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From mail-order to Internet, this article examines the Supreme Court's refusal in *Quill* to break with *Bellas Hess* and argues that the novelties of Internet commerce in intangibles should not affect the precedent expressed in these cases. Thus, until Congress or the Supreme Court says otherwise, Internet sellers of intangible personal property should enjoy the same constitutional safe harbors as mail-order sellers of tangible personal property.

Of Course the *Quill* Safe Harbor Applies To Sales of Intangibles Through the Internet

By Walter Nagel, Donald Griswold, Jeremy Abrams, and Raj Lapsiwala

Let us begin with the proposition that a seller is under no obligation to collect sales taxes, absent physical presence, whether the sale is via U.S. mail or the Internet. We do not say this lightly but only after a careful examination of both *Bellas Hess* and *Quill* and against the backdrop of what it means to be a common carrier.

Although we are not fans of the ''click through nexus'' theories that many states have adopted we do agree with the Appellate Division of the New York Supreme Court that ''while the Internet certainly represents a significant change in communication, the argument that it is a brave new world requiring its own definitions of terms that previously had a clear meaning is not persuasive.''[1] In many respects the Internet is not such a brave new world after all, and because it is a common carrier, it may berth its electronic commerce in the *Quill* safe harbor.[2]

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Internet sellers of intangible goods like music and video downloads should be reassured by even a cursory glance at the case law: there exists no precedent for taxation, and we do not believe that a course reversal is in the offing. In fact, courts remain inclined to bolster an electronic zone of free trade, in which they discern the intentions of the Framers of the Constitution. The Court in *Belles Hess* may not have possessed the foresight to predict the advent several decades later of the mode of selling that was the subject of *Quill*, but—strange as it may seem—the Court and its successors have anticipated the technological changes it could not

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[1] *Amazon.com LLC. v. New York Dept. of Taxn. and Fin.*, 81 A.D.3d 183, 201 (N.Y. App. Div. 1st Dept. 2010).

[2] *National Bellas Hess Inc. v. Illinois Dept. of Rev.*, 386 U.S. 753 (1967) (''*Bellas Hess*'') and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (''*Quill*'').

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imagine by, in effect, hard-wiring its interpretations of the law by conducting them along the lines of progressive first-principles.

Because the Internet is a common carrier, it may berth its electronic commerce in the *Quill* safe harbor.

In this article, we argue that the activities involved in selling intangible goods by means of the Internet are not sufficiently grounded in localities so as to permit states to tax them. And though we confine ourselves to an explication of what has come to be known as Commerce Clause ''nexus,'' we assert along the way that the selling of intangibles on the Internet stands protected from taxation by the Due Process Clause as well.

Background

The Court began in both *Bellas Hess* and *Quill* with the Commerce Clause of the United States Constitution, which provides: ''The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.''[3] It has long been the consensus that the other side of this affirmative granting of power is a palpable and actionable forbearance, a ''dormant'' Commerce Clause that the bench brings to life when states enact legislation that potentially circumscribes Congressional authority.[4]

Bellas Hess was just such a case. The state of Illinois enacted a ''Use Tax Act'' which required merchants to collect and remit appropriate levies. Bellas Hess objected; a small Kansas City mail order house, it kept its material presence in Illinois to a minimum, having neither offices, agents, nor any real property in the state. The Supreme Court held that the Due Process Clause and the dormant Commerce Clause prohibited Illinois from subjecting Bellas Hess to liability, where the firm transacted business in the state by means only of the U.S. mail and common carriers.[5] The Court was especially mindful of the ''sharp distinction'' it had drawn in prior decisions between, on the one hand, sellers with retail outlets, agents, or property in a taxing state, and those on the other ''who do no more than communicate with customers in the State by mail carrier as part of a general interstate business.''[6] In its opinion in *Bellas Hess*, the Court reiterated the distinction between local and ''general interstate'' sellers, and emphasized that by taxing the latter, states could run afoul of both the Due Process and dormant Commerce Clauses.[7]

By the time the Supreme Court revisited *Bellas Hess* a quarter-century later in *Quill*, it had refined its notion of the nature and extent of seller contacts with localities into the idea of substantial ''nexus.''[8] Quill, like Bellas Hess, kept its physical presence in the forum state to a minimum, using telephone calls and catalogues to solicit roughly $1 million in sales of office supplies, which it delivered by U.S. mail and common carrier. Considering its attenuated contacts with North Dakota, Quill naturally felt that state levies were unwarranted.

The Supreme Court of North Dakota held Quill responsible for collecting the use tax. The United States Supreme Court used its review of this case on appeal as an opportunity to overhaul it nexus jurisprudence, clarifying its prior reasoning and sharpening its analysis. Justice Stevens refused in *Quill* to break with *Bellas Hess* as behind the times, as the North Dakota Supreme Court had done; and his decision is still valued in state tax circles for the firm distinctions regarding nexus it establishes between the Due Process Clause and the Commerce Clause.

Simply put, the two clauses emerged from distinct concerns and serve different purposes: Due Process is about fairness, and thus required only minimal contacts with the forum state; while the Commerce Clause is a cure for the ''structural ills''[9] that plagued the nation under the Articles of Confederation, when every state was free to tax foreign commerce and domestic trade had become a morass, and so calls for a higher standard, which the Court termed substantial nexus.

States United in Trade

For Internet sellers of intangible products, perhaps the most notable aspect of the Court's reasoning in the line of cases culminating in *Quill* is its resolve not to depart from the Framers' vision of the nation as a body of states united through free trade. The *Bellas Hess* Court recognized the burden that would be imposed on the ''free conduct of . . . interstate business'' should it uphold the tax in question.[10] Specifically, if North Dakota prevailed, remote vendors would be subjected to unreasonable collection and reporting in thousands of jurisdictions. The Court stated that

> [t]he very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.[11]

The Court's gloss of the Commerce Clause bears just a bit of further scrutiny. While the Court's deference here to Congressional authority by means of the Commerce Clause is certainly more than mere pretext, it serves a broader ideological purpose that may be said to underwrite its reasoning.

The Court reveals its underlying logic when it ponders a world without the *Bellas Hess* rule—a world where a publisher who included a subscription card in three issues of its magazines, a vendor whose radio advertisements were heard in a state on three occasions, and a corporation whose telephone sales force made three calls into the state would all be subject to a collection duty.[12] Such an environment of countervailing state and local levies would trammel commerce, suspending it in a tax network from which it could never

[3] U.S. Const. art. I, §8, cl. 3.
[4] See *Oregon Waste Sys. Inc. v. Dept. of Environmental Quality of Oregon*, 511 U.S. 93, 98 (1994).
[5] *Bellas Hess*, 386 U.S. 753.
[6] *Id.* at 758.
[7] *Id.*
[8] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).
[9] *Quill*, 504 U.S. 298, 302.
[10] *Bellas Hess*, at 759.
[11] *Id.* at 760.
[12] *Quill*, 504 U.S. at 313 n. 6.

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profitably issue; in this context, trade would resemble nothing so much as the elusive waves of electrical energy the Court in the kindred case *Goldberg v. Sweet* could not contemplate taxing, a prescient conclusion that registers a certain skepticism about ever loading the Internet down with various taxes.[13] All of which is to say that the Commerce Clause is a device, albeit a Constitutional device, wielded by American courts in the service of a vision of this nation as the site of free interstate trade, a vision which precedes and informs law and which should reassure Internet sellers of intangible goods.

Inherent to this wider vision is the idea of increase, the promise of growth according to which law gets out of way of buying and selling, letting these forces find their own direction. The Supreme Court in *Quill* undertook its decision with the realization that they were presiding over a form of business that may not have thrived without the rule in *Bellas Hess*. The Court viewed requiring remote sellers to comply with thousands of sales tax jurisdictions and the complications that would arise as unduly burdening interstate commerce.[14] In admitting that the proliferation both of remote selling and taxing jurisdictions between 1967 and 1992 was unimaginable, the *Quill* Court lent its reasoning a certain expansiveness, a predisposition for technological innovation that bodes well for the remote sellers of intangibles.[15] And we do not need to tell Internet merchants that there is every reason to believe that their industry will grow at the very least in proportion to the dramatic expansion of the mail order industry, if only it is afforded the same constitutional protections.[16]

The Usefulness of Bright Lines

We have seen reasons to believe that courts, when called upon to think in terms of the Commerce Clause, will favor Internet sellers of intangible goods, for reasons having to do with the law and going deeper than the law. But there are practical considerations as well which lead us to conclude that courts will extend Commerce Clause protection. In affirming *Bellas Hess*, the Court focused on the potential burdens imposed on business and explained the benefits of having a bright-line test under the dormant Commerce Clause. ''Such a rule'' writes the Court, ''firmly establishes boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes.''[17] In law no less than in business—two arenas prone to vagaries that have traditionally evoked imagery of parlous seas, with entrepreneurs, judges, and lawyers all seeking still waters—''safe harbor[s]'' are not so much welcome as they are essential. The following statement from *Quill* signals that courts embrace expediency.

> [T]he bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. Bellas Hess followed the latter approach and created a safe harbor for vendors ''whose only connection with customers in the [taxing] state is by common carrier or the United States mail.'' Under *Bellas Hess*, such vendors are free from state-imposed duties to collect sales and use taxes.[18]

The Commerce Clause is a device wielded by American courts in the service of a vision of this nation as the site of free interstate trade.

To have done away with *Bellas Hess* and the obvious demarcations of its ''safe harbor'' would have been to inaugurate a regimen of balance-testing, of adjudicating the levies of each state and locality as they might arise. Such a procedure would be tantamount to gridlock, with the port master no less confused than the ship's captain about which way to turn. The *Quill* Court was, in fact, solicitous toward business, writing that ''a bright-line rule in the area of sales and use taxes . . . encourages settled expectations and in doing so, fosters investment by businesses and individuals.''[19] Justice Stevens in *Quill* showed the inclination of American courts not to trouble the waters of bright-line tests and stare decisis, to save themselves from inundation and remote sellers from perpetual uncertainty.

From Mail-Order to the Internet:

The More Things Change, the More They Stay the Same

The novelty of Internet commerce in intangibles, furthermore, should not affect the precedent expressed in *Bellas Hess* and *Quill*. As we indicated above, the Supreme Court incorporated into its decisions in *Bellas Hess* and *Quill* a leeway for innovation by accepting in each case as the context of its reasoning a commercial growth it professes not to have foreseen. Maintaining bright-line tests, the Court suggested, is the only way to deal with entrepreneurial imagination.

And the similarities between Internet sellers of intangible goods and mail-order sellers of personal property are compelling.[20] In terms of the constitutional analysis

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[13] *Goldberg, et al. v. Sweet*, 488 U.S. 252 (1989).

[14] *Bellas Hess*, 386 U.S. at 759 n. 12.

[15] The Court recognized as much. ''Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.'' *Quill*, 504 U.S. at 316.

[16] In 2009, digital downloads of music grew $ 363 million. Sam Oliver, *Digital Music Grows $363 M in 2009: iTunes a Quarter of All U.S. Sales*, available at http://www.appleinsider.com/articles/10/04/28/digitalmusic_grows_363m_in_2009_itunes_a_quarter_of_all_u_s_sales.html (last visited April 17, 2011).

[17] *Quill*, 504 U.S. at 315.

[18] *Id*.

[19] *Id*. at 316.

[20] *See* David R. Johnson, Kevin A. Marks, ''Mapping Electronic Data Communications onto Existing Legal Metaphors: Should We Let Our Conscience (and Our Contracts) Be Our Guide?'' *38 Vill. L. Rev*. 487 (1993).

for determining ''substantial nexus'' under the first prong of the *Complete Auto* test, both kinds of seller are similarly situated. The Court expressly distinguished between brick-and-mortar sellers who have a physical presence and remote sellers who only contact the forum state by means of the U.S. mail or common carrier. Indeed, Internet sellers of intangible goods would seem to be nothing less than the archetype of the seller described by the Court in the quotation at the beginning of this essay as contacting buyers without intentional incursion into a given state during the course of a general interstate business. In this respect, the sentiments the Court expressed in *Goldberg*, a telecommunications case, are instructive. While insisting on its prior conclusion that interstate commerce can be made to pay its way,[21] the Court effectively threw up its hands when faced with the chore of tracing the pathway traversed by an interstate call through and across an ornate network of wires. Noting the unpredictability with which a given signal might hop a connection, seek an involution, backtrack upon itself, and become sidetracked literally at a moment's notice, the Court could only muster up ''doubt'' that ''the termination of an interstate call, by itself'' could justify state taxation.[22] That the Court arrived at this conclusion in 1989—ancient history in the Internet age—suggests a continued reticence when it comes to situating Internet commerce in intangibles even momentarily at any single location.

Although we typically think of railroads or UPS and FedEx as common carriers, the Internet, too, is a common carrier.

In such circumstances, insisting that the holding in *Quill* and its predecessor *Bellas Hess* be confined to the mail-order business is shortsighted. In fact, such an argument would be positively foolhardy, given the attitude with which the *Quill* Court undertook its decision. Notably, the Court confined itself to a consideration of the nature of the seller's contact with the forum state, making only a passing reference to the state's burden in disposing of catalogues—a burden of which Internet sellers happily relieve states by not making them forums. More importantly, Justice Stevens betrayed impatience with the kind of reasoning that would confine the Court's decision to a single variety of commerce. He considered the Supreme Court of North Dakota mistaken in the cramped view it took of *Complete Auto* and *Bellas Hess*, terming its interpretation as a function of its moment in history, ''this latest rally between formalism and pragmatism.''[23] To recur to what we said above, the Court can be expected to undertake a functional analysis of any Commerce Clause challenge to Internet selling of intangible goods. *Stare decisis*, expediency, laissez-faire, ''pragmatism''—call it what you will, the decision in *Quill* points courts away from the sort of unimaginative formalism that would draw the bright-line of *Bellas Hess* around a single industry.

[21] *Goldberg*, 488 U.S. at 267.
[22] *Id*. at 265.
[23] *Quill*, 504 U.S. at 310.

The Internet Is a Common Carrier For Purposes of State Tax

A remote seller whose only link to customers consists of sending catalogues through the U.S. mail and delivering products by means of a common carrier is not subject to use tax collection duties. Thus, it is worth determining whether the Internet is a common carrier. Legally, a common carrier holds itself out to the general public as transporting people or property from one location to another.[24] An entity generally qualifies as a common carrier if its services are: (1) offered for a fee; (2) offered to the general public; and (3) offered without discrimination.[25]

Although we typically think of railroads or UPS and Federal Express as common carriers, the Internet, too, is a common carrier. The Internet shares many of the same features and serves the same purposes of other, more traditional common carriers. Moreover, the Internet is merely a continuation of the economic and technological innovations that the Supreme Court rejected as a basis for overturning *Bellas Hess*.

The object of a common carrier need not be tangible. Telegraph and telephone companies (collectively referred to as ''Common Law Common Carriers'') initially were not considered common carriers because of the misconception that a common carrier must physically transport tangible goods. Telegraph companies, however, which do not transport anything tangible, are subject to similar laws regulating railroads and other carriers.[26] Additionally, telegraph companies qualify as common carriers because they are ''public carriers of intelligence with rights and duties similar to those of a carrier of goods or passengers.''[27] Mediums that transmit intelligence or information, such as the telegraph, telephone, and Internet, are common carriers. Furthermore, the method of transportation, whether of the physical or intangible medium, is not particularly important; rather, the object transported is important; indeed, as we mentioned above, the Court has expressed doubt as to whether termination of an interstate telephone call without more creates substantial nexus under the dormant Commerce Clause.[28]

As for its ''public function,'' the Internet serves as a medium for transferring and transmitting data, goods, and intelligence. The Internet in its simplest form is a communications system which allows for the near instantaneous transmission of information. Similarly, the

[24] 13 Am. Jur.2d Carriers §2.
[25] *Brockway v. Travelers Ins. Co.*, 107 Wis. 2d 636 (Ct. App. 1982); *see also United States v. Louisiana & P.R. Co.*, 234 U.S. 1 (1914) (a railroad, typically transporting people or property, offering its services to the public is a common carrier). In the context of aviation, see ''Private Carriage Versus Common Carriage of Persons or Property'' FAA Advisory Circular No. 120-12A (4/28/86) (There are four elements in defining a common carrier: (1) a holding out of a willingness to (2) transport persons or property (3) from place to place (4) for compensation. This 'holding out' which makes a person a common carrier can be done in many ways and it does not matter how it is done.'')
[26] *Western Union Telegraph Co. v. Call. Pub. Co.*, 62 N.W. 506, 510 (1895); *Parks v. Alta Cal. Tel. Co.*, 13 Cal. 422, 426 (1859) (stating a telegraph company is a public vehicle, and as such must be governed under the rules of common carriers).
[27] *Western Union*, 62 N.W. at 506.
[28] *Goldberg*, 488 U.S. at 263.

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telegraph and telephone are communications systems where information is transmitted over a wire through a series of electrical current pulses allowing individuals to communicate in a relatively short period of time. And although the Federal Communications Commission views the Internet as an ''information service'' rather than a communications device, its position in recent years has come to be viewed as a distinction without meaning. Observers point to the fact that the Internet in its infancy was used as a research and communications network.[29]

It is important in this regard to emphasize that the considerable technological innovations in the telephonic communication, including Internet and Voice over Internet Protocol services (''VoIP'') and the change in data transmission from analog to digital signals, have not changed the treatment of the telephone as a common carrier. The public function of each of these services is identical: to transmit information from one user to another.

A brief look at recent regulatory trends indicates that the common-carrier regimen has been extended to the Internet, at least in its function as a communications venue. Even new technology such as VoIP is a telecommunications service and thus subject to the same fees as traditional telephone carriers. The FCC explained that VoIP is a service that fits within the definitions of ''telecommunications''[30] and ''telecommunication services.''[31] The FCC declared that VoIP services fit these definitions under the Telecommunications Act of 1996 (the ''1996 Act'')[32] because the difference between telecommunications services provided via VoIP and telecommunications services provided over traditional analog or digital services is irrelevant.[33] Significantly, the FCC did not differentiate between services provided over traditional telephone systems and services provided over the Internet, thus providing further proof that the object of both carriers is substantially similar.[34] This FCC Order is further proof that the public function is decisive, not the medium (railroad, wire, Internet) by means of which services are provided. As long as the function involves providing service to the public, the entity in question is granted common carrier status.

Over-Due Process

It has been the purpose of this essay to examine the implications of the dormant Commerce Clause for sellers of intangible property by means of the Internet. The Due Process Clause, that alternative site of nexus and pendant to the Commerce Clause in *Quill*, is a subject all its own, with enough precedent and intricacy to merit several pieces. Here, we can only gesture toward a preliminary conclusion as to whether the sort of selling in question satisfies its nexus requirements.

It bears repeating that one of *Quill*'s most valuable functions is to have separated two strands of doctrine on nexus that had become entangled. Justice Stevens would not have courts confuse the Commerce Clause, with its emphasis on interstate free trade, with Due Process and its emphasis on fairness. Like the Commerce Clause, with its predisposition toward open markets, the Due Process Clause has a deeper motivation, a concern with fairness in its most fundamental form. Setting to the side the aspect of ''substantive'' Due Process as tangential to the subject at hand, ''procedural'' Due Process properly concerns merchants who sell intangibles by means of the Internet.

Procedural Due Process stands for an idea very near the heart of the democratic ethos: that entities should not find themselves without good cause subject to the judicial apparatus of the state. The most salient aspect of procedural due process for our purposes is the requirement that Internet sellers be put on notice that they are subject to state taxation—that they have reason at least to suspect, even before they undertake commerce, so as adequately to assess their interests, that their activities may be subject to levy. Our discussion above, particularly the notes on common carriers and our view of *Goldberg v. Sweet*, suggests that state taxation on Internet sellers of intangibles would violate procedural due process.

Notice the caution with which the Court in *Goldberg* handles the conglomeration of ''wires'' and ''pulses'' that constitutes the national telecommunications network. Now here and now there, all before anyone could possibly know it and with an impetus all but unpredictable (and, moreover, neither entirely its own nor that of network ''operators,'' judging from the Court's understanding of each) messages either carried by or embodied in electrical current—though by no means identical to the current—refuse to be segregated by the Court as to their identity or pinned down by the Court as to their locations.

> When a direct path is full or not working efficiently, the computer system instantly activates another path. Signals may even change paths in the middle of a telephone call without perceptible interruption. . . Thus, the path taken by the electronic signals is often indirect and typically bears no relation to state boundaries.[35]

If positing an Internet ''happening'' or ''occurrence'' definitely in a given state is hopelessly problematic, and a specific seller of intangibles can neither foresee nor reconstruct the path of their ''product'' into the hands of their customer, it follows that such a seller can never be put on notice that they may be subject to a specific jurisdiction. Just as well subject entrepreneurs to the taxes of every state and locality, thereby to deal with the ''redundancy'' built into every technological network.

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[29] *What is the Internet?* Available at http://www.cenerspan.org/tutorial/net.htm (last visited Nov. 1, 2011).

[30] Telecommunications is defined under the 1996 Act as the transmission, between or among points specified by the user, of information of the users choosing, without change in form or content of the information as sent and received. 47 U.S.C. §153 (50).

[31] A telecommunications service is defined under the 1996 Act as the offering of telecommunications for a fee directly to the public or to such classes of users to be effectively available directly to the public, regardless of the facilities used. 47 U.S.C. §153 (54).

[32] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

[33] 19 F.C.C.R. 7457.

[34] The FCC was rather explicit in not differentiating between the two services in 19 F.C.C.R. 7457. (stating the use of the Internet as opposed to private networks or some other networks was not relevant to its analysis).

[35] *Goldberg*, 488 U.S. at 254.

Conclusion

States may not impose liability for the collection of sales tax on Internet sellers of digital products unless the vendor is physically present in the state attempting to impose the obligation to collect. The bright-line physical presence standard for establishing substantial nexus under the dormant Commerce Clause is not limited to any industry in particular. Moreover, because the Internet is a common carrier, delivering goods over the Internet does not create a direct or indirect physical presence. Requiring an Internet seller not in any way physically present to collect sales tax would burden industries that courts have taken a stake in seeing grow. Accordingly, until Congress or the Supreme Court says otherwise, Internet sellers of intangible personal property enjoy the same Constitutional ''safe harbor'' as mail-order sellers of tangible personal property.

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