

## DECONSTRUCTING THE DEBATE OVER STATE TAXATION OF ELECTRONIC COMMERCE

*Walter Hellerstein\**

Elsewhere on these pages, the distinguished economist Charles McLure begins his contribution to the debate over taxation of electronic commerce by observing that “America is focusing on the wrong issues in debating the taxation of electronic commerce . . . .”<sup>1</sup> He proceeds to provide a fundamental critique of the states’ existing sales tax regimes and he lays out a roadmap for radical reform of the system that would, in the course of curing the basic defects in the existing state sales tax structure, incidentally resolve many of the issues that currently dominate the debate over taxing electronic commerce. I do not disagree with McLure — over the years I have learned better. Radical reform of the sales tax would clearly provide an antidote for many of the ills that plague it, including those reflected in the debate over taxation of electronic commerce. Nevertheless, by reason of training — we lawyers are weaned on the concept of *stare decisis*<sup>2</sup> — and, perhaps, of temperament, my observations will focus on the issues that are fueling the current debate over taxation of electronic commerce, and on the efforts to resolve them, with the recognition that, at a more profound level of analysis, they may be dismissed as merely “tinkering with the existing system.”<sup>3</sup>

### I. A PRINCIPLED APPROACH TO TAXATION OF ELECTRONIC COMMERCE: THE VIEW FROM ACADEMIA

Despite the vigorous national debate that is being waged over whether and how electronic commerce should be taxed, there is a broad consensus among academic tax specialists regarding the general

---

\* Francis C. Shackelford Professor of Taxation, University of Georgia School of Law. I would like to thank Charles E. McLure, Jr., for his helpful comments on an earlier draft of this article.

1. Charles E. McLure, Jr., *Radical Reform of the State Sales and Use Tax: Achieving Simplicity, Economic Neutrality, and Fairness*, 13 HARV. J.L. & TECH. (forthcoming Summer 2000).

2. Literally, “to stand by things decided.” BLACK’S LAW DICTIONARY 1414 (7th ed. 1999). More generally, a respect for precedent.

3. McLure, *supra* note 1.

principles that should guide any effort to deal with sales and use taxation of electronic commerce. These principles are embodied in an "Appeal for Fair and Equal Taxation of Electronic Commerce" endorsed by more than 170 academic tax economists and professors of law.<sup>4</sup> The principles are:

1. Electronic commerce should not permanently be treated differently from other commerce. There is no principled reason for a permanent exemption for electronic commerce. Electronic commerce should be taxed neither more nor less heavily than other commerce.
2. Remote sales, including electronic commerce, should, to the extent possible, be taxed by the state of destination of sales, regardless of whether the vendor has a physical presence in the state. In limited cases, where it is impossible to determine the destination of sales of digital content to households, it may be necessary to substitute a surrogate system. In no case should taxation of remote electronic commerce be limited to origin-based taxation, which would induce a "race to the bottom" and, in effect, no taxation at all.
3. There must be enough simplification of sales and use taxes to make destination-based taxation of sales feasible. Such simplification might include, for example, unification of the tax base across states, unification of tax rates within states, and/or sourcing of sales only to the state level, as well as simplification of administrative procedures.
4. A means must be found to eliminate burdens of compliance on sellers making only small amounts of sales in a state. These might include software-based systems made available at state expense, more realistic vendor discounts, and/or de minimis rules.<sup>5</sup>

It is instructive to consider the implications of these principles for issues that often dominate the public debate over taxation of electronic commerce. First, take the "big" question that has captured the popular imagination in the e-commerce taxation debate, namely, "Should states

---

4. *Federalism in the Information Age: Internet Tax Issues: Hearing Before the Senate Comm. on the Budget*, 106th Cong. (2000) (attachment to statement of Charles E. McLure, Jr., Senior Fellow, Hoover Institution, Stanford University).

5. *Id.*



tax e-commerce?”<sup>6</sup> The tax academics’ approach to the taxation of electronic commerce would not answer the “big” question, at least not directly. Since the guiding principle is that “[e]lectronic commerce should be taxed neither more nor less heavily than other commerce,” reflecting the fundamental goal of tax neutrality, the answer to the “big” question is that e-commerce should or should not be taxed according to whether equivalent conventional commerce is or is not being taxed. For example, if a state chooses to tax the sale of software in conventional commerce, a sound approach to taxation of e-commerce demands that the sale of software, if purchased or delivered electronically, likewise be taxed. By the same token, if a state chooses *not* to tax the sale of software in conventional commerce, a sound approach to taxation of e-commerce demands that the sale of software, if purchased or delivered electronically, *not* be taxed. In short, the right answer to the question “Should the states tax e-commerce?” is, “It depends.”

Second, the tax academics’ approach to taxation of electronic commerce likewise, and quite properly, does not speak to another issue that energizes many participants in the e-commerce debate — namely, the size of government. For these participants, the “big” question is not “Should the states tax e-commerce?” but rather “Should the states tax?” Many of these observers are concerned that the brave new world of e-commerce taxation will enable states to enrich their coffers beyond their reasonable needs. That is certainly a concern worthy of attention, but one that serves largely as a distraction from the critical tax policy issues raised by the debate over the problems raised by taxation of *electronic* commerce.<sup>7</sup> Indeed, I believe that most, if not all, of the

---

6. Indeed, even the American Bar Association Section of Taxation, which might be expected to take a more nuanced approach to the debate, presents the issue to its members under the rubric: *Point & Counterpoint: Should States Tax E-Commerce?*, NEWSLETTER (ABA Section of Taxation), Spring 2000, at 13.

7. It is difficult, for example, to take a proposal, such as the Internet Tax Elimination Act, H.R. 3252, 106th Cong. (1999) (co-sponsored by Representatives Kasich and Boehner of Ohio), as a serious effort to deal with the problems raised by taxation of electronic commerce. The Internet Tax Elimination Act, which extends and makes permanent the Internet Tax Freedom Act (“ITFA”), would prohibit the states and their political subdivisions from imposing “[a]ny sales or use tax on domestic or foreign goods or services acquired through electronic commerce.” *Id.* at § 2(b). The scope of the law, as defined by the ITFA, Pub. L. No. 105-277, §§ 1101–1104, 112 Stat. 2681-719 to 2681-726 (1998), is all encompassing. It embraces “any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services or information, whether or not for consideration, and includes the provision of Internet access.” *Id.* § 1104(3).

academics who endorsed the four principles set forth above willingly would have signed on to a fifth: revenue neutrality. In other words, they would have agreed as a matter of principle that changes in the system designed to achieve fair and equal taxation of electronic commerce should not be permitted to serve as a disguised tax hike (or cut) and that any increase (or decrease) in revenues attributable to those changes should be offset by a corresponding decrease (or increase) in tax rates.<sup>8</sup> If the debate over a sound approach to taxation of electronic commerce could be conducted without simultaneously confronting the highly charged question of the proper level of taxation — a question whose resolution, in the end, depends on one's taste for public goods and income redistribution — the e-commerce debate would be more focused and, one would hope, more productive.

Third, the tax academicians squarely endorse the view that a vendor should be required, to the extent possible, to collect tax on its sales into a jurisdiction *regardless of whether the vendor has a physical presence in the state*. In the entire debate over taxation of electronic commerce, this may be the hottest of hot-button issues, and one that, not surprisingly, has generated more heat than light. Part of the problem is attributable to a public that has grown to believe, as if by adverse possession, that it has a right not to pay taxes on anything it buys from a remote vendor. Witness the public outcry at the very suggestion that out-of-state mail order vendors had agreed to collect use taxes<sup>9</sup> — taxes that the state has indisputable constitutional power to impose<sup>10</sup> and that purchasers have an undeniable liability to pay, although one they largely

---

Consequently, the Act would cut a broad swath of tax immunity across state sales tax regimes. It would immunize from tax not only the typical remote sale (e.g., the purchase of a book from Amazon.com), but also the local purchase of goods and services as long as the transaction was “conducted . . . through Internet access.” A customer presumably could purchase a car tax-free if, after negotiating the deal in the showroom, the dealer directed the customer to a convenient on-premises kiosk where the customer could consummate the transaction (indicating his or her acceptance) “through Internet access” with a click of a mouse. The Internet Tax Elimination Act would therefore have a devastating impact on state revenues and seems to have more to do with shrinking government than it has to do with taxing electronic commerce. It would more appropriately be denominated the “Sales Tax Elimination Act.”

8. This is not to suggest that the academic position favors freezing the level of government. The point is simply that any decision about the size of government should be made independently of efforts to rationalize the system. See J. William McArthur, Jr. & Peter R. Merrill, *A Modest Principle: No Net Net Tax*, 17 ST. TAX NOTES 1431 (1999).

9. See David C. Johnston, *Angry Customers Hinder Mail-Order Tax Accord*, N.Y. TIMES, Nov. 7, 1997, at D2.

10. See, e.g., *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335 (1944).



ignore. Part of the problem is attributable to the fact that the states have done nothing to simplify their sales and use tax systems. They have therefore paved the way for the Supreme Court to articulate,<sup>11</sup> and then reaffirm,<sup>12</sup> a nexus rule that relieves out-of-state vendors of use tax collection responsibilities in states in which they lack physical presence.

But while a bright-line, physical-presence rule of nexus may be justifiable as a prophylactic (and politically popular) short-term solution to the quagmire of existing state sales tax laws confronting the remote vendor,<sup>13</sup> it makes little sense as a long-term solution in the context of taxation of activities conducted through cyberspace. The signal characteristic of cyberspace is the irrelevance of geographic borders. As the co-directors of the Cyberspace Law Institute have declared, “[g]lobal computer-based communications cut across territorial borders, creating a new realm of human activity and undermining the feasibility — and legitimacy — of laws based on geographic boundaries.”<sup>14</sup> Accordingly, while nexus rules are clearly necessary in the existing environment, and may well be necessary to protect the small business even in a utopian future characterized by greater uniformity among the states in their sales tax regimes, the debate should focus on rules that are appropriate to the twenty-first century, not the nineteenth.

Finally, the academic statement joins the chorus of those calling for simplification of the states’ sales tax systems to make a destination-based sales tax regime feasible. Indeed, if there is a theme that unites the proposals for dealing with state taxation of electronic commerce — other than those that would bar such taxation altogether — it is that

---

11. See *National Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753 (1967).

12. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

13. For example, Charles McLure has suggested that the rule of *Quill* may not be a bad idea in the short run to avoid a burden on interstate commerce and keep pressure on the states to reform their taxing systems but without creating a statutory exemption for either e-commerce or all remote commerce. See generally *Federalism in the Information Age: Internet Tax Issues: Hearing Before the Senate Comm. on the Budget*, 106th Cong. (2000) (statement of Charles E. McLure, Jr., Senior Fellow, Hoover Institution, Stanford University). Others, however, would question whether it makes sense even in that context. Rather than tying an out-of-state taxpayer’s liability for tax collection or payment responsibilities to the taxpayer’s physical activities in a state, which may not accurately reflect the extent of a taxpayer’s economic activity in a state, one might tie them to the level of sales (with respect to a sales tax) or income (with respect to an income tax). See 1 J. HELLERSTEIN & W. HELLERSTEIN, *STATE TAXATION* ¶¶ 6.04, 6.11 (3d ed. 1998, Cum. Supp. 2000).

14. David R. Johnson & David Post, *Law and Borders — The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1367 (1996).

simplification of the structure of the existing “system” is a sine qua non of any solution to the problem. What separates the proposals is whether simplification should be the result of voluntary state action or congressional mandate and the precise form that the simplification should take. The academic proposal does not enter the fray at this level of detail, and there is no reason why it should. In Part II of this Article, however, I pursue one aspect of that question — namely, the necessity for and the limitations on congressional action in this domain.

## II. FEDERAL CONSTITUTIONAL RESTRAINTS ON CONGRESSIONAL POWER TO LEGISLATE REGARDING STATE TAXATION OF ELECTRONIC COMMERCE

Any effort to design a solution to the problems raised by state taxation of electronic commerce will almost certainly require congressional action of some kind.<sup>15</sup> Most of the proposals for reform in this area have suggested that the states should be required to adopt uniform definitions of goods and services in taxing or exempting goods and services sold in electronic commerce and to impose only one rate per state.<sup>16</sup> It is difficult to imagine that this result can be achieved without congressional legislation. Similarly, many observers believe that any sensible approach to taxation of electronic commerce must modify the rule of *Quill Corp. v. North Dakota*,<sup>17</sup> that out-of-state vendors without physical presence in the state may not be compelled to collect use taxes on sales to local consumers, regardless of the nature or extent of their sales into the state. Congressional action will almost certainly be required to alter the rule of *Quill*, except in the unlikely event that the Court would revisit and reverse its stare decisis based decision in that case.

---

15. The following discussion draws freely, but in excruciatingly abbreviated form, from Walter Hellerstein, *Federal Constitutional Limitations on State Taxation to Legislate Regarding State Taxation of Electronic Commerce*, 53 NAT'L TAX J. (forthcoming 2000).

16. See, e.g., Kendall L. Houghton & Walter Hellerstein, *State Taxation of Electronic Commerce: Perspectives on Proposals for Change and Their Constitutionality*, 2000 BYU. L. Rev. 77 (2000); Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 TAX L. REV. 425 (1997).

17. 504 U.S. 298 (1992).



*A. Commerce Clause Considerations*

The question whether Congress possesses power under the Commerce Clause to provide a comprehensive solution to the problem of state taxation of electronic commerce is, at first glance, an easy one. The Constitution grants Congress the power “[t]o regulate commerce . . . among the several States . . . .”<sup>18</sup> The U.S. Supreme Court has interpreted that power in sweeping terms.<sup>19</sup> It has sustained as legitimate exercises of Congress’ power to regulate interstate commerce limitations on: (1) the amount of wheat a farmer can grow for his own consumption,<sup>20</sup> (2) discriminatory practices in local hotels and restaurants,<sup>21</sup> and (3) local criminal activity.<sup>22</sup> Furthermore, Congress’ authority not only to restrict but also to expand state power to tax or regulate interstate commerce, by comparison to the restraints on such power that would otherwise exist under the so-called “dormant” Commerce Clause in the absence of congressional legislation, is well settled.<sup>23</sup>

From the foregoing, one might reasonably conclude that there could be no serious objection to Congress’ exercise of its power under the Commerce Clause to forge a comprehensive solution to the problems raised by state taxation of electronic commerce. Indeed, the Court has explicitly indicated that Congress possesses power to legislate uniform state tax rules among the states — a subject of particular relevance to any legislative solution to the problems raised by sales and use taxation of electronic commerce. Thus, the Court has observed 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.”<sup>24</sup> Moreover, it is equally clear that Congress may consent to state legislation that would be an integral part of a rational solution to the problem of taxing electronic commerce, even if such legislation would be unconstitutional under the dormant Commerce Clause in the

---

18. U.S. CONST. art. I, § 8, cl. 3.

19. *See, e.g.,* *Houston E. & W. Texas Ry. v. United States*, 234 U.S. 342, 350–51 (1914).

20. *See Wickard v. Filburn*, 317 U.S. 111 (1942).

21. *See Katzenbach v. McClung*, 379 U.S. 294 (1964); *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964).

22. *See Perez v. United States*, 402 U.S. 146 (1971).

23. *See Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946).

24. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 280 (1978).

absence of such consent.<sup>25</sup> As the Court observed in *Quill* itself, which reaffirmed the dormant Commerce Clause principle that the physical presence of an out-of state vendor is an essential prerequisite of a state's power to require the vendor to collect the state's use tax, "Congress is . . . free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."<sup>26</sup>

*B. Recent Decisions Invalidating Congressional Exercises of the Commerce Power: Lopez and Printz*

Despite Congress' broad authority under the Commerce Clause to legislate in the domain of state taxation, one might argue that some of the Court's more recent opinions reflect a less expansive view of congressional power to restrict state action and that they require rethinking of the position articulated above.<sup>27</sup> Specifically, in *United States v. Lopez*,<sup>28</sup> the Court held that Congress lacks power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce. In *Printz v. United States*,<sup>29</sup> the Court held that Congress lacks the power under the Commerce Clause to require state officials to conduct background checks on prospective gun purchasers under the Brady Handgun Violence Protection Act. Do these decisions seriously inhibit Congress in its ability to fashion a solution to the problems raised by state taxation of electronic commerce? In my judgment, the answer to this question is no, although they do suggest that certain forms of congressional action would lie outside Congress' commerce power.

1. *Lopez*

In *Lopez*, even though the Court invalidated the Gun-Free School Zones Act of 1990, it did so in an opinion that reaffirmed, rather than discredited, the essential contours of the Court's affirmative Commerce Clause doctrine. Thus the Court, after summarizing the "era of

---

25. See *supra* text accompanying note 23.

26. *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992).

27. Indeed, such an argument has been advanced. See Richard D. Nicholson, *Preemption of State Sales and Use Taxes on Goods Purchased Over the Internet: An Unconstitutional Mission*, 18 ST. TAX NOTES 213 (2000).

28. 514 U.S. 549 (1995).

29. 521 U.S. 898 (1997).



Commerce Clause jurisprudence that greatly expanded the previous defined authority of Congress under that Clause,”<sup>30</sup> identified “three broad categories of activity that Congress may regulate under its commerce power.”<sup>31</sup>

First, Congress may regulate the use of the channels of interstate commerce. Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities. Finally, Congress’ commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce, i.e., those activities that substantially affect interstate commerce.<sup>32</sup>

The Court found that the Gun-Free School Zones Act of 1990 fell within none of these categories. It clearly was not a regulation of the use of the channels of interstate commerce, nor was it an attempt to prohibit the interstate transportation of a commodity through the channels of commerce. The only close question, in the Court’s opinion, was whether the activity that Congress sought to regulate “substantially affects” interstate commerce. Here, too, the Court concluded that the legislation fell outside of even its most expansive precedents — including those involving regulation of intrastate coal mining, intrastate extortionate credit transactions, restaurants using substantial interstate supplies, inns and motels catering to interstate guests, and production and consumption of homegrown wheat.<sup>33</sup> The Gun-Free School Zones Act, by contrast, “has nothing to do with ‘commerce’ or any sort of economic enterprise, however broadly one might define those terms.”<sup>34</sup> Nor was there any “jurisdictional element”<sup>35</sup> that would ensure that the firearm in question affected interstate commerce, i.e., there was no requirement in the statute that the guns banned from the school zone be shipped or transported in interstate commerce.

---

30. *Lopez*, 514 U.S. at 556.

31. *Id.* at 558.

32. *Id.* at 558–59 (citations omitted).

33. *See id.* at 559–60; *see also supra* text accompanying notes 20–22.

34. *Lopez*, 514 U.S. at 561.

35. *Id.*

In short, “[t]he possession of a gun in a local school zone is in no sense an economic activity that might . . . substantially affect any sort of interstate commerce.”<sup>36</sup> In the Court’s view, “[t]o uphold the Government’s contentions here, we would have to pile inference upon inference in a manner that would bid fair to convert congressional power under the Commerce Clause to a general police authority of the sort retained by the States.”<sup>37</sup>

*Lopez* does not impose significant restraints on Congress’ power under the Commerce Clause to legislate regarding state taxation of electronic commerce. One cannot seriously maintain that electronic commerce does not “substantially affect” interstate commerce within the meaning of the precedents that the Court explicitly reaffirmed in *Lopez*. Indeed, if, as the Court reiterated, such activities as intrastate extortionate credit transactions, restaurants using substantial interstate supplies, inns and motels catering to interstate guests, and production and consumption of homegrown wheat “substantially affect” interstate commerce, electronic commerce would appear to be a “lesser included offense.” Moreover, one could clearly draft congressional legislation as a regulation of the channels of interstate commerce — the Internet — that would fall squarely within another well accepted basis for the exercise of the congressional commerce power.

## 2. *Printz*

In *Printz*, the Court held that certain provisions of the Brady Handgun Violence Prevention Act commanding state and local law enforcement officers to conduct background checks on prospective handgun purchasers exceeded Congress’ authority. In contrast to *Lopez*, the focus of the controversy in *Printz* was not whether regulation of the activity in question — the distribution of firearms — fell within the scope of Congress’ power to regulate interstate commerce. Indeed, the Court did not appear to take issue with the dissent’s observation that “there can be no question that the [Commerce Clause] adequately supports the regulation of commerce in handguns effected by the Brady Act.”<sup>38</sup>

---

36. *Id.* at 567.

37. *Id.* In *Morrison v. United States*, 120 S. Ct. 1740 (2000), the Court closely tracked the reasoning of its decision in *Lopez* in holding that Congress exceeded its power under the Commerce Clause in providing a civil remedy for victims of gender-motivated violence. Because the decisions are doctrinal twins, the observations in the text bearing on *Lopez* are equally applicable to *Morrison*.

38. *Printz v. United States*, 521 U.S. 898, 941 (1997) (Stevens, J., dissenting).



Instead, the key issue in *Printz* was whether state and local law enforcement officers could be required to implement a federal regulatory regime. The Court in *Printz*, gave an unequivocally negative answer to this question:

The Federal Government 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. It matters not whether policymaking is involved, and no case-by-case weighing of the burdens or benefits is necessary; such commands are fundamentally incompatible with our constitutional system of dual sovereignty.<sup>39</sup>

What implications does this holding have on congressional power to enact legislation affecting state taxation of electronic commerce? First, it clearly indicates that Congress may not rely on state and local tax personnel to administer a federal regulatory scheme directed to state taxation of electronic commerce. Up to now, discussions of alternative federal legislative solutions to the problems raised by state taxation of electronic commerce have not seriously entertained the possibility of enlisting state and local personnel to implement a federal regulatory regime. *Printz* makes it clear that any such proposal would be dead on arrival from a constitutional standpoint, and we should not waste our time even considering any such proposal.

Second, *Printz* does not appear to jeopardize the constitutionality of the type of legislation that has been suggested in connection with state taxation of electronic commerce. For example, Congress could presumably enact a statute forbidding the states from imposing sales and use taxes on electronic commerce unless they: (1) limited their tax to one rate per state, (2) adopted uniform definitions of taxable and nontaxable items prescribed by Congress, (3) simplified their administrative procedures for collecting taxes in ways specified by Congress, and (4) compelled out-of-state vendors to collect taxes only if their in-state sales exceeded de minimis levels. At the same time, Congress could permit the states to require remote vendors to collect such taxes regardless of the physical presence of the out-of-state vendor in the state.

---

39. *Printz*, 521 U.S. at 935.

Legislation of this nature falls squarely within the traditional form of congressional Commerce Clause legislation limiting or consenting to state taxation. It would prescribe the conditions under which the states can tax particular activities in interstate commerce, just as it has done in Public Law 86-272,<sup>40</sup> which limits the states' power to tax income from interstate commerce, and more recently in the Internet Tax Freedom Act,<sup>41</sup> which limits the states' power to tax certain forms of electronic commerce. Legislation of this nature would consent to the taxation of interstate commerce, just as it has done with respect to state taxation of the insurance industry.<sup>42</sup> There is nothing in *Printz* that casts any doubt on the constitutionality of such legislation, because such legislation does not "compel the States to enact or administer a federal regulatory program."<sup>43</sup>

### 3. *Reno v. Condon*

The Court's recent decision in *Reno v. Condon*,<sup>44</sup> which sustained Congress' power under the Commerce Clause to enact the Driver's Privacy Protection Act of 1994 ("DPPA"), reinforces the foregoing reading of *Lopez* and *Printz*. The DPPA arose out of Congress' concern that many states, which routinely require drivers and automobile owners to furnish personal information to state motor vehicle departments, had been selling this personal information to individuals and businesses. In adopting the DPPA, Congress regulated the disclosure of such personal information. Among other things, the DPPA established a regulatory scheme that restricted the states' ability to disclose a driver's personal information without the driver's consent. Personal information was defined as "any information 'that identifies an individual,'" with an exception for "information on vehicular accidents, driving violations, and driver's status."<sup>45</sup> The DPPA's ban did not apply to drivers who consented to release of their data, and the Act established rules governing how such consent could lawfully be obtained. The DPPA also contained a number of exceptions to the

---

40. 15 U.S.C. § 381 (1994).

41. Pub. L. No. 105-277, §§ 1101-04, 112 Stat. 2681-719 to 2681-726 (1998). See generally Walter Hellerstein, *Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce*, 90 J. TAX'N 5 (1999).

42. See *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946).

43. *Printz*, 521 U.S. at 933 (quoting *New York v. United States*, 505 U.S. 144, 188 (1992)).

44. 120 S. Ct. 666 (2000).

45. *Id.* at 668-69 (quoting the DPPA).



prohibition against nonconsensual disclosures. South Carolina challenged the constitutionality of the DPPA, and the district court held that the Act is “incompatible with the principles of federalism.”<sup>46</sup>

The Supreme Court first addressed the claim that Congress lacked the authority under the Commerce Clause to enact the DPPA. Relying on its opinion in *Lopez*, where it had identified three broad categories of activity that Congress could regulate under its commerce power,<sup>47</sup> the Court found that the personal information that the DPPA regulates fell within the second category of activity that Congress could regulate under its commerce power — “things in interstate commerce.”<sup>48</sup>

The Court observed that the personal information that the states have historically sold was used by insurers, direct marketers, and others engaged in interstate commerce to contact drivers with customized solicitations. The information was also used in the stream of commerce by various public and private entities for matters related to interstate commerce. Accordingly, the Court concluded: “Because drivers’ information is, in this context, an article of commerce, its sale or release into the interstate stream of business is sufficient to support congressional regulation.”<sup>49</sup>

The *Condon* Court’s treatment of *Lopez* supports the view that *Lopez* is no obstacle to congressional legislation regulating state taxation of electronic commerce. Since electronic commerce invariably involves an “article of commerce” (e.g., the purchase and/or transfer of a digital or non-digital product over the Internet), there can be no question that “its sale or release into the interstate stream of business is sufficient to support congressional regulation.”<sup>50</sup> *Lopez* is therefore no more an obstacle to congressional legislation limiting state taxation of electronic commerce than it was an obstacle in *Condon* to congressional legislation limiting state sale of personal information in interstate commerce.

The fact that Congress possessed legislative authority over the subject matter of the DPPA did not end the dispute in *Condon*. In *Printz*, the Court held the Brady Handgun Prevention Act invalid *not* because Congress lacked authority over commerce in handguns, but rather because the Tenth Amendment and principles of federalism preclude the Federal Government from “issu[ing] directives requiring

---

46. *Id.* at 670.

47. *See supra* text accompanying note 32.

48. *Condon*, 120 S. Ct. at 670.

49. *Id.* at 671.

50. *Id.*

the States to address particular problems”<sup>51</sup> or “command[ing] the States’ officers . . . to administer or enforce a federal regulatory program.”<sup>52</sup> South Carolina claimed that this is exactly what the federal government had done in the DPPA by thrusting upon the states the day-to-day responsibility for administering its complex provisions and thereby making state officials unwilling instruments of federal policy. Specifically, South Carolina complained that the DPPA required its employees to learn and apply the Act’s substantive provisions and that this would consume the employees’ time and the state’s resources.

The Court rejected South Carolina’s argument. While acknowledging that the DPPA might require time and effort on the part of state employees, the Court concluded that the case was governed not by *Printz*, but by *South Carolina v. Baker*,<sup>53</sup> which sustained Congress’ power to enact legislation that prohibited the states from issuing unregistered bonds. The Court declared:

Like the statute at issue in *Baker*, the DPPA does not require the States in their sovereign capacity to regulate their own citizens. The DPPA regulates the States as the owners of databases. It does not require the South Carolina Legislature to enact any laws or regulations, and it does not require state officials to assist in the enforcement of federal statutes regulating private individuals.<sup>54</sup>

The Court’s decision in *Condon* reaffirms the conclusion that *Printz* does not constitute a significant limitation on federal legislation directed to state taxation of electronic commerce. As noted above,<sup>55</sup> the type of federal legislation that has been suggested in connection with state taxation of electronic commerce does not “require the States in their sovereign capacity to regulate their own citizens,” “to enact any laws or regulations,” or to “require state officials to assist in the enforcement of federal statutes regulating private individuals.”<sup>56</sup> Rather it would simply forbid the states from taxing electronic commerce unless they complied with congressionally prescribed conditions, a

---

51. *Printz v. United States*, 521 U.S. 898, 935 (1997).

52. *Id.*

53. 485 U.S. 505 (1988).

54. *Condon*, 120 S. Ct. at 672.

55. See *supra* text accompanying notes 40–43.

56. *Condon*, 120 S. Ct. at 668.



traditional form of federal legislation that lies outside the purview of *Printz*.<sup>57</sup>

### C. Due Process Clause Considerations

In addition to arguing that Congress lacks the power under the Commerce Clause to fashion a broad solution to the problem of state taxation of electronic commerce, one might also contend that such legislation would purport to authorize violations of the Court's due process doctrine and that, in contrast to Congress' power to consent to what otherwise would be violations of the Court's dormant Commerce Clause jurisprudence, Congress lacks the authority to consent to due process violations.

The question must be addressed in two parts. First, would the congressional legislation authorize violations of the Due Process Clause? If so, then does Congress have the power to eliminate the due process bar?

The answer to the first part of the question depends on whether a state would have the "definite link" or "minimum connection" that the Due Process Clause requires "between a state and the person, property or transaction it seeks to tax."<sup>58</sup> The Court in *Quill* construed this requirement to remove any condition that the "link" or "connection" be physical: "The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State."<sup>59</sup> What is required is that the out-of-state taxpayer "purposefully direct" its activities towards residents of the taxing state.<sup>60</sup>

Whether the congressional legislation would satisfy this criterion would, of course, depend on the precise nexus requirements in the federal legislation and on the particular facts of the case. In other words, even if the legislation authorized states to require collection of use taxes that, in some circumstances, would exceed state power under existing due process doctrine, the statute would arguably be invalid *only* in those circumstances. It would not provide a basis for attacking the

---

57. As the Court declared in *New York v. United States*, 505 U.S. 144, 167 (1992), "[W]here Congress has the authority to regulate private activity under the Commerce Clause, we have recognized Congress' power to offer States the choice of regulating that activity according to federal standards or having state law pre-empted by federal regulation."

58. *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954).

59. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992).

60. *Id.*

legislation on its face, since in most of its applications it would likely be unobjectionable.

Even assuming that, in some circumstances, congressional legislation might authorize the exercise of state taxing power that exceeds state authority under the Due Process Clause, it is an open question whether such legislation would nevertheless be sustained. The Court in dicta has declared that "while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce, it does not similarly have the power to authorize violations of the Due Process Clause."<sup>61</sup> Nevertheless, a strong case can be made that Congress has power to consent to violations of the Due Process Clause so long as they are not restraints by which Congress itself is bound.<sup>62</sup> Under this theory, Congress can authorize what would otherwise be federalism-based violations of the Due Process Clause but not Due Process violations of individual rights.

In the end, it seems unlikely that the U.S. Supreme Court would hold that the framers of the Constitution and the Fourteenth Amendment left the nation powerless, short of a constitutional amendment, to legislate an administratively workable solution to the problem of state taxation of electronic commerce, despite the joint exercise by Congress and the states of their respective powers under the Constitution.<sup>63</sup> Moreover, even if portions of such legislation were held to violate the

---

61. *Id.* at 305 (citation omitted); *see also id.* at 318; *ASARCO, Inc. v. Idaho State Tax Comm'n.*, 458 U.S. 307, 350 n.14 (1982) (O'Connor, J., dissenting).

62. *See, e.g.,* William Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 STAN. L. REV. 387 (1983); William Cohen, *Congressional Power to Interpret Due Process and Equal Protection*, 27 STAN. L. REV. 603 (1975).

63. As Professor Donald Regan, an eminent constitutional scholar, has put it:

The crucial question then becomes: Can Congress overturn Supreme Court decisions invalidating state laws on grounds of extra-territoriality? It is an understatement to say there is no settled doctrine on this question. Nonetheless, I would confidently expect the Court to hold that Congress can overturn most, if not all, such decisions, precisely because extra-territoriality is more a matter of federalism than of fundamental fairness.

*Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 Before the Subcomm. on Monopolies and Commercial Law of the House Judiciary Comm.*, 100th Cong. (1989) (letter of Donald H. Regan, Professor, University of Michigan School of Law, regarding the "Constitutionality of H.R. 3521 and Similar Bills Authorizing States to Require Tax Collection by Mail-Order Sellers").



Due Process Clause as applied, the lion's share of any such legislation would be invulnerable to due process attack on its face or as applied.

## CONCLUSION

The problems raised by state taxation of electronic commerce have spawned an enormous interest in — and controversy over — an area of the law that the Supreme Court has characterized as a “quagmire.”<sup>64</sup> The most promising prospects for resolving these problems reside today in the legislative branches of government at both the federal and state levels. One can only hope that as Congress and the state legislatures turn their attention to these issues, their decisions are informed by sound principles of tax policy.

---

64. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).