence of a standard on which multistate taxpayers may rely in conducting their business dealings.").

[57] *See* Alden v. Maine, 527 U.S. 706, 749 (1999) (warning of a danger of the federal government's "power to press a State's own courts into federal service...and ultimately to commandeer the entire political machinery of the State against its will").

[58] The Supreme Court has emphasized the importance of local control in matters of state taxation:

> The extent to which [state power] shall be exercised, the subjects upon which it shall be exercised, and the mode in which it shall be exercised,

process failed in the enactment of Public Law 86-272 because Congress passed the Act without affording the states any meaningful input into the legislative process.[59]

Congress' commerce power with respect to the states is generally enhanced when Congress seeks either to remove state discrimination against out-of-state interests[60] or to "protect the instrumentalities of interstate commerce."[61] In either of these cases, the federal benefit from the legislation will often outweigh any corresponding state detriment.[62] However, Public Law 86-272 manifestly does not protect the instrumentalities of interstate commerce, and it also fails to remove any state discrimination.[63] Indeed, by generally favoring larger compa-

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> are all equally within the discretion of the legislatures to which the States commit the exercise of power. That discretion is restrained only by the will of the people expressed in the State constitutions, or through elections, and by the condition that it must not be so used as to burden or embarrass the operations of the National government.

R.R. Co. v. Peniston, 85 U.S. (18 Wall.) 5, 30 (1873).

[59] For example, the Senate Finance Committee, whose bill was passed, held public hearings on the bill that lasted only two days, and permitted representatives from just two states to present limited testimony at these hearings. *See* Roland, *supra* note 5, at 1175. *Cf.* South Carolina v. Baker, 485 U.S. 505, 513 (1988) (suggesting that one factor to be considered in applying the political process test is whether the states were "deprived of any right to participate in the national political process").

[60] *See* New York v. United States, 505 U.S. 144, 171 (1992) ("[T]he Commerce Clause has long been understood to limit the States' ability to discriminate against interstate commerce...."); New York v. United States, 326 U.S. 572, 583 (1945) (stating that "[t]he restriction upon States not to make laws that discriminate against interstate commerce is a vital constitutional principle").

[61] *See* United States v. Morrison, 529 U.S. 598, 609 (2000) (quoting United States v. Lopez, 514 U.S. 549, 558 (1995)). As one federal court recently noted, "Congress' power to displace state regulation of railroads affecting interstate commerce has a particularly lengthy pedigree." *See* Southeastern Pa. Trans. Auth. v. Pennsylvania Pub. Util. Comm'n, 826 F.Supp. 1506, 1520 n.13 (E.D. Pa. 1993).

[62] *See, e.g.*, Arkansas-Best Freight Sys., Inc. v. Cochran, 546 F. Supp. 904, 912 (M.D. Tenn. 1981) ("[T]he federal interest in promoting interstate commerce by encouraging an efficient and competitive motor carrier system clearly outweighs any interest of Tennessee in taxing the property of motor carriers at rates higher than commercial and industrial property generally."). *See also* Richard D. Nicholson, *Preemption of State Sales and Use Taxes on Goods Purchased Over the Internet: An Unconstitutional Mission*, 18 STATE TAX NOTES (TA) 213, 215-16 (Jan. 17, 2000) (stating that under the Court's current Tenth Amendment jurisprudence, federal regulation of state taxation would be subject to a balancing test that would tip in favor of the federal regulation when that regulation is "addressing discriminatory taxation").

[63] *Compare* Arizona Pub. Serv. Co. v. Snead, 441 U.S. 141 (1979) (holding that Congress may strike down a state tax that discriminates against the in-state produc-

nies with a tax break at the expense of smaller companies, the federal Act itself is guilty of discrimination—paradoxically against the very types of companies that the Act was intended to protect. Further, because the Act is arbitrary in its application and generally benefits only manufacturing and mercantile companies, it has the effect of discriminating against all other types of businesses, both large and small.[64]

Although the Supreme Court has never evaluated the constitutionality of Public Law 86-272, several state courts did uphold the constitutionality of the Act during the mid-1960's. However, none of these cases evaluates the Tenth Amendment, and each case was generally based on the now rejected idea that Congress has plenary authority to determine what activities it can regulate under its commerce power.[65] Further, the Supreme Court has recently emphasized that, in cases that do not involve the channels or instrumentalities of interstate commerce, Congress may regulate private activities under the Commerce Clause only when these activities "substantially" affect interstate commerce. Because higher scrutiny is accorded federal regulation of the states, as opposed to private interests, it is unlikely that this same standard applies to federal regulation of the states. However, Public Law 86-272 does not even meet the substantial effects test. The activity regulated by Public Law 86-272 is the states' act in applying their income taxes based on in-state sales functions that generate income. This state taxation is not activity that "substantially" affects interstate commerce. Most businesses will engage in sales activity in a state whether or not they must pay a small percentage of the resulting income to the state in the form of tax.[66] Further, even in the remote case where a business decides that a state's tax burden is so high that it

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tion of electricity for consumption outside the state).

[64] *See* Brian S. Gillman, Comment, *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.: A Step Out of the Definitional Quagmire of Section 381?*, 78 IOWA L. REV. 1169, 1170 (1993) (noting that there continue to be questions concerning which business activities are covered by Public Law 86-272).

[65] *See generally* Int'l Shoe Co. v. Cocreham, 164 So. 2d 314, 320-21 (La. 1964), *cert. denied, sub nom.* Mouton v. Int'l Shoe Co., 379 U.S. 902 (1964); State ex rel. CIBA Pharm. Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645, 657 (Mo. 1964); Smith Kline & French Labs. v. State Tax Comm'n, 403 P.2d 375, 380 (Or. 1965). *But see* Nat'l Private Truck Council, Inc. v. Comm'r, 688 N.E.2d 936 (Mass. 1997), *cert. denied,* 523 U.S. 1137 (1998) (also upholding the Act in partial reliance on the earlier state tax cases).

[66] *See* S. REP. NO. 86-658, at 10 (1959) ("Businesses will likely operate across State lines so long as a profit can be realized. If no profit is made, there is no net income to be taxed.") (Gore & McCarthy minority view).

should withdraw from sales activity in that state, "interstate" commerce would be largely unaffected.

The proposals to expand Public Law 86-272 to encompass the broader notion of business activity nexus are predicated on the idea that the forty-three year old statute is beyond constitutional scrutiny.[67] However, under the Court's precedent, the constitutionality of a statute does not depend upon the age of the statute or the extent to which it has become accepted as law.[68] Indeed, if Public Law 86-272 can be expanded as proposed merely on the theory that the original enactment of the statute is beyond constitutional scrutiny, then using the same logic, Congress can simply abolish state income tax as applied to any activity with an interstate connection.[69]

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[67] *See* Kendall L. Houghton & Walter Hellerstein, *State Taxation of Electronic Commerce: Perspectives on Proposals for Change and their Constitutionality*, 2000 B.Y.U. L. REV. 9, 63 (2000) (arguing that the continuing existence of Public Law 86-272 affords a basis for concluding that Congress can forbid the states from imposing sales and use taxes on electronic commerce under certain circumstances).

[68] *See* Printz v. United States, 521 U.S. 898, 918 (1997) (noting that in *INS v. Chadha*, 462 U.S. 919 (1983), the Court struck down the legislative veto even though it was "enshrined in perhaps hundreds of federal statutes, most of which were enacted in the 1970's and the earliest of which was enacted in 1932"); Alden v. Maine, 527 U.S. 706, 744 (1999) (noting that the Court was striking down a federal statute even though "similar statutes have multiplied in the last generation" because the enactment of these statutes is not probative of the "constitutional tradition" and their "'persuasive force is far outweighed by almost two centuries of apparent congressional avoidance of the practice'") (quoting *Printz*, 521 U.S. at 918). The Court has also not shrunk from making constitutional determinations that would have retroactive fiscal effect. *See* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) (reinstating provisions of FLSA, pursuant to which the states were required to pay their employees higher benefits, as constitutional after a nine-year period in which the provisions had been considered unconstitutional under *National League of Cities v. Usery*, 426 U.S. 833 (1976)). This may be in part because Congress has broad ability to ameliorate the retroactive effect of a holding that one of its statutes is unconstitutional. *See, e.g.*, Rhinebarger v. Orr, 839 F.2d 387 (7th Cir. 1988); Jones v. Douglas County, 861 F.2d 1521 (11th Cir. 1988); Bester v. Chicago Transit Auth., 887 F.2d 118 (7th Cir. 1989).

[69] *See* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 381 (2d ed. 1988) ("If there is any danger, it lies in the tyranny of small decisions—in the prospect that Congress will nibble away at state sovereignty, bit by bit, until someday essentially nothing is left but a gutted shell.") (quoted in South Carolina v. Baker, 485 U.S. 505, 533 (1988) (O'Connor, J., dissenting)).

II. THE SUPREME COURT'S APPROACH TO THE INTERACTION BETWEEN THE COMMERCE CLAUSE AND THE TENTH AMENDMENT

A historical review of the Court's approach to the Commerce Clause and the Tenth Amendment illustrates both the judicial rules that have evolved with respect to federal regulation of the states and the Court's revised approach to federal regulation of private activity. Collectively, these rules reveal the Court's likely approach to federal regulation of the states in general and to Public Law 86-272 in particular, as explored in Parts III and V of this article.

A. The Early Cases, 1826-1936

The Constitution delegates to Congress the power "[t]o regulate Commerce with foreign Nations and among the several States...." [70] The Supreme Court, through Chief Justice Marshall, first defined the nature of the Congress' commerce power in 1824 in *Gibbons v. Ogden*.[71] In *Gibbons*, the Court noted that Congress' power to regulate commerce is "complete in itself" and is not limited except for limitations that are prescribed in the U.S. Constitution.[72] One limitation on the federal commerce power set forth in the Constitution resides in the Tenth Amendment.[73]

For nearly a century after *Gibbons*, the Supreme Court's Commerce Clause cases rarely dealt with the extent of Congress' power, but rather focused on the question whether, in the absence of federal regulation, the states were themselves entitled to enact certain regulations of commerce.[74] These cases probed the breadth of the dormant or "negative" Commerce Clause, pursuant to which the Court would determine whether the states were seeking to regulate in an area reserved to Congress.[75] During this time, the cases reflected a common theme and dealt "almost entirely with the Commerce Clause as a limit on state legislation that discriminated against interstate commerce."[76] In general, the Court concluded that certain categories of activities, such as production, manufacturing, and mining could be regulated by

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[70] U.S. CONST. art. I, § 8, cl. 3.
[71] 22 U.S. (9 Wheat.) 1, 189-90 (1824).
[72] *Id.* at 196.
[73] *See supra* note 35.
[74] *See* United States v. Lopez, 514 U.S. 549, 553 (1995).
[75] *Id.*
[76] *Id.*

the states in which the activity occurred, and hence that this regulation was "beyond the power of Congress under the Commerce Clause."[77]

In the late 1800s, the enactment of the Interstate Commerce Act and Sherman Antitrust Act "ushered in a new era of federal regulation under the commerce power."[78] These federal statutes required the Court to adjudicate, at times, actual conflicts between federal and state interests. In general, when these cases first reached the Court, it "imported" from its negative Commerce Clause cases the notion that Congress could not regulate activities such as production, manufacturing, and mining.[79] Simultaneously, however, the Court concluded that "where the interstate and intrastate aspects of commerce were so mingled together that full regulation of interstate commerce required incidental regulation of intrastate commerce, the Commerce Clause authorized such regulation."[80] These latter cases led to thorny determinations as to whether the effects of the statute in question "directly" or "indirectly" impacted interstate commerce, as opposed to intrastate commerce.[81]

B. The New Deal and Expanded Federal Regulation

During the course of reviewing Roosevelt's New Deal legislation, the Court liberalized its review of federal statutes pursuant to the Commerce Clause in recognition of the great changes that had occurred in the way business was conducted.[82] These cases dispensed with the "direct" versus "indirect" approach and "greatly expanded the previously defined authority of Congress under [the Commerce] Clause."[83]

The Court's liberal approach to Commerce Clause regulation began with *NLRB v. Jones & Lauglin Steel Corp.*, in which the Court upheld the National Labor Relations Act.[84] Subsequently, in *United*

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[77] *Id.* at 554.

[78] *Id.*

[79] *Id.*

[80] *Id.* (citing *Shreveport Rate Cases*, 234 U.S. 342 (1914), which pertains to federal regulation of the in-state rates charged by interstate railroads).

[81] *See id.* at 554-55.

[82] *See id.* at 556 (stating also that the Court recognized that businesses that were regional in nature had become national in scope).

[83] *Id.*

[84] 301 U.S. 1, 37 (1937). The Court's recent cases have recognized *NLRB* as the case in which the Court began to give Congress "considerably greater latitude in regulating conduct and transactions under the Commerce Clause than our previous case law permitted." *See* United States v. Morrison, 529 U.S. 598, 608 (2000).

States v. Darby,[85] the Court upheld the Fair Labor Standards Act, which provided for minimum wages and overtime pay for private workers.[86] Then, in *Wickard v. Fillburn*, the Court upheld amendments to the Agricultural Adjustment Act of 1938.[87] *Wickard* is generally conceded to be the Court's broadest endorsement of congressional power under the Commerce Clause since the regulation that was upheld limited the amount of wheat that a farmer could grow for his own consumption. In *Wickard*, the Court stated that the regulated activity was "local" and was arguably not "commerce," but nonetheless concluded that the activity was subject to federal regulation.[88]

The Court's deference to Congress' commerce power continued into the 1960's and became the basis for two cases in which the Court upheld Title II of the Civil Rights Act of 1964.[89] The statute prohibited racial discrimination in places of public accommodation, including hotels and restaurants.[90] Although the operation of a hotel or restaurant is an intrastate activity, the Court upheld the Civil Rights Act using sweeping language.[91] While the holdings in the cases were broad, they were supported by "overwhelming evidence" that documented "the burdens that discrimination by race or color places upon interstate commerce."[92] Further, the cases noted that they were addressing "a national commercial problem of the first magnitude."[93]

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[85] 312 U.S. 100 (1941).

[86] The Act in its original version, as reviewed by the Court, specifically excluded the states and their political subdivisions from its coverage. *See* Nat'l League of Cities v. Usery, 426 U.S. 833, 836 (1976) (citing 29 U.S.C. § 203(d) (1940)).

[87] 317 U.S. 111 (1942).

[88] *See id.* at 125.

[89] *See* Katzenbach v. McClung, 379 U.S. 294, 299-301 (1964) (addressing the regulation of restaurants using substantial interstate supplies); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 252-53 (1964) (addressing the regulation of inns and hotels catering to interstate guests).

[90] *See Heart of Atlanta*, 379 U.S. at 247.

[91] *See McClung*, 379 U.S. at 305 (stating that congressional power in the field regulated was "broad and sweeping"); *Heart of Atlanta*, 379 U.S. at 258 ("[T]he power of Congress to promote interstate commerce also includes the power to regulate the local incidents thereof, including local activities in both the States of origin and destination, which might have a substantial and harmful effect upon that commerce.").

[92] *Heart of Atlanta*, 379 U.S. at 252-53. *See McClung*, 379 U.S. at 299-300.

[93] *McClung*, 379 U.S. at 305.

C. Consideration of Federal Regulation of the States

As the Court liberalized its evaluation of federal regulation of private citizens in the mid-part of the Twentieth Century, it continued to voice questions concerning the ability of Congress to similarly regulate the states. For example, in *New York v. United States*, a plurality of the Court upheld a federal tax imposed upon New York State's sale of bottled mineral water taken from springs owned by the state.[94] Six of the eight Justices that took part in the decision supported the result, but the Court authored four opinions, which generally diverged on the issue of state sovereignty. In the plurality decision, Justice Frankfurter equated Congress' power to impose taxes with its power to regulate commerce, and stated in dicta that Congress' ability to impose tax on state tax proceeds was prohibited since it would constitute "taxing the State as a State."[95] Justice Frankfurter noted that, unlike private commercial ventures, "only a State can get income by taxing."[96]

The proliferation of federal regulation in the aftermath of the New Deal accelerated the Court's evaluation of congressional regulation as applied to the states.[97] In 1968, in *Wirtz v. Maryland*, the Court considered amendments to the Fair Labor Standards Act, which extended that statute's minimum wage and maximum hour protections to state and local workers employed at schools, hospitals, and institutions.[98] In *United States v. Darby*,[99] the Court had previously determined that FLSA was valid as applied to private employees and employers. While *Wirtz* upheld the federal amendments to FLSA, it was sensitive to the Tenth Amendment issue. The Court stated that the federal commerce power "has limits," but that "valid general regulations of commerce do not cease to be regulations of commerce be-

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[94] 326 U.S. 572 (1946).

[95] *Id.* at 582.

[96] *Id.* In his dissent, Justice Douglas argued that a federal tax imposed upon a state should not be sustained merely because the tax is one of "general application" since this "suggested test...disregards the Tenth Amendment [and] places the sovereign States on the same plane as private citizens...." *Id.* at 591, 596 (Douglas, J., dissenting).

[97] *See* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528, 544 n.10 (1985) ("Most of the Federal Government's current regulatory activity originated less than 50 years ago with the New Deal, and a good portion of it has developed within the past two decades."). *See also id.* at 576-77 (Rehnquist, C.J., dissenting) (discussing the current operation of the federal bureaucracy).

[98] 392 U.S. 183 (1968), *rev'd by* Nat'l League of Cities v. Usery, 426 U.S. 833 (1976), *overruled by Garcia*, 469 U.S. 528.

[99] 312 U.S. 100 (1941).

cause a State is involved."[100] The Court also limited its holding by stating that when a state "is engaging in economic activities that are validly regulated by the Federal Government when engaged in by private persons, the State too may be forced to conform its activities to federal regulation."[101] The Court not only limited its holding, but affirmatively stated that "[t]he Court has ample power to prevent...'the utter destruction of the State as a sovereign political entity.'"[102]

In 1976, the Court faced a similar issue in *Fry v. United States.*[103] In *Fry*, the Court evaluated the Economic Stabilization Act (ESA) of 1970, which temporarily froze the wages of all workers, including state and local government employees. The Court upheld ESA using a more careful balancing analysis than applied in *Wirtz.* In particular, the Court recognized that ESA was "an emergency measure to counter severe inflation that threatened the national economy," and noted that ESA resulted in no "drastic invasion of state sovereignty."[104] The Court also noted that "[t]he [Tenth] Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system."[105]

D. Federal Regulation of the States Under a Law of General Application

In *Usery*[106] and *Garcia,*[107] the Court revisited the question it addressed in *Wirtz* and *Fry* concerning the Tenth Amendment limitations that apply when Congress seeks to regulate the states under a statute of general applicability. Both *Usery* and *Garcia* pertained to the situation in which the provisions of FLSA, previously evaluated in *Darby* and *Wirtz*, were extended to cover most state and local employees. In *Usery*, the Court struck down the amendments on Tenth Amendment grounds and reversed its decision in *Wirtz*, whereas in

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[100] *Wirtz*, 392 U.S. at 196-97.

[101] *Id.* at 197.

[102] *Id.* at 196 (quoting appellants). Justice Douglas dissented in *Wirtz*, as he had in *New York*, and stated that federal intrusions on state power ultimately threatened to "devour the essentials of state sovereignty." *See id.* at 205 (Douglas, J., dissenting).

[103] 421 U.S. 542 (1975).

[104] *Id.* at 547 n.7, 548. *See Garcia*, 469 U.S. at 562 (Powell, J., dissenting) (stating that *Fry* applied a balancing test).

[105] 421 U.S. at 547 n.7.

[106] 426 U.S. 833 (1976), *overruled by Garcia*, 469 U.S. 528.

[107] 469 U.S. 528.

Garcia the Court upheld the amendments and reversed its *Usery* decision.

The Court in *Usery* rejected the notion that the states can be regulated like private citizens under the federal commerce power. The Court conceded that Congress has broad power to regulate private citizens, but stated that "the States as States stand on a quite different footing from an individual or a corporation when challenging the exercise of Congress' power to regulate commerce."[108] The Court concluded that, because the amendments to FLSA would "directly displace the States' freedom to structure integral operations in areas of traditional governmental functions," Congress could not "abrogate the States' otherwise plenary authority to make [these decisions]."[109] The *Usery* decision reversed *Wirtz*, but not *Fry*. The Court in *Usery* determined that the *Fry* decision was not inconsistent because the legislation considered in *Fry* was a temporary solution to an "extremely serious" problem, and the "degree of intrusion upon the protected area of state sovereignty" was not that substantial.[110]

After *Usery*, the federal courts struggled with the application of that decision's "traditional government functions" test. Questions arose as to whether various activities conducted by the states and other municipalities were "traditional government functions."[111] Because of the confusion created by *Usery*, the Court revisited that decision in *Garcia*.[112]

Garcia, like *Usery*, involved the question of whether the provisions of FLSA could be generally applied to most state and local employees. In *Garcia*, the Court reversed *Usery* and rejected as "unsound in principle and unworkable in practice, a rule of state immunity from federal regulation that turns on a judicial appraisal of whether a particular

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[108] *Usery*, 426 U.S. at 854.

[109] *Id.* at 846, 852.

[110] *Id.* at 852, 853. The decision in Usery was 5-4, with the deciding vote cast by Justice Blackmun. Justice Blackmun's concurrence was based on his understanding that the Court was merely balancing the interests of the federal and state regulation at issue in the case. *Id.* at 856 (Blackmun, J., concurring).

[111] Many of the cases considered activities that either could or would likewise be conducted by private entities such as state and local: (1) operation of an airport; (2) performance of solid waste disposal; (3) operation of a telephone system; (4) leasing and sale of natural gas; (5) operation of a mental health facility; and (6) provision of in-house domestic services for the aged and handicapped. *See Garcia*, 459 U.S. at 538.

[112] The issue was "[w]hether or not the principles of the Tenth Amendment as set forth in *National League of Cities v. Usery* should be reconsidered." *Id.* at 536 (citation omitted).

governmental function is 'integral' or 'traditional.'"[113] The Court conceded that constitutional limitations imposed upon Congress are intended to protect the "States as States," but concluded that these restraints result from the national political process.[114] Further, the Court in *Garcia* stated that "[a]ny substantive restraint on the exercise of Commerce Clause powers must find its justification in the procedural nature of this basic limitation, and it must be tailored to compensate for possible failings in the national political process...."[115] The Court did not explain how the national political process might fail, but rather concluded on the facts that "the internal safeguards of the political process have performed as intended."[116]

The vote of the Justices in *Garcia*, as in *Usery*, was 5-4. The *Garcia* dissent complained that the majority made only a "single passing reference to the Tenth Amendment" and [therefore] rejected "almost 200 years of the understanding of the constitutional status of federalism."[117] The dissent also claimed that the majority mischaracterized "the mode of analysis" employed by *Usery*, which was, the dissent claimed, as in *Fry*, a "balancing approach" that weighed "the seriousness of the problem addressed by the federal legislation...against the effects of compliance on state sovereignty."[118] Further, the dissent accused the majority of replacing the Court's "balancing standard" with a new judicial rule that it failed to explain.[119]

Two years after *Garcia*, in *South Carolina vs. Baker*,[120] the Court upheld another "generally applicable" federal statute, which regulated

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[113] *Id.* at 546-47.

[114] *Id.* at 554 ("[W]e are convinced that the fundamental limitation that the constitutional scheme imposes on the Commerce Clause to protect the 'States as States' is one of process rather than one of result.").

[115] *Id.*

[116] *Id.* at 556.

[117] *Id.* at 560 (Powell, J., dissenting).

[118] *Id.* at 562, 563.

[119] *See id.* at 564 n.7 (stating that the majority does not "identify the circumstances in which the 'political process' may fail and 'affirmative limits' are to be imposed"). In separate dissents, Chief Justice Rehnquist, who authored *Usery*, and Justice O'Connor opined that the seeming breadth of the *Garcia* limitation would be short-lived. *See id.* at 580 (Rehnquist, C.J., dissenting) (stating that *Usery* represents "a principle that will, I am confident, in time again command the support of a majority of this Court"); *id.* at 589 (O'Connor, J., dissenting) ("I would not shirk the duty acknowledged by *National League of Cities* and its progeny, and I share Justice Rehnquist's belief that this Court will in time again assume its constitutional responsibility.").

[120] 485 U.S. 505 (1988).

the issuance of bonds by private parties and also by state and local governments.[121] Although the Court purportedly based its *Baker* decision upon *Garcia's* political process standard,[122] the court also evaluated *Usery*.[123] In *Baker*, the Court rejected the state's claim that the political process had failed in the enactment of the statute because the statute was "'imposed by the vote of an uninformed Congress relying upon incomplete information.'"[124] However, as in *Garcia*, the Court stated that it would not seek to "identify or define the defects that might lead to [the] invalidation" of a statute under the political process test.[125] In his concurrence, Chief Justice Rehnquist suggested that the *Baker* decision was based on a balancing analysis.[126] In particular, Justice Rehnquist referenced the "well supported conclusion" that the statute would have only a "de minimis" effect on the states' ability to raise debt capital and upon the manner in which the states would raise this capital.[127]

Three years after *Baker*, the tension between the Court's "political process" standard and a balancing approach resurfaced in *Gregory v. Ashcroft*.[128] In *Ashcroft*, the Court held that a federal age discrimination statute that applied generally to all employees did not conflict with a state constitutional provision that required state judges to retire at the age of seventy.[129] The Court in *Ashcroft* concluded that there was no preemption question since it was not apparent on the face of the federal statute that it intended to regulate state judges, and absent a clear

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[121] *Id.* at 514.

[122] *Id.* (concluding that on the facts "the national political *process* did not operate in a defective manner").

[123] *Id.* at 515 (stating that the appellant's view of the case "would also restrict congressional regulation of state activities even more tightly than it was restricted under the now overruled *National League of Cities* line of cases").

[124] *Id.* at 513 (quoting Brief for Plaintiff 101).

[125] *Id.* The Court did note, however, that the state "has not even alleged that it was deprived of any right to participate in the national political process or that it was singled out in any way that left it politically isolated and powerless." *See id.* (citing United States v. Carolene Prods. Co., 304 U.S. 144, 152 n.4 (1938)).

[126] *Id.* at 529 (Rehnquist, C.J., concurring).

[127] *Id.* (quoting Report of Special Master 118, who also found that the statute "has not changed how much the States borrow, for what purposes they borrow, how they decide to borrow, or any other obviously important aspect of the borrowing process"). *See* Printz v. United States, 521 U.S. 898, 932 (1997) (citing the Rehnquist concurrence in *Baker* for the proposition that the Court will sometimes balance the respective federal-state benefits and burdens attendant to federal regulation).

[128] 501 U.S. 452 (1991).

[129] *See id.* at 455.

statement to this effect the Court would not make this presumption.[130] However, while the Court in *Ashcroft* technically avoided the Commerce Clause question, the Court nonetheless suggested that if the federal statute had sought to regulate state judges, it would have violated the Tenth Amendment because a state's authority to determine the qualifications of its highest officers "lies at 'the heart of a representative government.'"[131] In *Ashcroft*, the Court emphasized that there is a "constitutional balance" between federal and state powers.[132] Further, the Court noted that it would determine "the limits that the state-federal balance places on Congress' powers under the Commerce Clause," and that in performing this role it was merely "constrained" by the political process standard set forth in *Garcia*.[133]

The Court most recently addressed a generally applicable statute in *Reno v. Condon*.[134] In *Condon*, the Court upheld a federal statute that regulated the disclosure of personal information set forth in the records maintained by the states' motor vehicle departments. The Court concluded that the statute was one of "general applicability" because it applied both to the states as initial suppliers of the regulated information as well as to private resellers of this same information.[135] Although this determination aligned *Condon* with *Garcia*, *Baker*, and *Ashcroft*, the Court did not mention or even allude to the "political process" standard that was referenced in each of those prior cases. Instead, the Court evaluated the federal burdens imposed upon the state and concluded that these burdens were comparable to those in *Baker*.[136] Therefore, the Court upheld the federal statute.[137]

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[130] *Id.* at 467.

[131] *Id.* at 463 (quoting Bernal v. Fainter, 467 U.S. 216, 221 (1984)). *See* William N. Eskridge, Jr. & Philip P. Frickey, *Quasi-Constitutional Law: Clear Statement Rules in Constitutional Lawmaking*, 45 VAN. L. REV. 593, 623-24 (1992) (arguing that *Ashcroft* represents constitutional decision-making and not merely a case of statutory construction).

[132] 501 U.S. at 460 ("Congressional interference with this decision of the people of Missouri, defining their constitutional officers, would upset the usual constitutional balance of federal and state powers.").

[133] *Id.* at 464. *See also id.* at 464 (stating that "this Court in *Garcia* has left primarily to the political process the protection of the States against intrusive exercises of Congress' Commerce Clause powers").

[134] 528 U.S. 141 (2000).

[135] *Id.* at 151.

[136] *Id.*

[137] *See id.* at 150-51. The fact that *Condon* does not reference the political process standard applied by *Garcia* suggests that this standard may no longer be good law. One year prior to *Condon*, in *Alden v. Maine*, 527 U.S. 706 (1999), the Court had

E. Federal Regulation of the States "as States"

One year after *Ashcroft*, in the 1992 case *New York v. United States*,[138] the Court acknowledged the "unsteady path" that it had traveled in its cases from its 1946 decision in *New York v. United States* through *Ashcroft*.[139] The Court distinguished these prior cases as pertaining to the situations in which Congress "subject[s] state governments to generally applicable laws," i.e., to "the same legislation applicable to private parties."[140] In contrast, in the 1992 case of *New York*, the state challenged federal legislation that was directed solely at the states. This federal statute required each state to develop a plan to dispose of low-level radioactive waste and to take title to and possession of the waste if the state did not develop a plan by a certain date.[141]

As in *Ashcroft*, the Court in *New York* noted a "constitutional line" between permissible state and federal powers, and explained that the Court must adjudicate disputes over whether an exercise of federal power has crossed that line.[142] Further, the Court stated that in making these determinations it has used a balancing approach that evaluates "the strength of federal interests in light of the degree to which such laws would prevent the State from functioning as sovereign."[143] However, a balancing approach was not necessary in *New York* because "whether or not a particularly strong federal interest enables Congress to bring state governments within the orbit of generally applicable federal regulation...the Constitution simply does not give Congress the authority to require the States to regulate."[144] In essence, the federal burden in *New York* was so great that the federal benefits that might

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significantly undercut the practical implications of *Garcia*, also suggesting that the case is no longer good law. *See* Brown & Enrich, *supra* note 39, at 19.

[138] 505 U.S. 144 (1992).

[139] *See id.* at 160. The Court referenced, inter alia, *Maryland v. Wirtz*, 392 U.S. 183 (1968); *Fry v. United States*, 421 U.S. 542 (1975); *National League of Cities v. Usery*, 426 U.S. 833 (1976); *Garcia*, 469 U.S. 528; and *South Carolina v. Baker*, 485 U.S. 505 (1988). *See id.* In addition, the Court referenced two cases that considered the application of *Usery* pre-*Garcia*, *Transportation Union v. Long Island Railroad Co.*, 455 U.S. 678 (1982) and *EEOC v. Wyoming*, 460 U.S. 226 (1983). *See id.*

[140] *Id.*

[141] *See id.* at 150-54.

[142] *Id.* at 155.

[143] *Id.* at 177. *Garcia*, the Court said, was merely an instance in which the Court "departed from this approach." *Id.* at 178.

[144] *Id.* (stating also that "[w]here a federal interest is sufficiently strong to cause Congress to legislate, it must do so directly; it may not conscript state governments as it agents").

derive from the statute were simply irrelevant. On the facts, the Court concluded that Congress had exceeded its permissible powers in seeking to require a state either to "enact or administer a federal regulatory program."[145]

The subsequent case of *Printz* v. *United States*[146] is similar to *New York*. In *Printz*, the Court evaluated the constitutionality of a statute that required state and local enforcement officers to conduct background checks on proposed handgun purchasers and to perform related tasks.[147] The federal government advanced a number of arguments concerning the importance of the Act and the limited nature of the burdens imposed.[148] The Court conceded, as in *New York*, that such factors had been relevant in some of its prior cases.[149] However, the Court stated that when "it is the whole *object* of the law to direct the functioning of the state executive, and hence to compromise the structural framework of dual sovereignty, such a 'balancing' analysis is inappropriate."[150] As in *New York*, the Court in *Printz* concluded that the means by which Congress sought to regulate the states was so intrusive that the relative merits of the intrusion were irrelevant.[151]

The Court based both its *New York* and *Printz* decisions on a concern for Congress' potential to distort the voters' sense as to when elected state officials' are acting in their representative capacity, on the one hand, or as "puppets of a ventriloquist Congress," on the other.[152]

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[145] *Id.* at 188. Professor John Yoo has concluded that *New York* suggests a balancing inquiry in which "judicial intervention will depend on the character of the exercise of federal power in each case." *See* John C. Yoo, *The Judicial Safeguards of Federalism*, 70 S. CAL. L. REV. 1311, 1346-47 (1997).

[146] 521 U.S. 898 (1997).

[147] *Id.* at 902.

[148] *Id.* at 931-32.

[149] *Id.* at 932 (citing Fry v. United States, 421 U.S. 542 (1975); National League of Cities v. Usery, 426 U.S. 833 (1976); and South Carolina v. Baker, 485 U.S. 505 (1988) (Rehnquist, C.J., concurring)).

[150] *Id.* (emphasis in original) (stating also that in these cases "[i]t is the very *principle* of separate state sovereignty that such a law offends, and no comparative assessment of the various interests can overcome the fundamental defect" (emphasis in original)).

[151] *Printz* held that Congress "may neither issue directives requiring the States to address particular problems, nor command the States' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program." 521 U.S. at 935.

[152] *See Printz*, 521 U.S. at 928 (quoting Brown v. EPA, 521 F.2d 827, 839 (9th Cir. 1975)). *See also* Deborah Jones Merritt, *Three Faces of Federalism: Finding a Formula for the Future*, 47 VAND. L. REV. 1563, 1570-75 (1994) (referring to this concept as the "autonomy model" of federalism).

Both cases emphasized that the "[t]he Constitution...contemplates that a State's government will represent and remain accountable to its own citizens."[153] In *New York,* the Court noted that "where the Federal Government directs the States to regulate, it may be state officials who will bear the brunt of public disapproval, while the federal officials who devised the regulatory program may remain insulated from the electoral ramifications of their decision."[154]

New York and *Printz* pertained to a particular situation in which Congress sought to "commandeer" either the state legislature or the state's executive officers. However, the substantial burdens that can occur in these situations can also occur in other instances in which Congress regulates the states as states. For example, in *Alden v. Maine,* the issue was whether a federal statute could require a nonconsenting state to be subject to private lawsuits, initiated in state court, for the failure to pay benefits due under FLSA.[155] Prior to *Alden,* the Court had concluded that federal legislation could not authorize private citizens to initiate suits against the states in federal court because of the Eleventh Amendment.[156] However, the Eleventh Amendment does not apply to state court actions, and in *Alden* the Court concluded that the Tenth Amendment bars Congress from authorizing private lawsuits for money damages against a nonconsenting state in state court.[157]

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[153] *See Printz,* 521 U.S. at 920. *See also New York v. United States,* 505 U.S. 144, 168-69 (1992).

[154] *New York,* 505 U.S. at 169. *Printz* stated similarly that:

> By forcing state governments to absorb the financial burden of implementing a federal regulatory program, Members of Congress can take credit for 'solving' problems without having to ask their constituents to pay for the solutions with higher federal taxes. And even when the States are not forced to absorb the costs of implementing a federal program, they are still put in the position of taking the blame for its burdensomeness and for its defects.

521 U.S. at 930.

[155] 527 U.S. 706 (1999).

[156] *See* Seminole Tribe v. Florida, 517 U.S. 44 (1996). Although based upon the Eleventh Amendment, *Seminole Tribe* echoes the Court's Tenth Amendment jurisprudence since the case suggests that state sovereign immunity derives in part from the notion of federalism as generally incorporated in the Constitution. *See id.* at 54. *See also* Yoo, *supra* note 145, at 1354 (discussing the Court's rationale in *Seminole Tribe*).

[157] *See* Alden v. Maine, 527 U.S. 706, 713-14 (1999) (noting that this attribute of state sovereignty existed prior to the enactment of the Constitution and then was "confirmed" by the Tenth Amendment).

In striking down the FLSA remedy, *Alden* emphasized the dollar cost that the provision would impose upon the states' treasuries. For example, the Court stated that "[a] general federal power to authorize private suits for money damages would place unwarranted strain on the States' ability to govern in accordance with the will of their citizens." [158] Further, the Court concluded that the federal statute impermissibly struck at "the heart of political accountability" by transferring the decision-making with respect to debt payments from state elected officials to the state judiciary.[159]

F. Federal Regulation of Private Intrastate Activity

In two recent cases, *Morrison v. United States*[160] and *Lopez v. United States*,[161] the Court's continuing emphasis on the protection of state sovereignty caused it to reevaluate some of its prior precedents pertaining to federal regulation of private parties. Although neither *Morrison* nor *Lopez* involved a federal attempt to regulate the states, each case struck down a federal statute on the theory that Congress had exceeded its authority under the Commerce Clause by invading the realm of state sovereignty.[162]

In *Morrison* and *Lopez*, the Court concluded that there are "three broad categories of activity that Congress may regulate under its commerce power."[163] The first two types of activity that Congress may regulate pertain to "the channels of interstate commerce" and "the

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[158] *Alden*, 527 U.S. at 750-51. *See also id.* at 749 ("Not only must a State defend or default but also it must face the prospect of being thrust, by federal fiat and against its will, into the disfavored status of a debtor, subject to the power of private citizens to levy on its treasury or perhaps even government buildings or property which the State administers on the public's behalf."). The Court determined that the Constitution could not have contemplated this federally approved raid on the states' treasuries in part because at the time the Constitution was adopted, the States were struggling to pay off their war-time debts. *See id.* at 717, 741.

[159] *Id.* at 751 ("When the Federal Government asserts authority over a State's most fundamental political processes, it strikes at the heart of the political accountability so essential to our liberty and republican form of government.").

[160] 529 U.S. 598 (2000).

[161] 514 U.S. 549 (1995).

[162] *See Morrison*, 529 U.S. at 614; *Lopez*, 514 U.S. at 566. In *Morrison*, Congress sought to provide a federal civil remedy for victims of gender-motivated violence. 519 U.S. 598. In *Lopez*, Congress sought to make it a federal offense for any individual to knowingly possess a firearm at a place that the individual knows or has reasonable cause to know is a school zone. 514 U.S. 549.

[163] *Morrison*, 529 U.S. at 608-9 (quoting *Lopez*, 514 U.S. at 558).

instrumentalities of interstate commerce."[164] Congressional power in the latter instance is apparently broader since the Court noted that Congress has the ability both to "regulate" and "protect" such instrumentalities.[165]

Morrison and *Lopez* concluded that, when Congress is not regulating the use of the channels or instrumentalities of interstate commerce, the federal commerce power is limited to the regulation of "activities that substantially affect interstate commerce."[166] The Court's "substantial effects" test implies a balancing analysis like that applied in the cases in which Congress seeks to regulate the states, because it requires a judicial determination as to when the affects on interstate commerce are "substantial."[167]

Unlike the cases in which the Court has struggled to define appropriate restrictions to be placed upon federal regulation of the states, *Morrison* and *Lopez* represent a major break from the Court's prior precedent.[168] The Court's prior cases had suggested that, at least when regulating the activities of private persons, Congress possesses "plenary power" to determine both the subject matter of its regulation and the manner in which this subject would be regulated.[169] However, *Morrison* and *Lopez* both reject this circular logic.[170] Indeed, these cases even reject the notion that Congress can immunize its commerce legislation

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[164] *Id.* at 609.

[165] *See id.* (citing Shreveport Rate Cases, 234 U.S. 342 (1914)).

[166] *Id.* (quoting *Lopez*, 514 U.S at 558-59).

[167] *See Lopez*, 514 U.S. at 578 (Kennedy, J., concurring) (stating that the Court will "intervene when one or the other level of Government has tipped the scales too far"). *Compare* Katzenbach v. McClung, 379 U.S. 294, 305 (1964) (upholding the moral legislation set forth in the Civil Rights Act of 1964 based in part on the notion that the Court was "addressing a national commercial problem of the first magnitude").

[168] *See Morrison*, 529 U.S. at 636 (Souter, J., dissenting) (stating that the majority has supplanted "rational basis scrutiny with a new criterion of review"). *See also* Brown & Enrich, *supra* note 39, at 1 (stating that these cases along with the Court's other recent decisions portend "a jurisprudential sea change").

[169] *See supra* notes 29-32 and accompanying text.

[170] *Morrison*, 529 U.S. at 613 (stating that "'if we were to accept the Government's arguments, we are hard pressed to posit any activity by an individual that Congress is without power to regulate'") (quoting *Lopez*, 514 U.S. at 564); *id.* at 614 ("'[W]hether particular operations affect interstate commerce sufficiently to come under the constitutional power of Congress to regulate them is ultimately a judicial rather than a legislative question, and can be settled finally only by this Court.") (quoting Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 273 (1964) (Black, J., concurring)).

from judicial scrutiny by making specific findings concerning the legislation's impact on interstate commerce.[171]

III. APPLYING THE SUPREME COURT'S APPROACH TO FEDERAL REGULATION OF STATE TAXATION

The Court's recent cases concerning the federal commerce power suggest a balancing approach that generally focuses upon the federal benefit to be derived from a regulation as opposed to the costs that the federal regulation imposes on the states. The Court applies the highest level of scrutiny when the statute regulates the states directly—and in particular when the regulation applies only to the states and not generally to both the states and private parties. This is because, unlike private parties, the states are separate sovereigns, and the Constitution generally permits Congress "to regulate individuals, not States."[172]

In evaluating the burdens that a federal regulation imposes upon the states, the Court will consider the extent to which the regulation impacts the accountability of elected state officials[173] and impairs the states' ability to raise funds.[174] More generally, the Court will apply

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[171] *See Morrison*, 529 U.S. at 614 ("'[S]imply because Congress may conclude that a particular activity substantially affects interstate commerce does not necessarily make it so.'") (quoting *Lopez*, 514 U.S. at 557 n.2). Justice Breyer disagreed with the decision, but acknowledged that the law in this area is "unstable" and that there are "difficult Commerce Clause cases." *Id.* at 663-64 (Breyer, J., dissenting). He predicted that in these difficult cases the Court may evolve towards a rule that "takes account of the thoroughness with which Congress has considered the federalism issue." *Id.*

[172] Printz v. United States, 521 U.S. 898, 920 (1997) (quoting New York v. United States, 505 U.S. 144, 166 (1992)). *See also id.* at 924 ("'[T]he Commerce Clause...authorizes Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce.") (quoting *New York*, 505 U.S. at 166); Thomas H. Odom & Gregory S. Feder, *Challenging the Federal Driver's Privacy Protection Act: The Next Step in Developing a Jurisprudence of Process-Oriented Federalism Under the Tenth Amendment*, 53 MIAMI U. L. REV. 71, 157-59 (1998) (discussing how laws that single out constitutionally protected entities, like the states, are subject to a heightened standard of review).

[173] *See Printz*, 521 U.S. 898; *New York*, 505 U.S. 144.

[174] *See* Alden v. Maine, 527 U.S. 706, 751-52 (1999) (commenting critically on the fact that the federal statute transferred the decision-making concerning debt payments from elected officials to the state judiciary); South Carolina v. Baker, 485 U.S. 505, 529 (1988) (Rehnquist, C.J., concurring) (focusing on whether the federal legislation would impact the state's ability to raise debt capital). *See also id.* at 533 (O'Connor, J., dissenting) ("Federal taxation of state activities is inherently a threat to state sovereignty...[because] 'the power to tax involves the power to destroy,'" but

higher scrutiny in cases where the regulation involves a state decision that "lies at the heart of a representative government." [175] In some cases, the analysis may assess whether the national political process has failed in the enactment of a federal statute.[176] However, this standard may apply only in cases involving a federal statute of general application since in these cases parties with private interests will likely protest if the federal statute is deficient or unduly restrictive.[177]

In evaluating the benefits to be derived from a federal regulation, the Court will consider whether the activity regulated "substantially affects" interstate commerce.[178] If not, the federal benefit is not one that is recognized under the Commerce Clause. In contrast, there is a cognizable federal benefit when Congress regulates either the channels of interstate commerce or, in particular, the instrumentalities of interstate commerce.[179] Further, when a state discriminates against interstate commerce, Congress has broad entitlement to act to remove the state discrimination.[180]

Although none of the Court's recent Tenth Amendment cases has considered the ability of Congress to regulate state taxation, these cases collectively suggest the analysis that would apply to federal regulation

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stating that "'the power to tax is not the power to destroy while this Court sits.'") (quoting McCulloch v. Maryland, 17 U.S. (4 Wheat) 316, 431 (1819) and Panhandle Oil Co. v. Mississippi ex rel. Knox, 277 U.S. 218, 223 (1928) (Holmes, J., dissenting)).

[175] Gregory v. Ashcroft, 501 U.S. 452, 463 (1991) (quoting Bernal v. Fainter, 467 U.S. 216, 221 (1984)).

[176] *See* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985); South Carolina v. Baker, 485 U.S. 505 (1988).

[177] *See* Odom & Feder, *supra* note 172, at 161. *Cf. Baker*, 485 U.S. at 513 (suggesting the Court's concern with situations in which the states are singled out by federal regulation in a way that leaves them "politically isolated").

[178] Morrison v. United States, 529 U.S. 598, 609 (2000); Lopez v. United States, 514 U.S. 549, 558-59 (1995).

[179] *See Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558-59. For a discussion of the numerous cases that pertain to federal restrictions imposed upon state taxation of railroads, motor carriers and air transportation, see Hellerstein & Hellerstein, *supra* note 4, ¶ 4.24[1][a] & [b].

[180] *See* New York v. United States, 505 U.S. 144, 171 (1992) ("[T]he Commerce Clause has long been understood to limit the States' ability to discriminate against interstate commerce."). *See also* H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525, 532-34 (1949) (distinguishing between economic protectionism and the states' authority to manage their "internal affairs"); Shreveport Rate Cases, 234 U.S. 342, 356 (1914) (cited in *Lopez*, 514 U.S. at 554) (permitting federal regulation to address the "evil of discrimination" reflected in the intrastate railroad rates charged by interstate railroads).

of this type. In all instances, the court would apply its highest scrutiny to the federal regulation of state taxation because this regulation applies to the states as states and pertains to an area of state governance of the utmost importance. A federal restriction on state taxation will generally impair a state's fund raising and may impact the political accountability of state officials—although the magnitude of these detriments will vary depending upon the specific case. The federal interest in the restrictions placed upon state taxation will also vary, but generally will be greatest when the restrictions are intended to eliminate a discriminatory state tax or to regulate an instrumentality of interstate commerce.[181]

A. Moorman Manufacturing Co. v. Bair and Arizona Public Service Co. v. Snead

The Court's pronouncements on the ability of Congress to regulate state taxation in *Moorman Manufacturing Co. v. Bair*[182] and *Arizona Public Service Co. v. Snead*,[183] accord with the above analysis. In *Snead*, the Court considered Congress' ability to strike down a New

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[181] *See supra* notes 60-62 and accompanying text. *Cf.* Deer Park Indep. School Dist. v. Harris County Appraisal Dist., 132 F.3d 1095, 1098 (5th Cir. 1998), *cert. denied*, 524 U.S. 938 (1998) (stating that Congress may prohibit state tax imposed upon property stored in foreign trade zones because "uniformity in foreign commerce is a well-recognized federal interest"). Professors Brown and Enrich argue that the Court is not anxious to repeat the mistake of *National League of Cities v. Usery*, 426 U.S. 833 (1976), in which it gave the lower federal courts an amorphous standard that they could not administer. *See* Brown & Enrich, *supra* note 39, at 9. Thus, they argue that the Court has been seeking categorical standards that will allow it to separate the appropriate spheres of federal and state authority, even ones like the "substantial effects" test that are ultimately a matter of degree. *See id.* But this logic is not inconsistent with the idea that the Court is in fact applying a balancing standard, or with the idea that the Court would apply a literal balancing standard in the instance of state taxation. For example, although the Court has not formally adopted a balancing standard, it has consistently referred to this notion, which suggests that the Court does *in fact* apply a balancing approach when settling upon its categorical tests. *See* Yoo, *supra* note 145, at 1346-47 (suggesting that this is what happened in the 1992 "commandeering" case *New York v. United States*, 505 U.S. 144 (1992)). In addition, the realm of state taxation does not implicate *Usery*-type concerns since there is no question that state taxation is an "integral" and "traditional" state function. *See supra* notes 111-113 and accompanying text. Hence, the realm of state taxation invites the creation of a separate federalism standard, like the commandeering standard that the Court created in 1992 in *New York*, which can fairly be a literal balancing standard without any danger of recreating *Usery*-type problems.

[182] 437 U.S. 267 (1978).

[183] 441 U.S. 141 (1979).

Mexico tax that discriminated against the production of electricity within the state's borders for consumption outside the state.[184] The Court determined that "[b]ecause the electrical energy tax *itself* indirectly but necessarily discriminates against electricity sold outside New Mexico, it violates the federal statute."[185] Further, under the Commerce Clause, the Court concluded that "Congress had a rational basis for finding that the New Mexico tax interfered with interstate commerce, and selected a reasonable method to eliminate that interference."[186] The Court noted that Congress was not eliminating the state's capacity to tax, but "required only that New Mexico, if it chooses to tax the generation of electricity for consumption in either [Phoenix or Albuquerque], tax it equally for each."[187]

In *Moorman*, the Court evaluated the constitutionality of a single-factor apportionment formula that was applied by Iowa to source income to the state for taxing purposes.[188] Most states apply a three-factor approach, based upon property, payroll, and sales. Therefore, Iowa's formula, which relied solely on sales, created the asserted possibility that a corporation could be taxed on more than 100% of its income. The Court upheld the Iowa statute, but was troubled by the prospect that a corporation could be subject to "duplicative" or "multiple" taxation on the same income—a possibility that the Court concluded was merely "speculative" on the facts.[189] In contemplation of this possibility, the Court stated in dicta that "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income."[190]

Although *Moorman* suggests that Congress can regulate the manner in which the states compute a corporation's income—as opposed to whether these corporations can be taxed at all—the case also specifically states that, in so doing, Congress must balance the "interests of all affected States."[191] Further, it is significant that the potential issue

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[184] *See id.* at 147.

[185] *Id.* at 150 (emphasis in original).

[186] *Id.*

[187] *Id.* at 151.

[188] 437 U.S. 267, 269 (1978).

[189] *See id.* at 279-80.

[190] *Id.* at 280.

[191] *Id. See also id.* at 283 (Powell, J., dissenting) (recognizing that the Court's duty is "'to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers'") (quoting Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 329

addressed by the Court in *Moorman*, multiple taxation, resembles the type of discriminatory state tax that the Court addressed in *Snead*. Indeed, the very prospect that a corporation might be taxed on more than 100% of its income by two or more states necessarily suggests that one or more states seeks to tax greater than its proportionate share.[192]

B. Quill Corp. v. North Dakota

In *Moorman*, the Court addressed Congress' power under the Commerce Clause in its analysis of the dormant Commerce Clause. In the 1992 case *Quill Corp. v. North Dakota*,[193] the Court also opined upon Congress' power to regulate state tax in the context of a dormant Commerce Clause question. While *Quill* is a complex case that has generated much controversy, the general thrust of the case also accords with the notion that the federal commerce power must respect the states' sovereign interests.

In *Quill*, the Court reaffirmed its holding from twenty-five years earlier, in *National Bellas Hess, Inc. v. Department of Revenue*.[194] The decision in *Bellas Hess* had prohibited the states from imposing a use tax collection duty on a mail order vendor where the vendor limits its contacts with the state to communications effected by mail and common carrier.[195] The Court based its *Bellas Hess* decision on a dual determination under the dormant Commerce Clause and Due Process Clause concerning whether a mail order vendor's connection to a state

(1977)).

[192] *See* Arizona v. Atchison, Topeka & Santa Fe R.R. Co., 656 F.2d 398, 406 (9th Cir. 1981) ("In broad terms, the Commerce Clause restricts states from taxing more than their fair share of interstate commerce or from otherwise discriminating against interstate commerce."). Notwithstanding the dicta in *Moorman*, Professor Kathryn Moore notes that although numerous federal bills have been introduced through the years to restrict the states' right to tax income from interstate commerce, these bills have not generally sought to address multiple taxation. *See* Moore, *supra* note 4, at 196-98. Professor Moore concludes that "multijurisdictional" businesses have not pushed this issue because uniform apportionment would potentially harm these companies by forcing them to pay more in state taxes and not less. *See id.* at 197. Therefore, rather than pushing for uniform apportionment, business lobbyists have sought rules like Public Law 86-272 that would eliminate the states' capacity to tax outright. *See id.*

[193] 504 U.S. 298 (1992).

[194] 386 U.S. 753 (1967).

[195] *See id.*

is sufficient to justify a state's attempt to collect use tax.[196] Concerning the due process question, the Court noted that the question was "whether the state has given anything for which it can ask return."[197] As to the Commerce Clause question, the issue was whether the tax was "justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys."[198] The Court concluded that the state's use tax collection duty as applied to a mail order vendor was not justified under these "closely related" questions, and emphasized the peculiar burdens that arise in the context of this duty.[199] The Court also noted that "it is difficult to conceive of commercial transactions more exclusively interstate in character than...mail order transactions...."[200]

Although the Court in *Quill* reaffirmed the *Bellas Hess* decision, the Court questioned whether the prior decision had become economically outdated.[201] In particular, the Court concluded that when a mail-order house is "engaged in continuous and widespread solicitation of business within a State," this vendor "clearly has 'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.'"[202] Further, the Court concluded that, on such facts, "there is no question that...the use tax is related to the benefits [the vendor] receives from access to the State."[203] Although the Court apparently

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[196] *Id.* at 756.

[197] *Id.* (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1967)).

[198] *Id.* (quoting Freeman v. Hewit, 329 U.S. 219, 253 (1946)).

[199] These included the fact that there were hundreds of state and, mostly, local municipalities that impose this duty and also that there was great diversity in the underlying sales tax exemptions and filing requirements. *Id.* at 759-60. These burdens are much greater in the context of a transaction tax, like the use tax collection duty, as opposed to an income tax, because the tax reporting applies to individual, continuous sales. *See id.*

[200] *Id.* at 759.

[201] For example, the Court noted that it would not necessarily reach the same result if the question were one of first impression. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992). Also, the Court initiated its analysis by noting that the lower court, the North Dakota Supreme Court, had refused to follow *Bellas Hess* because it concluded that "'the tremendous social, economic, commercial, and legal innovations' of the past quarter-century have rendered [the *Bellas Hess*] holding 'obsolete.'" *Id.* at 301 (quoting State v. Quill Corp., 470 N.W.2d 203, 208 (1991)). *Quill* responded to this interpretation of *Bellas Hess* by observing that the Court would reverse the North Dakota decision, although it noted that "we agree with much of the State Court's reasoning." *Id.* at 302.

[202] *Id.* at 308 (citing Shaffer v. Heitner, 433 U.S. 186, 218 (1977)) (alterations in original).

[203] *Id.* The Court also noted the observation of the lower North Dakota court that

concluded that there was no Due Process or Commerce Clause issue—at least within the meaning of *Bellas Hess*—it nonetheless reaffirmed *Bellas Hess* on Commerce Clause grounds. The Court's Commerce Clause analysis was tortuous and garnered the acquiescence of only five of the eight justices that supported the result. However, each of these eight justices agreed that the judicial notion of "stare decisis" supported the retention of the *Bellas Hess* rule.[204] Further, these eight justices approved of the fact that by eliminating the due process underpinnings for *Bellas Hess*, the Court had made clear that Congress could address the virtues of that case under the affirmative aspect of the Commerce Clause.[205]

Though dicta, the Court's statements in *Quill* concerning the federal commerce power have generated much scrutiny and congressional activity.[206] However, viewed in context, these statements have a fairly narrow scope. As noted, the analysis in *Quill* suggests that the Court was uncomfortable with the *Bellas Hess* rule even as a Commerce Clause principle. Although the Court seemed prepared to strike down the rule under both the Due Process and Commerce Clause, it noted

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"advances in computer technology [have] greatly eased the burden of compliance with [what was noted in *Bellas Hess* to be] 'a welter of complicated obligations' imposed by state and local taxing authorities." *Id.* at 303 (citing *Quill,* 470 N.W.2d at 215) (quoting *Bellas Hess,* 386 U.S. at 759-60). Further, the Court noted the state court's observation that, because the "'very object' of the Commerce Clause is protection of interstate business against discriminatory local practices, it would be ironic to exempt [a mail order vendor] from this burden and thereby allow it to enjoy a significant competitive advantage over local retailers." *Id.* at 304 n.2 (quoting *Quill,* 470 N.W.2d at 214-15).

[204] *See Quill,* 504 U.S. at 317, 320 (Scalia, J., concurring). Both the five-Justice majority and three-Justice concurrence noted that not only had the Court's prior decision in *Bellas Hess* remained good law for twenty-five years, but that the Court had repeatedly cited it. *See id.* at 317, 320-21 (Scalia, J., concurring).

[205] *Id.* at 318, 320 (Scalia, J., concurring). Prior to *Quill,* Congress was restricted in its ability to modify or eliminate the *Bellas Hess* rule because Congress cannot generally encroach upon the Supreme Court's interpretation of the Due Process Clause. *See id.* at 318. In his concurrence in *Quill,* Justice Scalia noted that the "the Court has long recognized that the doctrine of stare decisis has 'special force' where Congress remains free to alter what we have done." *Id.* at 320 (quoting Patterson v. McLean Credit Union, 491 U.S. 164, 172-73 (1989) (Scalia, J., concurring)).

[206] For example, the case spawned several federal bills that were intended to regulate the state taxation of mail order vendors. *See* Julie M. Buechler, *Virtual Reality: Quill's "Physical Presence" Requirement Obsolete When Cogitating Use Tax Collection in Cyberspace,* 74 N.D. L. REV. 479, 504 n.169 (1998). The case has also been cited as the basis for the recent congressional bills pertaining to business activity nexus. *See supra* note 2 and accompanying text.

that an evaluation of "the burdens" that are imposed by the states' use tax collection duty is one that Congress is "better qualified to resolve."[207] The Court tipped its own view of the issue by stating that, if it "overrule[d]" *Bellas Hess*, it would raise thorny issues concerning the retroactivity of the states' use taxes, and that the "precise allocation" of this tax burden would be better resolved by Congress.[208]

In *Quill,* the Court encouraged Congress to address the *Bellas Hess* issue, noting that "Congress is now free to decide whether, when, and to what extent the States may burden mail-order concerns with a duty to collect use taxes."[209] In light of the Court's general analysis, this phrase seems intended to signal to Congress that it could legislatively eliminate the *Bellas Hess* rule, in whole or part, without infringing upon any taxpayer's due process rights.[210] The specific means and manner of this elimination were placed within the discretion of Congress. On the other hand, in *Quill* the Court suggests that in the event Congress does not act, the Court will itself ultimately eliminate the *Bellas Hess* rule.[211]

Some persons are inclined to view the *Quill* dicta concerning Congress' power as to "mail order concerns" as signaling that Congress has broad power to immunize various "interstate" industries from state tax.[212] However, this interpretation conflicts with the Court's general analysis and its statement that "it was not the purposes of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the

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[207] *See Quill,* 504 U.S. at 318. The Court also referenced the burdens that the *Bellas Hess* rule imposes upon the states. It noted that mail order businesses had grown "'from a relatively inconsequential market niche in 1967 to a 'goliath' with annual sales that reached the 'staggering figure of $183.3 billion in 1989.'" *Id.* at 303 (citing *Quill,* 470 N.W.2d at 208).

[208] *See id.* at 318 n.10.

[209] *See id.* at 318. *See also* Walter Hellerstein, *Supreme Court Says No State Use Tax Imposed on Mail-Order Sellers...for Now,* 77 J. TAX'N 120, 123-24 (1992) (noting that the Court's language may have been intended, as a practical matter, to elicit action by Congress).

[210] *See* Hellerstein & Hellerstein, *supra* note 4, ¶ 4.23[1], at 4-201-02 & n.883 and accompanying text (noting that this language suggests that Congress can "empower[] the states to collect use taxes on mail-order sales").

[211] *See* Julie Minor, *Federalism, Sales and Use Taxes Discussed at Multistate Tax Commission Seminar,* 63 STATE TAX REV. (CCH) No. 5, at 9 (Feb. 4, 2002) (noting the comments of Professor Richard Pomp that the Supreme Court will likely find for the states in its next case that evaluates the *Quill* holding).

[212] This is the general claim of persons that support the business activity nexus bills discussed earlier in this article. *See supra* note 2 and accompanying text.

cost of business."[213] While this latter statement was made in the context of the Court's "dormant" Commerce Clause analysis, there is only one Commerce Clause, and it is inconceivable that the Clause has different "purposes" when applied by Congress and not the Court. Further, an expansive view of the *Quill* dicta concerning the federal commerce power is inconsistent with the fact that this dicta specifically relates to a Court-established rule and one that pertains to a specific type of transaction that the Court has considered, at least previously, to be commercially distinct. [214]

IV. THE ENACTMENT AND TERMS OF PUBLIC LAW 86-272

The impetus for Public Law 86-272 was the Supreme Court's holding in *Northwestern States Portland Cement Co. v. Minnesota*,[215] and two subsequent state court cases for which the Supreme Court denied certiorari.[216] In *Portland Cement*, the Court determined that a state could apply an apportioned net income tax to two manufacturing companies that were engaged in making sales within the state.[217] In both cases, the out-of-state company maintained offices in the state and employed sales persons who solicited orders there.[218] However, the

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[213] *See Quill*, 504 U.S. at 310 n.5 (quoting Commonwealth Edison Co. v. Montana, 486 U.S. 24, 31 (1981)).

[214] Three years after *Quill*, in another dormant Commerce Clause case, the Court upheld a state sales tax applied to the gross price of an interstate bus ticket. *See* Oklahoma Tax Comm'n. v. Jefferson Lines, Inc., 514 U.S. 175 (1995). Justice Scalia in his concurrence noted that, despite the Court's holding, Congress was free under the affirmative aspect of the Commerce Clause to prohibit the tax. *See id.* at 200 (noting that Congress could consider such "imponderables as how much 'value [is] *fairly attributable* to economic activity within the taxing state,' and what constitutes '*fair relation* between such a tax and benefits conferred upon the taxpayer by the State'") (Scalia, J., concurring) (emphasis in original). Congress did subsequently act to prohibit the tax at issue in *Jefferson Lines* and justified this legislation as a regulation of an instrumentality of interstate commerce. *See* The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (codified at 49 U.S.C. § 14505 (1995)).

[215] 358 U.S. 450 (1959).

[216] *See* S. REP. NO. 86-658, at 2 (1959); H.R. Rep. No. 86-936, at 2 (1959). The state cases were *Brown-Forman Distillers Corp. v. Collector of Revenue*, 101 So. 2d 70 (1958), *cert. denied*, 359 U.S. 28 (1959) and *International Shoe Co. v. Fontenot*, 107 So. 2d 640 (1958), *cert. denied*, 359 U.S. 984 (1959). *See also* Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 220-22 (1992); Heublein, Inc. v. South Carolina Tax Comm'n, 409 U.S. 275, 279 (1972).

[217] One corporation manufactured cement and the other valves and pipe fittings. *See* 358 U.S. at 453, 455.

[218] *See id.* at 454-55.

orders were sent outside the state for processing and delivery.[219] In approving the taxation of the two companies, the 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 same."[220]

Within two months of *Portland Cement*, the Court denied certiorari in two similar state court cases, *Brown-Forman Distillers Corp. v. Collector of Revenue*[221] and *International Shoe Co. v. Fontenot.*[222] The court in both *Brown-Forman* and *Fontenot* applied logic like that in *Portland Cement* to uphold a state's application of an apportioned net income tax. In *Fontenot*, the taxpayer, a shoe manufacturer, engaged in "regular and systematic" solicitation of orders in the state though the use of fifteen salesmen.[223] The orders taken in the state ranged in dollar volume from $5-6 million annually.[224] *Brown-Forman* pertained to a company that distilled and packaged whiskey for distribution amongst the states. The court concluded that the state in question could tax the company's in-state "source income" based on the presence of its in-state sales persons.[225] The *Brown-Forman* court dismissed the company's claim that the tax was unconstitutional because its in-state sales representatives were "missionary men" who neither solicited nor accepted orders, but rather merely served to enhance the company's in-state sales.[226]

Under the pervading constitutional notions of the late 1950's, business persons expressed concerns with the tri-part holdings in *Portland Cement*, *Brown-Forman*, and *Fontenot.*[227] Because the sales in

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[219] *See id.* at 453-54, 456.

[220] *Id.* at 452. *See also id.* at 464 (noting that the valid basis for the tax was the "net profits earned in the taxing State" and that the tax would apply to "that portion of the taxpayer's net income which arises from its activities within the taxing State").

[221] 101 So. 2d 70.

[222] 107 So. 2d 640. The Court denied certiorari in *Brown-Forman* less than one week after *Portland Cement* and denied certiorari in *International Shoe* two months later. *See Wrigley*, 505 U.S. at 220-21.

[223] 107 So. 2d at 640.

[224] *See* Roland, *supra* note 5, at 1181. This volume of in-state proceeds suggests that the company was not a small or medium-sized business relative to the other businesses of the day. *See* H.R. REP. NO. 88-1480, at 428 (1964) (using as a benchmark for what would constitute a "larger sized" company in the early 1960s whether the company had total annual sales of $5 million or more).

[225] *See* 101 So. 2d at 72.

[226] *See id.* at 70, 72.

[227] *See* S. REP. NO. 86-658, at 2 (1959); H.R. REP. NO. 86-936, at 1-2 (1959).

these three cases were effected through both in-state and out-of-state activity, the cases suggested that a taxpayer that was engaged exclusively in "interstate commerce" could be subject to state income tax. In particular, the two state cases suggested that mere in-state sales solicitation was enough to create tax jurisdiction.[228] The three cases created fear that businesses with relatively minor income would suddenly be "required to file returns in numerous States where their activities and income were relatively insignificant."[229]

In response to the concerns of business, Congress commenced hearings concerning *Portland Cement* within seven weeks of that decision.[230] These hearings were brief in duration and were dominated by testimony from business persons. For example, the bill that became Public Law 86-272 was reported out of the Senate Finance Committee, which held a public hearing on the bill that lasted just two days.[231] Further, just two states were allowed to present limited testimony at the hearing, which otherwise was devoted to witnesses from various trade groups.[232] In just over six months' time, Congress passed Public Law 86-272 as an emergency "stop-gap" measure that was intended to restrict the application of *Portland Cement* and the two state cases.[233]

The "truncated" process[234] by which Congress deliberated and enacted Public Law 86-272 stands in stark contrast to the magnitude of the Act's intrusion on state sovereignty and its unprecedented nature. The United States Constitution was ratified in 1788, during which time even the most ardent supporters of federal power commented upon the states' sovereign right to raise income through the unrestricted right of taxation.[235] In the enactment of Public Law 86-272, 171 years after the ratification of the Constitution, Congress "for the first time exercised its power over interstate commerce to enact a general statute dealing with State taxation of interstate business."[236] Even

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[228] *See* S. REP. NO. 86-658, at 2-3; H.R. REP. NO. 88-1480, at 7 (1964).

[229] H.R. REP. NO. 88-1480, at 7.

[230] *Id.* at 8.

[231] *See* Roland, *supra* note 5, at 1174-75.

[232] *Id.*

[233] *See* S. REP. NO. 86-658, at 4-5.

[234] *See* Paul J. Hartman, *"Solicitation" and "Delivery" Under Public Law 86-272: An Uncharted Course*, 29 VAND. L. REV. 353, 359 (1976).

[235] *See supra* note 53 and accompanying text (noting the comments of Alexander Hamilton).

[236] *See* H.R. REP. NO. 88-1480, at 8. *See also supra* note 4. By way of contrast, Congress has deliberated for five years the appropriate restrictions to place upon state taxation of the Internet, a single industry that has just recently come into existence. *See generally* Houghton & Hellerstein, *supra* note 67.

those who favored "congressional intervention...criticized the technical draftsmanship exhibited in the act and the abbreviated procedure used in its adoption."[237] The dissenting Senators objected that "this bill is premature. It has been hastily devised to meet fears of future developments. There is no necessity for hasty, premature, and possibly hurtful action. There is time for a proper study by a competent staff."[238]

Both houses of Congress understood Public Law 86-272 as temporary.[239] Because both the House and the Senate recognized "the complexity of the issues," the Act contained a provision that required a congressional subcommittee to "study the entire problem with a view toward the enactment of appropriate legislation."[240] The subsequent 1255-page study, commonly called the "Willis Report" because Congressman Edwin Willis chaired the subcommittee, provides a detailed analysis of Public Law 86-272—particularly when compared to the thin congressional record compiled during the six months in which Congress deliberated and passed the Act.[241]

The actual text of Public Law 86-272 prohibits a state from imposing any tax on a company's net income that is derived "from interstate commerce if the only business activities within the State by or on behalf of such company are the minimum activities described in the bill."[242] The minimum activities are that the company must limit its activities in the state to the mere "solicitation" of sales of "tangible personal property."[243] Also, all of the company's orders must be sent

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[237] Hartman, *supra* note 5, at 1008.

[238] S. REP. NO. 86-658, at 12 (Gore & McCarthy minority view).

[239] *See* S. REP. NO. 86-658, at 4; H.R. REP. NO. 86-936, at 2 (1959).

[240] *See* H.R. REP. NO. 86-1103, at 2 (1959). Similarly, the Senate Report stated that:

> Your committee recognizes that the bill it has reported is not a permanent solution to the problem that exists. It was not intended to be. Your committee, like the Select Committee on Small Business of the U.S. Senate, recognizes that the problem is a complex one which requires extensive and exhaustive study in arriving at a permanent solution fair alike to the States and to the Nation. Your committee believes, however, that the bill it has reported will serve as an effective stopgap or temporary solution while further studies are made of the problem.

S. REP. NO. 86-658, at 4-5.

[241] The Willis Report was produced in 1964 and 1965 in four volumes. It included, by reason of later legislation, study of state taxation outside the area of income tax. This article refers only to volumes 1 and 2, which focus on corporate income tax. *See* H.R. REP. NO. 88-1480.

[242] S. REP. NO. 86-658, at 1.

[243] 15 U.S.C. § 381(a)(1) (2001). *See* S. REP. NO. 86-658, at 1.

outside the state for approval or rejection, and if approved, the order must be filled by a "delivery" from a location outside the state.[244] The terms "solicitation," "delivery," and "tangible personal property" are pivotal in the application of the Act, yet Congress fails to define these terms. Questions concerning the meaning of these terms were acknowledged in the Willis Report and continue to this day.[245]

Although Public Law 86-272 was enacted in response to three cases, *Portland Cement*, *Brown-Forman*, and *Fontenot*, the statute only reversed the results in the latter two state court cases.[246] In particular, the Act posits as the key determinant for the permissibility of a tax whether the taxpayer maintains an employee-staffed office in the state, whether or not these employees are responsible for the taxpayer's in-state sales. That is, so long as a taxpayer maintains an employee-staffed in-state "office," it will be outside the protections of the Act and therefore subject to state income tax.[247] In contrast, if the taxpayer maintains no in-state office, or maintains an office that is staffed by sales persons that are "independent contractors," the protections of the Act still apply.[248] The Act fails to define the important term "office,"[249]

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[244] 15 U.S.C. § 381(a)(1) (2001). *See* S. REP. NO. 86-658, at 1.

[245] *See* H.R. REP. NO. 88-1480, at 146 (noting that the "primary area of ambiguity in the statute revolves around the terms 'solicitation' and 'delivery'"); John Dane, Jr., *Small Business Looks at Public Law 86-272 in the Perspective of Its Alternatives*, 46 VA. L. REV. 1190, 1206-7 (1960) (stating that "there is considerable uncertainty as to whether state or federal law is to be applied in determining what is tangible personal property"); Roland, *supra* note 5, at 1180 (noting questions concerning the terms "tangible personal property" and "solicitation"); Tatarowicz, *supra* note 56, at 293-94 (noting inconsistent interpretations of the terms "solicitation and "delivery"). *See generally* Timothy J. Sweeney, *State Taxation of Internet Commerce under Public Law 86-272: "A Riddle Wrapped in an Enigma Inside a Mystery,"* B.Y.U. L. REV. 169 (1984). For years, tax practitioners urged the Supreme Court to step in and define the term "solicitation." *See* Hartman, *supra* note 234, at 362; Tatarowicz, *supra* note 56, at 293-94; Sweeney, *supra,* at 194. Thirty-three years after the enactment of Public Law 86-272, the Court did so in *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992), whereupon commentators concluded that the term remains ambiguous. *See, e.g.*, Guttormsson, *supra* note 17, at 1392 (stating, inter alia, that "[c]ourts and businesses will probably spend another thirty years trying to determine what the [Court's rule] means").

[246] *See* H.R. REP. NO. 86-936, at 3 (1959). *See also* H.R. REP. NO. 88-1480, at 145 (1964).

[247] *See* H.R. REP. NO. 86-936, at 3. *See also* H.R. REP. NO. 88-1480, at 145 (noting that "a foreign corporation which maintains an office in the taxing State is not immunized from taxation even though engaged exclusively in interstate commerce").

[248] 15 U.S.C. § 381(c).

[249] *See* 15 U.S.C. §§ 381-384. *See also* Sweeney, *supra* note 245, at 186 n.83.

and the term "independent contractor" is defined in a confusing manner.[250]

Although Public Law 86-272 specifically reverses the results in *Brown-Forman* and *Fontenot*, but retains the result in *Portland Cement*, the cases themselves suggest that this distinction is arbitrary. For example, in one of the two fact patterns addressed by the Court in *Portland Cement*, the taxpayer maintained an in-state office that was staffed by only one sales person and one secretary—with the sales person dedicating only one-third of his efforts to in-state sales.[251] In contrast, in *Fontenot*, the taxpayer engaged in "regular and systematic" solicitation in the state through the efforts of fifteen sales persons.[252] In addition, though these sales persons did not maintain an office in the state, they did, at the expense of the taxpayer, display samples in the state using hotel rooms or rooms in public buildings.[253] These facts suggest that the nature of the solicitation was greater in *Fontenot* than it was in *Portland Cement*. However, the provisions of Public Law 86-272 provide complete income tax immunity to taxpayers like that in *Fontenot*, but no tax benefit to companies like that described in *Portland Cement*, merely because in the former instance the taxpayers do not maintain an in-state office.

V. APPLYING THE SUPREME COURT'S TENTH AMENDMENT JURISPRUDENCE TO PUBLIC LAW 86-272

Public Law 86-272 cannot pass muster under the Supreme Court's current Tenth Amendment jurisprudence, whether the applicable test is the Court's balancing analysis, the *Garcia* political process standard, or some combination of both. This section applies the Supreme Court's various Tenth Amendment tests to illustrate the Act's lack of constitutional foundation.

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[250] The statute does provide that a company "representative" is "not an independent contractor," but since the Act does not define the term "representative," this provision merely serves to restate the question. *See* 15 U.S.C. § 381(d)(2). *See also* Hartman, *supra* note 5, at 1008; Tatarowicz, *supra* note 56, at 299; Sweeney, *supra* note 245, at 188-94.

[251] Portland Cement Co. v. Minnesota, 358 U.S. 450, 455 (1959).

[252] Int'l Shoe Co. v. Fontenot, 107 So. 2d 640, 640 (1958), *cert. denied*, 359 U.S. 984 (1959).

[253] *See Int'l Shoe*, 107 So. 2d at 640; Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 241 (1992) (Kennedy, J., dissenting). Apparently, although this fact is not noted in the case, some of these salespersons also resided in the state. *See* Roland, *supra* note 5, at 1181.

A. Balancing the Federal Benefits and State Burdens Under Public Law 86-272

It has been claimed that Public Law 86-272 benefits interstate commerce in various ways. Congress emphasized some of these claims in passing the Act, and other claims have been hypothesized after-the-fact. However, as this section demonstrates, most of the asserted benefits of Public Law 86-272 have either been disproved or mooted through the passage of time. Further, whatever benefits can still be reasonably claimed do not outweigh the Act's enormous cost to the states, both in terms of the tax revenues forgone and the considerable administrative and political costs.

1. Intent to Benefit Interstate Commerce By Decreasing Compliance Burdens on Small Businesses

In passing Public Law 86-272, Congress was primarily concerned with the cost of tax compliance that the Act purportedly could impose upon smaller businesses if a state acquired taxing jurisdiction over a business based upon its mere in-state sales solicitation.[254] So significant was this concern that in its three-page discussion as to the "need for the legislation," the Senate Report that accompanied the Act as passed refers four times to the potential "costs of compliance" that could be imposed upon smaller businesses.[255] The specific rationale for this congressional concern is clear: smaller companies, unlike larger companies, could not afford to incur relatively high compliance costs to create what would be smaller amounts of income.[256] A primary reason

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[254] *But see* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-24 (1981) ("'[I]t 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 business.'") (quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975)).

[255] *See* S. REP. NO. 86-658, at 2-4 (1959).

[256] For example, the Senate Report states that because of these "burdens of compliance" smaller businesses "may be hesitant to develop new markets in some States by extending their solicitation activities to such States, or may cause the withdrawal of such activities from some existing markets in other States...." *Id.* at 4. The Report noted that this in turn "may tend to leave the markets to larger businesses whose activities are already widespread and which can better absorb the overhead expenses...." *Id.* These costs of compliance were also emphasized in the House Report:

> These [small and moderate size] businesses are concerned not only with the costs of taxation, but also with the inescapable fact that compliance

for the disparate compliance costs faced by smaller companies was thought to be the fact that smaller companies, unlike their larger competitors, lacked any form of mechanized equipment to track the location of their sales.[257]

In the abbreviated period in which both the House and Senate deliberated and passed Public Law 86-272, each body generally took it on faith that the statute would primarily benefit smaller companies consistent with the statute's intent. However, after the passage of Public Law 86-272, the Willis committee studied the practical application of the Act and found that this conclusion was largely unsubstantiated. In particular, the Willis Report found that almost one-half of "larger sized" companies—defined as companies with $5 million or more in annual sales as measured during the early 1960's—received some tax benefit under the Act.[258] Further, the Willis Report found that this percentage held true even for companies with more than $50 million in annual sales.[259] On the other hand, the Report found that only about 25% of smaller companies—defined as companies with less than $200,000 in sales—received any protection under Public Law 86-272.[260] Hence, the Willis Report concluded that "insofar as the sup-

> with the diverse tax laws of every jurisdiction in which income is produced will require the maintenance of records for each jurisdiction and the retention of legal counsel and accountants who are familiar with the tax practice of each jurisdiction. This will mean increases in overhead charges, in some cases to an extent that will make it uneconomical for a small business to sell at all in areas where volume is small.

H.R. REP. NO. 86-936, at 2 (1959). *See also* 105 CONG. REC. 16,359 (1959) (statement of Sen. Saltonstall) ("What small business cannot afford to do is to be taxed in all those States, as compared to big business which, we might say, could afford to be taxed in those States, even though it might not desire to be taxed.").

[257] *See* H.R. REP. NO. 88-1480, at 91 (1964):

> The accounting required to develop information needed for tax purposes is usually done by hand, with the assistance of only the simplest of machinery such as adding machines. Some use is made of bookkeeping machines, but the use of punch-card or electronic data processing equipment is confined to larger companies.

See also Hearings on State Taxation on Interstate Commerce Before the Senate Select Committee on Small Business, 86th Cong. 55 (1959) (where a party testifies that assigning invoices to the varying states "is a task so monumental and so susceptible of clerical error that in our company we are compelled to use the most advanced electronic data processing machines to handle the job").

[258] H.R. REP. NO. 88-1480, at 428.

[259] *Id.*

[260] *Id.* In his defense of Public Law 86-272, one commentator echoed the concerns for small business expressed in the House and Senate Reports and argued that

porters of the statute believed that the law would be beneficial primarily to small businesses, they appear to have been mistaken."[261] Further, the Willis Report noted that "[t]o the degree that it gave exemption to some of the larger companies, P.L. 86-272 may well have gone beyond the results anticipated by its supporters."[262]

Some persons have claimed that Congress intended for Public Law 86-272 to rectify state tax discrimination vis-à-vis smaller businesses, noting Congress' concern that the potential tax compliance burdens imposed upon smaller businesses would be unduly harsh compared to the potential compliance burdens imposed upon larger businesses.[263] However, the Willis Report debunks this claim because it concludes that, as embodied in the Act, "the jurisdictional line drawn is not one that distinguishes between the large and the small."[264] Further, the Willis Report suggests that Public Law 86-272 actually discriminates *against* smaller companies and not in favor of them because it forces a greater percentage of smaller businesses than larger businesses to bear a tax burden. In particular, Public Law 86-272 discriminates against smaller businesses because most smaller businesses are local and do not engage in the Act's conception of "interstate" sales.[265] Therefore, most smaller businesses are generally subject to tax on all of their in-state income, whereas many of their larger competitors will be interstate companies that are more likely to qualify, at least in part, for the protections of the Act.[266] Also, smaller businesses, to

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"in the case of firms doing less than $100,000 of business in any state, costs of compliance to the taxpayer and costs of administration and enforcement by the state will exceed any given revenue." *See* Dane, *supra* note 245, at 1202. However, the subsequent issuance of the Willis Report proved that firms doing less than $100,000 in business made up only a very small percentage of the companies that were actually protected by the Act.

[261] H.R. REP. NO. 88-1480, at 428.

[262] *Id.* at 431. The Report further notes that:

> Among the supporters of P.L. 86-272, the view also seems to have been widely held that the protection given by the statute would be of value primarily to small and medium-sized businesses. This view of the statute's impact, however, does not receive support from the data now available. While the law did give substantial protection to many smaller businesses, many of the larger corporations also received considerable benefit.

Id. at 438.

[263] *See, e.g.*, Sweeney, *supra* note 245, at 173-74.

[264] H.R. REP. NO. 88-1480, at 438.

[265] *See* McLure, *supra* note 7, at 387.

[266] As stated by one commentator:

the extent that they do conduct interstate commerce, are more likely to engage in this commerce only on a limited or occasional basis. However, occasional contacts with another state would not have established nexus under the holding in *Portland Cement* and do not establish nexus even today.[267] Even the attributes of a smaller business as noted by Congress in 1959 have ceased to exist because smaller businesses now generally have access to computer technology for purposes of tracking sales.[268]

Pubic Law 86-272 generally confers tax immunity on certain companies that sell tangible personal property based upon whether the business maintains an in-state office. However, as *Fontenot* suggests, even at the time Congress enacted Public Law 86-272, a company did not need to maintain an in-state office to make substantial in-state sales.[269] Therefore, Public Law 86-272 encourages businesses that make interstate sales of tangible personal property—generally larger companies—to engage in tax planning to obtain the protections of the Act.[270] This tax planning has been prevalent virtually since the day the

> The Federal statute discriminates against small and medium-sized businesses by forcing them to bear the burden of tax for which big businesses are granted immunity. A small business, domiciled in and taxed upon its profits by its home state is compelled to compete at a discriminatory disadvantage when a large multistate operator is granted immunity on profits from exclusively interstate sales.

Fred L. Cox, *Federal Limit on State Taxes is Unfair to Consuming States and to Local Firms*, 11 J. TAX'N, 354, 356 (1959). *See also* S. REP. NO. 86-658, at 11 (1959) (minority view of Sen. Russell B. Long) (noting that smaller companies are local and therefore are generally subject to tax but must compete with larger companies whose sales activities cross state lines).

[267] H.R. REP. NO. 88-1480, at 426 (noting that even in the absence of Public Law 86-272, "occasional" contacts would not establish nexus). *See* Nat'l Geographic v. Calif. Bd. of Equal., 430 U.S. 551, 556 (1977) (noting that the mere "slightest" in-state presence does not establish nexus).

[268] *Cf.* Quill Corp. v. North Dakota, 504 U.S. 298, 303 (1992) (noting that, in comparison to what was true at the time of *National Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753 (1967), advances in computer technology have greatly eased the burden of state tax compliance).

[269] *See supra* notes 223-224, and accompanying text.

[270] *See* Hartman, *supra* note 5, at 1009 ("The act prevents the states from reaching the income of numerous large-scale multistate enterprises, for which the cost of compliance is not a significant deterrent to conducting business and which are capable of limiting their marketing activities so as to come within the statute while realizing substantial revenues from sales into the state."); Roland, *supra* note 5, at 1176 & n.28 ("There was widespread concern about the cost of complying," but "[l]ittle was said about the sizeable amounts of tax that can now be avoided under the artificial standards of Public Law 86-272.").

Act was passed[271] and also has the effect of discriminating against small in-state business persons because it decreases the use of in-state offices and in-state employees.[272]

Public Law 86-272 not only discriminates against smaller companies but also discriminates against certain types of companies, large and small. As noted, the Act protects companies that engage in the sale of tangible personal property when those companies generally limit their in-state activities to the solicitation of sales. However, Public Law 86-272 does not apply to companies that sell intangible property, such as securities or custom software, even when these companies otherwise generally limit their in-state activities to solicitation within the meaning of the Act.[273] Further, Public Law 86-272 does not apply to a broad spectrum of service-type companies such as advertising firms, financial institutions, trucking and transportation companies, communications companies, insurance firms, and pipeline companies.[274]

The Willis Report noted Congress' view that because Public Law 86-272 was intended to benefit smaller companies, it would have only a limited impact on the collection of state tax.[275] However, as noted, the Act failed in its goal to limit narrowly its benefits to smaller businesses, and so its impact on the states' finances was certainly larger than Congress anticipated. In addition, as noted by the Willis Report, most small businesses were not protected by the Act, so the specific benefits that were obtained for these small companies were certainly smaller than Congress anticipated.[276] These factors suggest that, to the extent that Congress balanced the potential federal benefits against the state burdens in enacting Public Law 86-272, it did so based upon incorrect assumptions. Further, these factors suggest that the eco-

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[271] *See* Cox, *supra* note 266, at 356.

[272] *See* S. REP. NO. 86-658, at 10 (Gore & McCarthy minority view) (arguing that the Act would hurt small business persons because large companies would be less likely to open in-state offices or warehouses and would deemphasize in-state employees).

[273] *See* Hartman, *supra* note 5, at 1008.

[274] *See* S. REP. NO. 86-658, at 10 (Gore & McCarthy minority view). *See also* Hartman, *supra* note 5, at 1008; Tatarowicz, *supra* note 56, at 302.

[275] The Report noted Congress' view that "if small- and medium-sized taxpayers would be the primary beneficiaries of the statutory policy, it would appear that the States would not gain significant amounts of revenue even if permitted to impose income taxes on the basis of the activities protected by the statute." H.R. REP. NO. 88-1480, at 422.

[276] *See id.* at 431 (noting that Congress failed to provide protection to many small companies that were its intended beneficiaries).

nomic benefit to interstate commerce that was achieved under Public Law 86-272 by protecting smaller companies is substantially outweighed by the burdens—financial and otherwise—that the Act imposes upon the states.[277]

2. Intent to Maintain the Judicial Status Quo

A second rationale for the enactment of Public Law 86-272 was that the law would maintain the status quo concerning state tax jurisdiction as it existed prior to *Portland Cement* until Congress could determine what limits on this jurisdiction were appropriate.[278] This rationale was premised on the view that most states did not apply a sales solicitation nexus standard for taxing purposes prior to *Portland Cement* and therefore, most businesses did not anticipate being subject to tax on the basis of this activity. As a result, there was a concern that

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[277] As stated by one commentator:

> The contribution to the national economy of a business so marginal that its profitable operation within a particular state depends upon the absence of annual tax return requirements would seem so slight as to at least be offset by consideration of the economic welfare of the various states and preservation of the constitutional rights and obligations which are guaranteed to and imposed upon those states.

Roland, *supra* note 5, at 1178.

[278] The Willis Report stated that:

> When Public Law 86-272 was enacted in 1959, the need for a thorough study of State income taxation was recognized by both proponents and opponents of the statute's substantive provisions. There appears to have been universal agreement that Congress was not then in a position to reach a definitive decision as to what Federal legislation might be appropriate in this area. But in the absence of the information which a study could provide, a decision had to be made as to what the law should be while the study was being conducted. Congress could leave the latter untouched, or it could adopt a variety of proposals for stopgap legislation. The decision was reached to enact in statutory form a jurisdictional rule which many had long believed existed prior to the 1959 Court decisions. While the legislation was considered stopgap and Congress thus made no lasting commitment to it, the decision necessarily reflected certain views as to what the impact of such a law would be.

H.R. REP. NO. 88-1480, at 421. *See* Sweeney, *supra* note 245, at 181-82 & nn.67-69 (noting comments of various congressmen to this same effect, including the statement of Representative Walter that, "[t]he proposed legislation would in effect hold the taxing power of the several States to the exact situation passed on by the Court only until Congress has a chance to examine into the whole question and enact permanent corrective legislation").

the states could collectively begin to impose a "new" tax under *Portland Cement*, and that they could impose this tax retroactively going back an extended period of years.[279] Further, it was thought that because Public Law 86-272 merely reimposed the judicial status quo as it existed prior to *Portland Cement*, the Act could not have much impact on the states' finances.[280]

a. Portland Cement and Spector Motor Service

Congress' interest in retaining the judicial status quo concerning state tax jurisdiction was based in part on two specific observations concerning the Supreme Court's jurisprudence. First, despite the holding in *Portland Cement*, Congress concluded that the constitutional rule stated in that case was not a firm one. In this respect, Congress noted that *Portland Cement* was decided by a 6-3 vote, was somewhat equivocal, and featured an animated dissent.[281] Second, it was observed that the *Portland Cement* holding was inconsistent with the Court's rules concerning a state's power to impose a net income tax as opposed to a tax on "the privilege" of engaging in interstate commerce.[282] While the *Portland Cement* decision determined that the former type of tax was appropriate under certain circumstances, it distinguished this result from that in *Spector Motor Service, Inc. v.*

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[279] One of the assessments in *Portland Cement* went back fifteen years. *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 453 (1959). *See* S. REP. NO. 86-658, at 4 ("One of the problems raised by the broad scope of the language of the Supreme Court is the extent of tax liability of firms engaged in interstate commerce for past years to States in which they may now find they may be exposed to tax liability for many prior years.").

[280] *See* H.R. REP. NO. 88-1480, at 422 (stating that Congress had concluded that to the extent that the Act "was preserving a pre-existing jurisdictional rule rather than contracting the States' power to tax, it could not result in a material diminution of the States' income tax revenues").

[281] *Portland Cement* stated that it was clarifying "'the tangled underbrush of past cases' with reference to the taxing power of the States...." 358 U.S. at 457 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940)). However, House Report 936 concluded that, despite the 6-3 decision, "it may be argued that the Supreme Court has not yet decisively disposed of the precise question of whether solicitation alone is a sufficient activity for the imposition of a State income tax upon an out-of-State business...." H.R. REP. 86-936, at 2 (1959). The Willis Report stated that, "[w]hether [*Portland Cement*] broke new ground or whether it was compelled by prior decisions of the Court was the subject of controversy within the Court itself." H.R. REP. NO. 88-1480, at 7.

[282] *See* H.R. REP. NO. 88-1480, at 143. *See also Portland Cement*, 358 U.S. at 458.

O'Connor,[283] where the Court held that the latter type of tax was an impermissible "direct" tax on interstate commerce.[284] The Willis Report observed that it was appropriate for Public Law 86-272 to equate the state tax rules concerning an income or privilege tax since the Court's legal distinction was "artificial."[285] Indeed, one commentator who defended the Act noted that the strongest argument in its favor was that it created uniformity in the treatment of these two types of taxes, which he concluded are economically identical.[286]

Questions concerning the viability of *Portland Cement* and the Court's jurisdictional rules, as they pertain to either an income tax or a privilege tax, no longer provide a valid justification for Public Law 86-272. Forty-three years ago when *Portland Cement* was decided, "interstate commerce" was a fairly new development and the Court's 6-3 decision as to whether sales solicitation could establish income tax nexus reflected the Court's caution with respect to this issue. However, since 1959 there have been innumerable technological and other advances with respect to such things as transportation, communications, and distribution, and now interstate commerce—indeed international commerce—is pervasive.[287] Further, while the Court's decision in *Portland Cement* was arguably equivocal, the rule of law established by that case no longer is. Indeed, immediately after *Portland Cement* the Court unanimously embraced a sales solicitation nexus standard in the context of a sales tax in *Scripto, Inc. v. Carson*.[288] While *Scripto* pertained to a state sales tax and not an income tax, the Court

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[283] 340 U.S. 602 (1951).

[284] *See Portland Cement*, 358 U.S. at 458, 461-64. *See also* H.R. REP. NO. 88-1480, at 143. The holding in *Spector* was the result of the Supreme Court's early twentieth-century Commerce Clause cases, which generally concluded that the states could not impose any "direct" burden on interstate commerce. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 309-10 (1992).

[285] *See* H.R. REP. NO. 88-1480, at 151-52.

[286] *See* Dane, *supra* note 245, at 1192-93.

[287] *See Quill*, 504 U.S. at 327-28 (White, J., dissenting); Eugene F. Corrigan, *Interstate Income Taxation—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423, 424-25 (1975).

[288] 362 U.S. 207 (1960). *Scripto* further concluded that it was irrelevant for purposes of determining nexus whether an employee or an independent contractor conducted the in-state solicitation. *See id.* at 211 (noting that the designation of these persons as independent contractors does not change the "local function of the solicitation" and does not impact the solicitation's "effectiveness in securing a substantial flow of goods" in the state). *But cf.* 15 U.S.C. § 381(c) (provisions of Public Law 86-272 providing for different nexus rules depending upon whether an employee or an independent contractor conducts the in-state solicitation).

has since unanimously applied the solicitation nexus standard in income tax cases as well.[289] Further, this same nexus standard has been applied in numerous state court cases.[290]

To the extent that Public Law 86-272 was based on the Court's divergent treatment of income taxes and privilege taxes, this rationale has also ceased to exist. In *Portland Cement*, the Court distinguished the former type of tax from the latter, as previously addressed by *Spector*. Specifically, *Portland Cement* permitted the imposition of a fairly apportioned, nondiscriminatory income tax based upon in-state sales solicitation, but retained the rule in *Spector*, which held that a state could not impose tax on the privilege of doing business—even on identical facts.[291] Commentators criticized this distinction, noting that these two taxes can be identical in practical effect and therefore argued that Public Law 86-272 was justified in creating a uniform rule. However, the Court itself later concluded that its distinction between income and privilege taxes could not be justified on economic terms, and therefore overruled *Spector*.[292] In essence, the Court resolved the inconsistency between *Portland Cement* and *Spector* by reaffirming its commitment to *Portland Cement*.[293] In so doing, the Court eliminated one of the justifications that had been raised in support of Public Law 86-272.

Public Law 86-272 was also justified because it would prevent the retroactive application of state taxes that, it was claimed, business persons could not have reasonably anticipated under the then-prevalent jurisdictional law. However, to the extent that the goal of the statute was to prevent the retroactivity of a particular state tax, this goal could have been accomplished directly, and it was not necessary for Congress

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[289] *See* Tyler Pipe Indus. v. Washington Dep't of Revenue, 483 U.S. 232 (1987); Standard Pressed Steel Co. v. Dep't of Revenue of Wash., 419 U.S. 560 (1975).

[290] *See, e.g.*, Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954 (N.Y. 1995), *cert. denied*, 576 U.S. 989 (1995); Magnetek Controls, Inc. v. Michigan Dep't of Treasury, 562 N.W.2d 219 (Mich. Ct. App. 1997); Arizona Dep't of Revenue v. O'Connor, 963 P.2d 279 (Ariz. App. Div. 1997).

[291] *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458-59 (1959).

[292] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). *Complete Auto* determined that the rule in *Spector* had to be overruled because it "has no relationship to economic realities." *Id.*

[293] *See id.* at 285. *See also id.* at 279 & 279 n.8 (citing *Portland Cement* and other cases for the proposition that "[i]t 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)).

to create an entirely new jurisdictional rule. Further, even to the extent that Public Law 86-272 was justified as preventing the retroactive application of what was perceived to be a "new" tax, this justification is no longer valid because it is now understood that persons that perform in-state sales solicitation will generally establish nexus on the part of the companies they represent.

b. The Recommendations of the Willis Report

Public Law 86-272 was not thought of as the answer to *Portland Cement*, but rather a "stop-gap" measure that would provide Congress with time to determine what federal restrictions, if any, were appropriate with respect to state tax jurisdiction. These considerations were addressed by the Willis Report, which generally determined that the appropriate jurisdictional rules depended in large part upon the rules that the states apply to divide or "source" income amongst the states. In particular, the Willis Report concluded that if the states' sourcing rules tend to source income from sales to the destination state of the buyer, then the presence of these in-state purchasers should be a factor in determining the state's taxing jurisdiction. Otherwise, the Report concluded, the state tax rules would be such that a company's income could be sourced in large part or even exclusively to locations where the company was not subject to tax. Thus, the Willis Report stated that:

> The formulation of a jurisdictional rule and the formulation of division-of-income rules involve essentially the same question. Both kinds of rule embody a policy as to where income should be subject to income taxation. In any rational system of State income taxation, both kinds of rule must embody the same policy. If the policy is that a State shall not tax a company which does not have a place of business there, there is not much to be said for an apportionment formula that attributes large amounts of income to States in which companies do not have places of business.[294]

The Willis Report concluded that the unanticipated benefits that were created for larger companies by Public Law 86-272 generally resulted because, at the time, many states sourced income for taxing purposes based largely upon a company's in-state sales or "destination

[294] H.R. REP. NO. 88-1480, at 513 (1964).

of shipments."[295] However, Public Law 86-272 eliminated any consideration of a company's in-state market for purposes of determining state tax jurisdiction, and instead determined jurisdiction based solely upon a company's maintenance of an in-state office or similar place of business. Hence, the result of Public Law 86-272 was to exacerbate a result that the Willis Report considered inappropriate: a rule that divorced the policies reflected in the state tax jurisdiction and division of income rules. As noted by the Report, "[i]n the context of a system in which income is widely attributed on the basis of the destination of shipments, the [jurisdictional] exemptions given to some of the larger companies may be difficult to defend."[296]

Although the Willis Report concluded that Public Law 86-272 was inconsistent with the income sourcing rules that were generally applied by the states—and that the Act therefore provided an unintended benefit to big business—the Report did not advocate repeal of the Act. Rather, the Report recommended congressional rules that would alter the states' sourcing rules to bring them into conformity with the jurisdictional exemption set forth in Public Law 86-272. In particular, the Willis Report proposed state sourcing rules that would depend entirely upon the location of a company's in-state property and payroll, and not sales.[297] However, this recommendation by the Willis Report was never adopted. Therefore, the anomaly that was acknowledged by the Report remains in place, and in fact has become greater since the states have increased their dependency upon sourcing formulas that emphasize in-state sales.[298] In light of subsequent developments, the Willis Report cannot be read to support Public Law 86-272 because, as stated by the Report, a "jurisdictional rule is open to serious criticism if it bars taxation of either a large proportion of the income of many companies or large dollar amounts of income for particular taxpayers."[299]

The concern with the states' apportionment rules, suggested by the Willis Report, reflects the view that perhaps Public Law 86-272 can be justified because it tends to diminish the possibility that a cor-

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[295] *Id.* at 439.

[296] *Id.*

[297] *See generally id.* at 517-63.

[298] *Compare id.* at 439 ("The statute's potential for significant revenue impact is limited to those States which now use, or may in the future adopt, the destination test.") *with* Walter Hellerstein, *Commerce Clause Restraints on State Tax Incentives*, 82 MINN. L. REV. 413, 434 (1997) (discussing the recent trend towards the adoption of apportionment formulas that give added significance to the sales factor).

[299] *See* H.R. REP. NO. 88-1480, at 486.

poration will be subject to "multiple taxation." The notion is that if a corporation is subject to income tax in two or more jurisdictions with conflicting apportionment rules, the corporation could potentially be subject to tax on more than 100% of its income.[300] However, this rationale was not a major factor in Congress' enactment of Public Law 86-272.[301] Indeed, *Portland Cement* provides no basis for this rationale since the case specifically determined that the tax evaluated did not result in multiple taxation.[302] Further, multiple taxation is now addressed in individual cases under the judicial rules established by the Court in *Complete Auto* because those rules require that the application of a state's income tax must reflect "fair apportionment."[303] Also, it is grossly unfair to the states to address a potential concern regarding the methods by which the states apportion income by forbidding the states from asserting any income tax at all.[304]

c. The Unintended Consequences of the Act to the States

Because it was thought that Public Law 86-272 merely maintained the judicial status quo prior to the Court's holding in *Portland Cement*, Congress assumed that the Act would have little impact on the states' finances. However, this rationale was based on the idea that the Act was temporary and assumed that commercial practices and the Court's jurisdictional rules would remain static.[305] In contrast, com-

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[300] *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 279-80 (1978).

[301] *See generally* S. REP. NO. 86-658, at 2-4 (1959); H. R. REP. NO. 86-936, at 1-2 (1959). *See also* Roland, *supra* note 5, at 1177-78 (stating that not a single witness at the public hearings attempted to show how the operation of the states' laws prior to the Act could have subjected his or her business to multiple tax).

[302] *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 463 (1959) ("There is nothing to show that multiple taxation is present.").

[303] *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

[304] *See* Cox, *supra* note 266, at 354 (arguing that the "probability" of multiple taxation at the time of the Act was "remote," but also that even assuming that the states' apportionment formulas were diverse and therefore not equitable, "uniformity, not tax immunity, is the solution to this problem"); *cf.* Moore, *supra* note 4, at 197 (arguing that business lobbyists have repeatedly used a purported concern with multiple taxation as the basis for attempting to obtain jurisdictional exemptions like that set forth in Public Law 86-272).

[305] As stated by the Willis Report:

> Pub. Law 86-272 was enacted as stopgap legislation to forestall what was viewed as a possible expansion of the taxing jurisdiction of the States. Its purpose was not to change the pre-existing jurisdictional rules, but rather to resolve some jurisdictional issues which had not been finally resolved

mercial practices have changed radically since 1959, and the Court's jurisdictional rules have evolved to address them. These changes, when combined with the once-temporary, now-permanent status of Public Law 86-272, have resulted in an ever-increasing cost to the states in the form of forgone tax revenues.

Paradoxically, the mere enactment of Public Law 86-272 had the effect of upsetting the status quo that Congress sought to retain. The Willis Report concluded that it was unlikely that large corporations would plan around Public Law 86-272 because many of these companies had in-state business locations that they would not simply relinquish for tax purposes.[306] However, the Report underestimated the ingenuity of these companies, which merely began to use "independent" representatives or to subdivide their activities into separate corporations so as to take full advantage of the statute.[307] Further, because Public Law 86-272 is ambiguously worded in multiple respects, the Act has required that the states devote an enormous amount of resources to its administration,[308] and also has resulted in a great deal of time-consuming and expensive state court litigation.[309] This litigation

> through the litigation process. The statute may or may or may not have resolved these issues differently from the way in which they would ultimately have been resolved by the courts, and in this sense it may have had no effect at all on the legal obligations of interstate companies.

H.R. REP. NO. 88-1480, at 438 (1964).

[306] *See, e.g., id.* at 425 ("If Public Law 86-272 represents merely a codification of a pre-existing pattern...its enactment would not be expected to be the signal for widespread changes in methods of doing business."). *But see id.* at 435 ("Very little is known about the ease with which businesses change their methods of operation.").

[307] *See* Cox, *supra* note 266, at 356; Corrigan, *supra* note 287, at 425. *See also* Richard D. Pomp, *The Future of State Corporate Income Tax: Reflections (and Confessions) of a Tax Lawyer*, 16 STATE TAX NOTES (TA) 939, 943 (Mar. 22, 1999) (noting that Public Law 86-272 provides "a tax planning opportunity that significantly affects [a company's income tax] calculations"); Tatarowicz, *supra* note 56, at 294 (stating that if a taxpayer plays the "game" of carefully planning with respect to the various state cases and rules that have been brought about by Public Law 86-272, they will "succeed in minimizing their multistate corporate income tax liabilities").

[308] The provisions of the Act have been generally incorporated into the tax regulations of the various states. *See, e.g.*, Mass. Reg. 830 CMR 63.39.1; New York Reg. § 1.32(a); Texas Reg. Tit. 34 § 3.546(b). Also, the Act must be considered when the states make specific rulings on income tax issues. *See, e.g.*, Mass. Directive 96-2; Mich. RAB 1998-1; Minn. Rev. Notice 96-16. *See also MTC Nexus Program Bulletin 95-1, Computer Company's Provision of In-State Services Creates Nexus, reprinted in* 95 STATE TAX NOTES (TA) 246-71 (Dec. 22, 1995).

[309] One commentator performed a LEXIS search in 1993 that revealed that there had not been a single federal case that had construed the meaning of the term "solicitation of orders" set forth in Public Law 86-272, but that 215 state cases including

requires not merely that the states wrangle with a taxpayer concerning the meaning and application of federal law, but also that they allocate state judicial time to the resolution of the dispute—all with the potential disbursement of otherwise collectible state funds hanging in the balance.[310] While Congress intended for Public Law 86-272 to benefit smaller companies, the states have been forced to defend state court litigation under the statute against some of the largest companies in the United States.[311]

B. The Operation of the National Political Process

The recent Supreme Court cases suggest that an additional factor in evaluating a federal statute against a Tenth Amendment claim is the extent to which the political process failed in the enactment of the statute.[312] However, it is not clear that this standard applies in the context of a federal regulation directed at the states as states, as opposed to the case of a federal regulation of the states under a law of general application.[313] Indeed, the political process standard makes less sense as applied to federal regulation of states as states because broad-based political activism is much less likely in these cases.[314] This is particularly true when the regulation pertains to state taxation because of the complexity of the issues.[315]

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administrative decisions cited both the federal statute and this statutory term. *See* Guttormsson, *supra* note 17, at 1376 n.3. This author repeated this search on Westlaw in late 2001 and found 350 citations. *See* S. REP. NO. 86-658, at 12 (1959) (noting prophetically that "[e]ven in the restrictive field with which it deals [the Act] may well create more problems than it will solve") (Gore & McCarthy minority view).

[310] *Cf.* Alden v. Maine, 527 U.S. 706, 750-51 (1999) (noting that when individuals bring private lawsuits in state courts under FLSA, "[n]ot only must a State defend or default but also it must face the prospect of being thrust, by federal fiat and against its will, into the disfavored status of a debtor, subject to the power of private citizens to levy on its treasury....").

[311] *See supra* note 18.

[312] *See* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1986); South Carolina v. Baker, 485 U.S. 505 (1989).

[313] *Compare Garcia*, 469 U.S. 528, and *Baker*, 485 U.S. 505, *with* New York v. United States, 505 U.S. 144 (1992), and *Alden*, 527 U.S. 706.

[314] *Cf. Baker*, 485 U.S. at 513 (expressing the Court's concern with situations in which the states are "singled out in a way that [leaves them] politically isolated and powerless").

[315] As noted by Professor Jerome Hellerstein:

The Supreme Court has not determined the circumstances in which a federal statute will be struck down because of a failure in the national political process.[316] However, Public Law 86-272 fails any reasonable application of this test. There is broad consensus that Public Law 86-272 was the result of a one-sided lobbying initiative mounted by big business.[317] The states were granted very little input into the congressional deliberations, in large part because they lacked the lobbying clout of big business.[318] Thus, for example, although the

> The delineation of the states' jurisdiction to tax out-of-state enterprises and the prescription of apportionment and allocation rules are too technical and complex to excite public interest.... Besides, the issues can easily be obfuscated by the public relations arms of various interested groups. Consequently any new federal legislation that may emerge may be determined more by the sheer political muscle of the groups with a direct stake in the matter than by a rational resolution of the legitimate positions of the state and local governments, multistate business, and its local competitors.

Jerome R. Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335, 351 (1976). The dissent in *Garcia* acknowledged the general issue:

> [W]e have witnessed in recent years the rise of numerous special interest groups that engage in sophisticated lobbying, and make substantial campaign contributions to some Members of Congress. These groups are thought to have significant influence in the shaping and enactment of certain types of legislation. Contrary to the Court's view, a 'political process' that functions in this way is unlikely to safeguard the sovereign rights of States and localities.

Garcia, 469 U.S. at 576 n.18 (Powell, J., dissenting).

[316] *See Baker*, 485 U.S. at 513.

[317] *See supra* note 5. *See also* Charles E. McLure, Jr., *Implementing State Corporate Income Taxes in the Digital Age*, 53 NAT'L TAX J. 1287, 1297 (2000) (stating that P.L. 86-272 has been falsely justified "as needed to limit extra-territorial taxation and interference with interstate commerce," but instead merely reflects "the exercise of raw political power").

[318] The Multistate Tax Commission (MTC) has been one of the states' primary advocates in contesting recent attempts to broaden the provisions of Public Law 86-272. *See, e.g.*, *supra* note 22 (noting the comments of Dan Bucks). However, the MTC did not exist at the time Public Law 86-272 was enacted, and in fact was organized in response to the Act and the subsequent recommendations made by the Willis Report pursuant to the Act. *See* David Brunori, *Gene Corrigan, A 'Proud Parent' of the MTC*, 17 STATE TAX NOTES (TA) 1295, 1295-96 (Nov. 15, 1999); Hellerstein, *supra* note 315, at 341-42. From its outset, the MTC contested further attempts by business to obtain favored federal legislation at the expense of the states. *See* Brunori, *supra*, at 1297. Consequently, many large corporations banded together and mounted a failed challenge to the very existence of the MTC. *See* United States Steel Corp. v. Multistate Tax Comm'n, 483 U.S. 452 (1978). *See also* Brunori,

Act was primarily justified by its reduction of the compliance burdens upon smaller businesses, Congress only actually considered the specific costs of larger companies.[319] Also, although Congress conducted public hearings on the statute, these hearings lasted just two days, and only two states were permitted to present limited testimony.[320]

Because of the complexity of the issues addressed by Public Law 86-272, there was broad consensus at the time of its enactment that Congress allocated insufficient time to its deliberation to study fully the underlying issues. Congress itself conceded this fact when it labeled the Act temporary and charged the Willis Commission with the responsibility to review the underlying subject matter.[321] Hence, it was the Willis subcommittee acting *after* the passage of Public Law 86-272 that provided the only in-depth congressional evaluation as to the justifications for the Act. This abdication of congressional duty, particularly as it pertains to a blanket prohibition placed upon the states' tax-raising function, suggests a breakdown in the political process.[322]

The Willis Report determined that Public Law 86-272 did not accomplish the primary goal for which it was enacted: the protection of smaller businesses.[323] Further, the Report advised Congress that the jurisdictional rules embodied in the Act were inconsistent with the division of income rules used by the states, and that therefore the statute was costly to the states in an unexpected way.[324] The crux of the Report was to advise Congress that, absent a more substantial overhaul of the states' apportionment rules, the provisions of Public Law 86-272 were worthy of "serious criticism."[325] However, Congress never did make any adjustments to the states' tax rules that would minimize the problems that were created by Public Law 86-272. As this section has illustrated, not only did the political process fail when Congress

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supra, at 1296-97.

[319] S. REP. NO. 86-658, at 12 (1959) (Gore & McCarthy minority view) ("A great deal has been said about the cost of compliance with various State laws, but the examples given as to specific costs concern large companies, such as Westinghouse.").

[320] *See* Roland, *supra* note 5, at 1174-75.

[321] *See supra* notes 239-241 and accompanying text.

[322] *See id. Compare* United States v. Morrison, 529 U.S. 598, 663 (2000) (Breyer, J., dissenting) (stating that in "difficult Commerce Clause cases," the Court may evolve towards a rule that "takes account of the thoroughness with which Congress has considered the federalism issue").

[323] *See supra* notes 258-262 and accompanying text.

[324] *See supra* notes 295-296 and accompanying text. *See also supra* notes 275-277 and accompanying text.

[325] *See supra* notes 297-299 and accompanying text.

enacted Public Law 86-272, but the process also failed again in the manner in which Congress has retained the Act.

C. "Substantial Effects" on Interstate Commerce; State Court Evaluations of Public Law 86-272

After its enactment, Public Law 86-272 was quickly subject to three constitutional tests in the state courts of Louisiana,[326] Missouri,[327] and Oregon.[328] In each case, the states argued, primarily relying upon *Portland Cement*, that a state tax imposed upon net income derived from sources in a state does not constitute a tax upon "interstate" commerce and therefore that Congress lacks the power to restrict it.[329] The rationale behind this claim was generally that a tax imposed upon sources located in a state does not impede the free flow of interstate commerce because the tax is only an exaction on part of the profit that is captured from sources in the state.[330]

The primary difficulty faced by the states in their early challenges to Public Law 86-272 was merely one of timing. Public Law 86-272 was passed shortly after the Supreme Court's cases upholding the New Deal. This was before the Court had begun even to consider the implications of federal regulation of the states, when the Court generally applied its most liberal view of the federal commerce power. Given the timing of the three state court cases, it is not surprising that the analysis in each case is sweeping in favor of the congressional Act. In essence, the three cases conclude that Congress can singularly decide which activities are subject to Commerce Clause regulation and then regulate those activities by whatever method it chooses.[331] In one of

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[326] Int'l Shoe Co. v. Cocreham, 164 So. 2d 314 (La. 1964), *cert. denied, sub. nom.* Mouton v. Int'l Shoe Co., 379 U.S. 902 (1964). A denial of certiorari has no precedential significance. *See* Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 221 (1992).

[327] State ex. rel. CIBA Pharm. Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964).

[328] Smith Kline & French Labs. v. State Tax Comm'n, 403 P.2d 375 (Or. 1965), *rev'ing* 1964 WL 134 (Or. Tax).

[329] *See Int'l Shoe*, 164 So. 2d at 318. *See also CIBA*, 382 S.W.2d at 654; *Smith Kline*, 403 P.2d at 379.

[330] *See Int'l Shoe*, 164 So. 2d at 318. *See also Smith Kline*, 403 P.2d at 379. *See generally* Cox, *supra* note 266, at 355-56.

[331] *See Int'l Shoe*, 164 So. 2d at 320-21 ("[W]hen Congress speaks, the right of the judiciary to determine whether the burden is undue or not is foreclosed," and, "[s]ince Congress has admittedly plenary power to regulate commerce, it follows, of course, that it had the power to find as a fact that enactment of P.L. 86-272 was

the cases, the court went so far as to suggest that Congress could simply preempt the states' right to tax any activity with an interstate connection.[332]

The three state court cases that upheld Public Law 86-272 in the mid-1960s (1960s Cases) are inconsistent with the Supreme Court's current notions of federalism in at least two respects. First, as noted, the 1960s Cases generally conclude that Congress has plenary authority to identify the subject matter of its commerce legislation. However, the Court's recent cases, *Morrison* and *Lopez*, reject this view—even as applied to federal regulation of *private* activity as opposed to *state* activity such as the imposition of state tax. In *Morrison* and *Lopez*, the Court concludes that, in cases that do not involve the "channels" or "instrumentalities" of interstate commerce, Congress can regulate private activity only when this activity "substantially" affects interstate commerce.[333] While this "substantial" affects test literally resembles the test applied by the Court in some of its older Commerce Clause cases—including those cited in the three 1960s Cases—the difference is that under *Morrison* and *Lopez* the Court will ultimately determine when this standard is met. Because the 1960s Cases merely deferred to Congress' exercise of its commerce power, those cases did not consider whether the activity regulated by Public Law 86-272—the states' imposition of income tax under certain circumstances—"substantially" affects interstate commerce. On closer scrutiny, it is clear that the state taxation regulated by Public Law 86-272 does not "substantially" affect interstate commerce. In general, a business will be willing to pay a small percentage tax on its profit derived from sources in a state, and even in the rare case when a business might

essential to prevent an undue burden to the free flow of commerce between the states."); *CIBA*, 382 S.W.2d at 657 ("The motive and purpose of a regulation of interstate commerce are matters for the legislative judgment upon the exercise of which the Constitution places no restriction and over which the courts are given no control.") (quoting United States v. Darby, 312 U.S. 100, 115 (1941)); *Smith Kline*, 403 P.2d at 380 ("Congress has now acted; its statute is contrary to the state action; the federal statute is valid and the state statute must yield.").

[332] *See Int'l Shoe*, 164 So. 2d at 317 ("For, in view of the Supremacy Clause of the Federal Constitution, and the fact that Congress has acted *ostensibly* within the ambit of its delegated power to regulate commerce, it would appear that congressional occupation in this field has rendered ineffective any state legislation on the subject....").

[333] United States v. Morrison, 529 U.S. 598, 609 (2000); United States v. Lopez, 514 U.S. 549, 558-59 (1995).

withdraw from sales activity in a state because of its tax burden, "interstate" commerce would be largely unaffected.[334]

Second and more importantly, none of the three 1960s Cases even considered the Tenth Amendment or whether Congress faced any special limitations related to the fact that it was regulating not private persons but rather sovereign entities.[335] The absence of this consideration is significant because the Constitution generally permits Congress "to regulate individuals, not States."[336] In general, the "substantial effects" test only determines whether the intended subject of proposed federal legislation is one that Congress can regulate, i.e., whether the legislation sufficiently relates to interstate commerce.[337] However, when Congress seeks to regulate state activity as opposed to private activity, the Tenth Amendment ensures that Congress must also consider the interests of the affected states and any attendant burdens that may be imposed upon them.[338] This explains why none of the Supreme Court's recent decisions that focus upon direct federal regulation of the states has been based upon whether the federal regulation was ultimately directed at private activity with a substantial relationship to interstate commerce.[339]

In 1997, a Massachusetts court relied upon the three 1960s Cases upholding Public Law 86-272 to similarly uphold the Act.[340] The

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[334] The point was succinctly made in dissent in the Senate Report that accompanied the Act: "Businesses will likely operate across state lines so long as a profit can be realized. If no profit is made, there is no net income to be taxed." S. REP. NO. 86-658, at 9 (1959) (Gore & McCarthy minority view).

[335] The Tenth Amendment was mentioned in *CIBA Pharmaceutical Products, Inc. v. State Tax Commission*, but not evaluated. *See* 382 S.W.2d 645, 654 (Mo. 1964). Also, the Tenth Amendment formed a basis for a determination by the lower court in *Smith Kline & French Laboratories v. State Tax Commission* that Public Law 86-272 was unconstitutional. 1964 WL 134 (Or. Tax 1964). However, the Oregon Supreme Court did not consider this rationale when reversing the lower court's decision. *See Smith Kline*, 403 P.2d 375 (Or. 1965).

[336] *See* Printz v. United States, 521 U.S. 898, 920 (1997) (quoting New York v. United States, 505 U.S. 144, 166 (1992)).

[337] *See Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558-59.

[338] *See supra* notes 172-181 and accompanying text.

[339] If one were to attempt to apply the substantial effects test to federal regulation of the states—something that the Court itself has not done—it would seem that the direct affect of the regulation on the states must also be considered along with any indirect affect on private interests. Significantly, in the context of Public Law 86-272, the "substantial" negative affects that are imposed upon the states significantly outweigh the benefits, if any, that can be claimed for interstate commerce.

[340] *See* Nat'l Private Truck Council, Inc. v. Comm'r, 688 N.E.2d 936 (Mass. 1997), *cert. denied*, 523 U.S. 1137 (1998).

Massachusetts case was rendered prior to the Supreme Court's decisions in *Alden* and *Morrison* and also contains no analysis of *Printz* or *Lopez*. The Massachusetts court suggested that a balancing inquiry was appropriate, but nonetheless concluded that "[t]he limitation set forth in § 381 is a permissibly small preclusion of State taxing power to protect interstate commerce."[341] While the court's suggested approach is correct, its conclusion cannot be justified in light of the Supreme Court's precedent and the history of Public Law 86-272.

VI. CONCLUSION

A voluminous amount of scholarship concerns the Supreme Court's recent Commerce Clause precedents restricting the right of Congress to impose limitations upon the states, either directly or through regulations imposed upon private activity in areas of traditional state government sovereignty. Many of these articles lament the passing of the notion expressed in the Court's precedents from the mid-part of the twentieth century concerning Congress' seemingly unrestricted right to impose regulations vis-à-vis the states. However, Congress should not have a free hand to impose direct restrictions on the states, and Public Law 86-272 perfectly exemplifies why. The Act provides very little, if any, federal benefit in terms of protecting interstate commerce, but at the same time, imposes an enormous cost upon the states. In practice, the Court has adopted a balancing analysis that measures these benefits and burdens to evaluate whether federal restrictions imposed on the states are consistent with the Commerce Clause. Under this analysis Public Law 86-282 should be struck down as unconstitutional. This article concludes by first addressing Public Law 86-272 generally, followed by an application of these conclusions to the recently proposed business activity tax nexus (BAT) statutes that would expand Public Law 86-272.

A. Public Law 86-272

Public Law 86-272 is enormously costly to the states, both in terms of the tax revenues that it removes from the states' coffers and in terms of the considerable administrative and political costs that it imposes upon the states. The administrative costs include the legal and judicial costs that the states must incur in attempting to define the Act's ambiguous provisions and in wrangling with taxpayers concern-

[341] *See id.* at 941.

ing the meaning of these terms in state courts and tribunals. The political costs include the states' cost of bearing the political accountability for arbitrarily providing complete income tax immunity to some taxpayers, but not others.

In contrast, Public Law 86-272 provides little or no federal benefit that relates to interstate commerce. The Act was intended to benefit smaller companies relative to their larger competitors, but in fact achieves the opposite result. Further, the Act was intended to maintain the state tax jurisdictional rules that existed forty-three years ago prior to the Court's decision in *Portland Cement.* However, the jurisdictional rules that the Act was intended to preserve have gone the way of the Edsel—and Public Law 86-272 is now grossly inconsistent with the Court's general rules concerning state tax jurisdiction.

Most federal restrictions on the states that courts have upheld under the Commerce Clause involve situations in which the regulation was intended either to remove discrimination by the states against out-of-state interests or to regulate or protect an instrumentality of interstate commerce. However, Public Law 86-272 accomplishes neither of these two goals. Indeed, by favoring certain businesses that sell tangible personal property at the expense of all other businesses—no matter how similar the crux of the different businesses may be—Public Law 86-272 actually engages in the same type of discrimination that the Commerce Clause is generally intended to prevent.[342]

In cases involving a statute like Public Law 86-272, which regulates the states alone and not under a law of "general applicability," there is some question whether the Court's judicial test includes an inquiry as to whether the national political process failed in the enactment of the statute. However, even under this standard, Public Law 86-272 should be struck down. The enactment of Public Law 86-272 was an unprecedented intrusion on the states' sovereignty because never before had Congress imposed general restrictions on the states' unquestioned right to tax. Yet despite the magnitude and cost of this intrusion, the law was enacted through a hasty process dominated by business lobbyists in which the states were given very little input.

[342] For example, the Act would potentially insulate sellers of canned software from state income tax because canned software is generally considered to be "tangible personal property." However, the sale of "custom" software is not generally considered to be tangible personal property, and therefore its sellers would not be protected by the Act. *See* Hartman, *supra* note 5, at 1008. *Cf.* Amway Corp. v. Dir. of Revenue, 794 S.W.2d 666 (Mo. 1990) (holding that the sale of an intangible right to distribute a seller's products is not protected under the Act).

Congress enacted Public Law 86-272 as a "stop-gap" or "temporary" measure and generally passed on the question whether the Act was justified as a long-term statute by instead leaving this determination to a congressional subcommittee.[343] This subcommittee later concluded that the Act did not serve the primary purpose for which it was enacted,[344] was costly to the states in an unexpected way,[345] and was open to "serious criticism" in the practical manner in which it operated.[346] Nonetheless, Congress never revisited the Act.

One commentator argued that the process by which Public Law 86-272 was enacted was one in which "small and medium-sized businesses...furnished the smoke-screen of propaganda for big-business tycoons in their campaign for tax immunity on interstate income."[347] This "smoke screen" was effective in the context of Public Law 86-272 in large part because state tax rules are generally "technical and complex."[348] Further, the complex nature of state tax tends to incite very little interest on the part of the general public and also makes federal legislators, who do not regularly address state tax issues, more susceptible to the "political muscle" of lobbyist groups.[349]

Subsequent to the enactment of Public Law 86-272, business lobbyists repeatedly attempted to obtain even greater jurisdictional exemptions from state taxation.[350] These efforts generally failed, probably in part because of questions raised about Public Law 86-272 by the Willis Report and the opposition of the MTC, which was organized in 1967 and now represents the states collectively on issues concerning federal legislation. However, Public Law 86-272 has not been repealed even though this result is warranted in light of the benefits and burdens that are generated by the Act.

If the Court were to strike down Public Law 86-272, it would likely not have to concern itself with questions concerning the retroactive effect of this holding. Assuming that the Court were to strike

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[343] *See supra* notes 239-241 and accompanying text.

[344] *See supra* notes 258-262 and accompanying text.

[345] *See supra* notes 275-277, 295-296 and accompanying text.

[346] *See supra* notes 297-299 and accompanying text.

[347] *See* Cox, *supra* note 266, at 356.

[348] *See* Hellerstein, *supra* note 315, at 351.

[349] *See id.*

[350] *See id.* at 340 (noting that since the Willis Report was published, "a stream of other measures designed to establish sweeping new federal restrictions on state taxation of interstate commerce has been introduced in each session of Congress"). *See also* Moore, *supra* note 4, at 195-96 (similar); Corrigan, *supra* note 287, at 426-27 (similar).

down the Act, Congress would likely respond quickly to limit the retroactivity of this result.[351] Further, while Public Law 86-272 fails under the Court's Tenth Amendment balancing test, this same test would apply differently to a statute that merely attempts to retain the rule of Public Law 86-272 on a retroactive basis. Federal legislation of this type would likely be upheld as constitutional,[352] and the Court could even suggest as much when striking down the Act.

B. Business Activity Tax Nexus Statutes

For the reasons stated above, the recently proposed business activity tax nexus statutes that would expand Public Law 86-272 should not be enacted and if enacted should be held unconstitutional. These statutes would be even more costly to the states than Public Law 86-272 in terms of tax revenues lost since the proposed statutes are even more broadly worded.[353] Further, these proposed statutes would be even more costly than Public Law 86-272, both administratively and politically, because they would include many more ambiguous terms and would create many more situations in which an arbitrary line determines what business activities qualify for a state-administered federal tax benefit.[354]

The proposed BAT statutes are literally related to Public Law 86-272 in that they propose to broaden the provisions of the Act. At the same time, the lobbyist campaign to enact these statutes also generally relies upon the same forty-three year old playbook. For example, as in the instance of Public Law 86-272, the proposed BAT statutes have been justified as necessary to establish state tax jurisdictional "clarity" and to protect smaller businesses from undue compliance burdens.[355] However, Public Law 86-272 did not accomplish either of these two goals, and it appears that the proposed BAT statutes would not either. Indeed, while the proposed statutes would add a number of additional

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[351] Similarly, when the Court overruled *National League of Cities v. Usery*, 426 U.S. 833 (1976) in *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), Congress moved quickly to mitigate the retroactive effects of *Garcia*, which would have imposed liability on the states for retroactive wages due to state employees for the intervening nine-year period. *See generally* Rhinebarger v. Orr, 839 F.2d 387 (7th Cir. 1988); Jones v. Douglas County, 861 F.2d 1521 (11th Cir. 1988).

[352] *See Rhinebarger*, 839 F.2d 387; *Jones*, 861 F.2d 1521. *See also supra* note 68.

[353] *See supra* notes 2, 19 and accompanying text.

[354] *See id.*

[355] *See supra* notes 25, 27 and accompanying text.

ambiguous terms into the nexus analysis, the premise for these rules in general is the "physical presence" jurisdictional standard that was referenced in *Quill Corp. v. North Dakota*[356] for state sales and use taxes.[357] However, the application of the *Quill* "physical presence" standard in the context of a state income tax has proven to be anything but clear.[358]

As was the case with Public Law 86-272, it seems likely that in the instance of the proposed BAT statutes, "smaller businesses" are being used as a "smoke screen" by larger businesses seeking to obtain greater jurisdictional protections.[359] Indeed, it is apparent that if the goal of federal legislation is to protect smaller businesses from burdensome state tax compliance, then Congress can accomplish this goal directly, without introducing a litany of new terms into the nexus lexicon. In general, smaller businesses are businesses that have a small volume of sales.[360] If the intent is to protect only these businesses from state tax jurisdiction, then a proposed federal bill should simply state that businesses with sales below a certain amount are not subject to state tax.[361]

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[356] 504 U.S. 298, 314, 317 (1992).

[357] *See supra* notes 27-28 and accompanying text.

[358] *See, e.g.*, Borden Chems. & Plastics v. Zehnder, 726 N.E.2d 73, 79-81 (Ill. Ct. App. 2000) (stating "this area of law is nebulous at best") (quoting Hartley Marine Corp. v. Mierke, 474 S.E.2d 599, 607 (W. Va. 1996)); MagneTek Controls, Inc. v. Dep't of Treasury, 562 N.W.2d 219, 222 (Mich. Ct. App. 1997) ("*Quill* leaves us with 'the vagaries' of determining how much physical presence is sufficient") (quoting *Quill*, 504 U.S. at 331 (White, J., dissenting)). *See generally* Fatale, *supra* note 28. The BAT proposals would codify the physical presence standard as one that requires "substantial" physical presence—an interpretation that is more favorable to larger businesses—despite the fact that *Quill* never uses this phrase and that three state courts have specifically rejected the claim that this is the *Quill* standard. *See* Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954 (N.Y. 1995), *cert. denied*, 576 U.S. 989 (1995); Brown's Furniture, Inc. v. Wagner, 665 N.E.2d 795 (Ill. 1995), *cert. denied*, 223 U.S. 866 (1996); *MagneTek Controls*, 562 N.W.2d 219.

[359] *See supra* notes 24-26 and accompanying text.

[360] This is the definition that was used by the Willis Report. *See* H.R. REP. NO. 88-4180, at 428 (1964).

[361] The Willis Report suggested this approach and noted that it is generally consistent with the states' "destination-oriented sales factor" rules. *See id.* at 515 ("If the jurisdictional rule is to operate within a system in which the destination-oriented sales factor is used, a rule under which jurisdiction depends in part on the volume of the business done in the state appears to be preferable."). *See also* Hartman, *supra* note 5, at 1009 ("To prevent possible diminution of state revenues, the statute might be amended to repeal the exemption for enterprises realizing net income or gross receipts from the state in excess of a specified dollar amount."); McLure, *supra* note 7, at 395 (arguing that commercial activities should establish nexus unless these activities are de minimis). However, this approach would have to take into account the propensity for larger companies to split themselves into separate affiliates. *See* Corri-

While this is so, it seems unlikely that Congress would ever be pass a bill of this type since larger businesses drive the national political process concerning state tax law and these businesses would not benefit from this type of legislation.[362]

APPENDIX

I. ELECTRONIC COMMERCE, THE INTERNET TAX ACTS, AND PROFESSOR HELLERSTEIN

This article focuses on congressional prohibitions, past and proposed, on state income tax as generally applied to "old economy" enterprises—although the proposed BAT statutes would pertain to "new economy" businesses as well. During the time that this article was being prepared Congress renewed the Internet Tax Freedom Act (ITFA), which barred the states from collecting sales tax on Internet access fees charged by out-of-state Internet vendors for a three-year period ending in October of 2001.[363] The new Act, the Internet Tax Nondiscrimination Act (ITNA), merely extends ITFA for an additional two-year period, until November 3, 2003.[364] Unlike Public Law 86-272, ITNA will be temporary because the legislation ensures this. On the other hand, the Internet tax acts are similar to Public Law 86-272 in that they have been justified as necessary to protect smaller businesses.[365] As in the case of Public Law 86-272, these laws are substantially overbroad with respect to this purpose.[366]

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gan, *supra* note 287, at 425.

[362] *Cf. supra* note 192 (discussing how larger companies have used the issue of "multiple taxation" to attempt to obtain nexus exemptions, but not to address directly the issue of uniform apportionment because many of these companies probably would not benefit from uniform apportionment).

[363] Pub. L. No. 105-277, 112 Stat. 261 (1998) (codified at 47 U.S.C. § 151 (2000)).

[364] *See* H.R. REP. NO. 107-240 (2001), 2001 WL 1239646, at *2, 11-12.

[365] *See* S. REP. No. 105-184 (1998), 1998 WL 229474, at *2.

[366] *See id.* at *25 (Senator Byron Dorgan minority view) (noting that "the beneficiaries of the tax break provided under this legislation will include some very significant telecommunications and computer companies"). As is suggested by the title of ITNA, both that law and IFTA, its 1998 predecessor, were based primarily on the idea that electronic commerce is threatened by the possibility of "discriminatory" state taxes. However, there is generally little basis for this claim. *See id.* at *19-21 (Dorgan minority view). *See also* Hellerstein & Hellerstein, *supra* note 4, ¶ 4.24[1][g] (3d. ed. 2000 & Supp. 2001).

During the current two-year ITNA moratorium, Congress will continue to attempt to determine appropriate long-term restrictions of state taxation of Internet service providers and Internet vendors.[367] It is this effort that paradoxically led to the BAT proposals previously discussed in this article, which were intended to expand the income tax prohibitions set forth in Public Law 86-272.[368]

When this article was presented at a conference sponsored by the Multistate Tax Commission in February of 2002, Professor Walter Hellerstein of the University of Georgia stated his disagreement with its central thesis.[369] Professor Hellerstein observed that his views on the breadth of the federal commerce power are set forth in his recent article, "Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce."[370] In that article, Professor Hellerstein states that he believes that Congress has the ability to impose restraints on state taxing power exerted over arguably local taxable events when these private activities "substantially" affect interstate commerce.[371] Yet no precedent supports the view that Congress can impose direct federal regulation upon the states merely because this regulation would then indirectly impact private activity having a substantial relationship to interstate commerce.[372] Indeed, this notion trivializes the fact that unlike private citizens the states are separate sovereigns, and it directly conflicts with the Court's repeated statement that Congress is generally permitted "to regulate

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[367] *See* Houghton & Hellerstein, *supra* note 67, at 43-56.

[368] *See supra* note 2 and accompanying text.

[369] *See* Julie Minor, *Business Activity Taxes Discussed at Multistate Tax Commission Seminar*, 63 STATE TAX REV. (CCH) No. 9, 14 (Mar. 4, 2002); Doug Sheppard, *What's the Appropriate Standard for Business Activity Tax Nexus?*, 23 STATE TAX NOTES (TA) 757, 759 (Mar. 4, 2002).

[370] 53 NAT'L TAX J. 1307 (2000).

[371] *Id.* at 1311, 1314.

[372] *See supra* notes 335-339 and accompanying text. Professor Hellerstein cites the Court's holdings in three prior cases in which Congress sought to regulate not state activity such as the imposition of state tax, but rather private commercial activity, such as farming or the operation of a restaurant or hotel. *See* Hellerstein, *supra* note 370, at 1308 nn.12-14 & 1311 (citing Wickard v. Filburn, 317 U.S. 111 (1942); Katzenbach v. McClung, 379 U.S. 294 (1964); and Heart of Atlanta Motel v. United States, 379 U.S. 241 (1964)). However, the Court itself has cited these decisions as among its broadest holdings with respect to the federal commerce power as applied to private citizens, and therefore the application of these precedents to federal regulation of the states seems questionable. *See* Morrison v. United States, 529 U.S. 598, 633-38 (2000) (Breyer, J., dissenting) (questioning the extent to which these three decisions remain as viable precedents even in the context of federal regulation of private activity).

individuals, not States."[373] Further, the application of an open-ended "substantial effects" test to federal regulation of state taxation would ultimately mean Congress could restrict or eliminate state taxes as applied to commercial activity except when the focus of the tax is entirely intrastate.[374] However, this prospect is inconsistent with the Tenth Amendment and conflicts with the Court's repeated statement that "[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business."[375] Professor Hellerstein also states in his recent article that:

> [E]ven if there were some doubt as to whether a restraint on state taxing power over arguably "local" taxable events would fall within Congress' power to regulate activities substantially affecting interstate commerce...one could...clearly draft congressional legislation as a regulation of the *channels* of interstate commerce—the Internet—that would fall within another well-accepted basis for the exercise of the congressional commerce power.[376]

Professor Hellerstein ultimately concludes that "under *New York*, [505 U.S. 144 (1992),] and kindred cases, Congress possesses considerable power, through positive and negative reinforcement, to persuade the states to follow federally prescribed guidelines in taxing electronic commerce."[377]

Whether and to what extent Congress can impose "guidelines" upon state taxation of electronic commerce—as opposed to imposing a blanket prohibition upon state taxation of a broad sphere of undefined commercial activity, as in the instance of Public Law 86-272—is not the focus of this article. However, it seems clear that even if Congress

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[373] *See* Printz v. United States, 521 U.S. 898, 920 (1997) (quoting New York v. United States, 505 U.S. 144, 166 (1992)). *See also id.* at 924 ("'[T]he Commerce Clause...authorizes Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce.'") (quoting *New York*, 505 U.S. at 166).

[374] Perversely, the effect on interstate commerce would be more "substantial" the bigger the commercial enterprise, and therefore the greater the amount of state tax that would potentially be at stake.

[375] *See* Quill Corp. v. North Dakota, 504 U.S. 298, 310 n.5 (1992) (citing Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623-623 (1981)). *See also supra* note 213 and accompanying text.

[376] *See* Hellerstein, *supra* note 370, at 1314 (emphasis added).

[377] *Id.* at 1323.

possesses broad capacity to impose regulations upon the states to protect the Internet as a "channel" of interstate commerce, this logic does not necessarily dictate that Congress has broad power to regulate state taxation of Internet vendors or even Internet service providers.[378] That is, the Internet as a means of commerce and communication is not necessarily coextensive with the persons that use the Internet in an attempt to make sales.[379] In the end, one can only hope that Congress will act reasonably on the Internet issue and that therefore this specific issue will not arise.

[378] Most of the cases that evaluate Commerce Clause restrictions as applied to state taxation involve the situation in which the focus was either the removal of state tax discrimination or regulation of an instrumentality of interstate commerce. *See supra* notes 60-62 and accompanying text. *Cf.* S. REP. NO. 105-184, at *21 (1998) (Dorgan minority view) (stating that "[t]here is no policy justification to enact a federal tax break that will cost the state and local governments millions of dollars simply because a new technology has emerged into commerce").

[379] *Cf. Morrison*, 529 U.S. at 614 ("Simply because Congress may conclude that a particular activity substantially affects interstate commerce does not necessarily make it so.") (quoting *Lopez*, 514 U.S. at 557); *id.* ("[W]hether particular operations affect interstate commerce sufficiently to come under the constitutional power of Congress to regulate them is ultimately a judicial rather than a legislative question, and can be settled finally only by this Court.") (quoting Heart of Atlanta Motel v. United States, 379 U.S. 241, 273 (1964) (Black, J., concurring)).