IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

September 2006 Term

**FILED**
**November 21, 2006**
released at 10:00 a.m.
RORY L. PERRY II, CLERK
SUPREME COURT OF APPEALS
OF WEST VIRGINIA

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No. 33049

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TAX COMMISSIONER OF THE STATE OF WEST VIRGINIA,
Petitioner Below, Appellee

v.

MBNA AMERICA BANK, N.A.,
Respondent Below, Appellant

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Appeal from the Circuit Court of Kanawha County
Honorable Louis H. Bloom, Judge
Civil Action No. 04-AA-157

AFFIRMED

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Submitted: September 19, 2006
Filed: November 21, 2006

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JUSTICE MAYNARD delivered the Opinion of the Court.
CHIEF JUSTICE DAVIS concurs and reserves the right to file a concurring opinion.
JUSTICE BENJAMIN dissents and reserves the right to file a dissenting opinion.

SYLLABUS BY THE COURT

1. "A state tax on interstate commerce will not be sustained unless it: '(1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate; and (4) is fairly related to the services provided by the State.' *Maryland v. Louisiana,* [451] U.S. [725], [754], 101 S.Ct. 2114, 2133, 68 L.Ed.2d 576 (1981)." Syllabus Point 1, *Western Maryland Ry. Co. v. Goodwin,* 167 W.Va. 804, 282 S.E.2d 240 (1981).

2. The United States Supreme Court's determination in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), that an entity's physical presence in a state is required to meet the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.

Maynard, Justice:

Appellant MBNA America Bank appeals the June 27, 2005, order of the Circuit Court of Kanawha County that ruled that imposition of West Virginia's business franchise tax and corporation net income tax on MBNA, a Delaware Corporation, for tax years 1998 and 1999, does not violate the Commerce Clause. For the reasons that follow, we affirm the circuit court.

## I.

## FACTS

Appellant MBNA America Bank is a foreign corporation which has its principal place of business and commercial domicile in Wilmington, Delaware. During the two years in question, 1998 and 1999, MBNA had no real or tangible personal property and no employees located in West Virginia. The principal business of MBNA at the relevant times in this case was issuing and servicing VISA and MasterCard credit cards. This business included the extension of unsecured credit to customers who use these credit cards. MBNA promoted its business in West Virginia via mail and telephone solicitation.

As noted above, the two tax years at issue are 1998 and 1999. In 1998, MBNA's gross receipts attributable to West Virginia customers amounted to $8,419,431.00, and in 1999, its gross receipts amounted to $10,163,788.00. For tax year 1998, MBNA paid a West Virginia Business Franchise Tax[1] of $32,010.00 and a West Virginia Corporation Net Income tax[2] of $168,034.00. For tax year 1999, MBNA paid a Business Franchise Tax in the amount of $42,339.00 and a Corporation Net Income Tax in the amount of $220,897.00.

Thereafter, MBNA filed refund claims with the State Tax Commissioner seeking the return of the business franchise and corporation net income taxes paid for 1998 and 1999, on the basis that the Tax Commissioner lacked jurisdiction over MBNA. The Commissioner denied the refunds based on its finding that MBNA regularly engaged in business in West Virginia under the applicable statutes.[3]

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[1]The West Virginia Business Franchise Tax is found in W.Va. Code §§ 11-23-1, *et seq*. According to W.Va. Code § 11-23-1 (1985) the tax is imposed on corporations and partnerships for the privilege of doing business in this state.

[2]The West Virginia Corporation Net Income Tax is found in W.Va. Code §§ 11-24-1, *et seq.*

[3]The statutory nexus required for the business franchise tax is found in W.Va. Code § 11-23-5a(d) (1996), which states in part:

> A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars.

(continued...)

MBNA subsequently filed an appeal from the Tax Commissioner's decision with the Office of Tax Appeals (hereafter "OTA"). By decision dated October 22, 2004, the Chief Administrative Law Judge (hereafter "ALJ") of the OTA ruled in favor of MBNA and authorized refunds to MBNA of its 1998 and 1999 franchise and corporation net income taxes. The ALJ reasoned that under the Commerce Clause, a state may not subject an activity to a tax unless that activity has a "substantial nexus" with the taxing state. The ALJ further reasoned that a substantial nexus requires a finding that the putative taxpayer has a physical presence in the taxing state, and mere economic exploitation of the market is not sufficient. Because it was agreed that MBNA does not have a physical presence in West Virginia, the ALJ concluded that the State's business franchise and corporation net income taxes could not be imposed on MBNA's activity within the State.

The Tax Commissioner appealed the ALJ's decision to the Circuit Court of Kanawha County. The circuit court reversed the decision of the ALJ. According to the circuit court, physical presence is not necessary in order to show a substantial nexus for

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[3](...continued)

The statutory nexus required for the West Virginia corporation net income tax is found in W.Va. Code § 11-24-7b(d) (1996) which provides in part:

> A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars.

purposes of state taxation of foreign corporations. Rather, the circuit court found that MBNA's significant business in the state is sufficient to meet the substantial nexus standard. Therefore, concluded the circuit court, MBNA had a substantial nexus with West Virginia during the tax years in question so that imposition of the State's business franchise and corporate net income taxes on MBNA did not violate the Commerce Clause. MBNA now appeals the circuit court's order.

## II.

## STANDARD OF REVIEW

The Court has previously recognized that a lower court's determination of whether a state tax violates the Commerce Clause is reviewed *de novo*. *See Hartley Marine Corp. v. Mierke,* 196 W.Va. 669, 474 S.E.2d 599 (1996) (explaining that review of lower court judgment on whether state legislation interferes with free flow of interstate commerce is *de novo*).

## III.

## DISCUSSION

The single issue[4] raised in this appeal is whether application of West Virginia's business franchise and corporation net income taxes to MBNA, a business with no physical presence in this state, violates the Commerce Clause of the United States Constitution.[5] In Article 1, § 8 of the United States Constitution, Congress is expressly granted the authority

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[4]In its petition for appeal to this Court, MBNA also raised an assignment of error concerning fair apportionment of the taxes at issue. However, MBNA subsequently abandoned this assignment of error.

[5]We are mindful that our task herein is a difficult one. The United States Supreme Court has acknowledged that its dormant Commerce Clause law "is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'" *Quill Corp. v. North Dakota,* 504 U.S. 298, 315-316, 112 S.Ct. 1904, 1915, 119 L.Ed.2d 91 (1992) (*quoting Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 457-458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). Likewise, this Court has characterized this area of the law as "nebulous at best," *Hartley Marine Corp.,* 196 W.Va. at 677, 474 S.E.2d at 607, and commented that,

> It would be a Herculean, if not impossible task, to review and harmonize the myriad decisions of the Supreme Court of the United States on the subject of interstate commerce and exactly what incidents thereof may be constitutionally taxed by the States. The dissenting opinions in many of those cases make clear that the task of reconciling all the decisions is more difficult than was the task of Theseus as he threaded his way through the famous Cretan Labyrinth in search of the Minotaur.

*J.C. Penney Co., Inc. v. Hardesty,* 164 W.Va. 525, 527, 264 S.E.2d 604, 607 (1979) (*quoting Roy Stone Transfer Corp. v. Messner,* 377 Pa. 234, 243-44, 103 A.2d 700, 705 (1954)).

"[t]o regulate Commerce with foreign Nations, and among the several States."[6] The Supreme Court has determined that the Commerce Clause, in addition to being a positive grant of power to Congress, also acts to prevent certain state regulation that interferes with interstate commerce. *See South Carolina State Highway Dept. v. Barnwell Bros., Inc.,* 303 U.S. 177, 58 S.Ct. 510, 82 L.Ed. 734 (1938). This prohibition on state action is known as the "negative" or "dormant" Commerce Clause.

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[6]An example of Congress's regulation of interstate commerce is found in 15 U.S.C. § 381(a) (2000), which provides that,

> No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
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> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Of relevance to the instant case is the fact that in the last two years bills have been introduced in both houses of Congress to amend 15 U.S.C. § 381 to apply to, in addition to tangible property, all other forms of property, services, and other transactions fulfilled from a point outside the State. *See* H.R. 1956, 109th Congress (April 28, 2005); H.R. 4845, 109th Congress (March 2, 2006); S. 2721, 109th Congress (May 4, 2006). These bills have not been enacted into law.

The Supreme Court's interpretation of the dormant Commerce Clause "has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers." *Quill Corp. v. North Dakota,* 504 U.S. 298, 309, 112 S.Ct. 1904, 1911, 119 L.Ed.2d 91 (1992) (citation omitted). In tracing this evolution, the Court has explained:

> Our early cases, beginning with *Brown v. Maryland*, 12 Wheat. 419, 6 L.Ed. 678 (1827), swept broadly, and in *Leloup v. Port of Mobile*, 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. *See, e.g., Sanford v. Poe*, 69 F. 546 (CA 6 1895), *aff'd sub. nom., Adams Express Co. v. Ohio State Auditor,* 165 U.S. 194, 220 (1897). *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256-258, 58 S.Ct. 546, 549-550, 82 L.Ed. 823 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would "impos[e] a direct tax on interstate sales."

*Quill,* 504 U.S. at 309-310, 112 S.Ct. at 1911. The Court subsequently abandoned formal distinctions in favor of looking at the practical effects of state taxing statutes. In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), the Court set forth the current test for determining whether a state tax violated the Commerce Clause. This Court recognized the *Complete Auto* test in Syllabus Point 1 of *Western Maryland Ry. Co. v. Goodwin,* 167 W.Va. 804, 282 S.E.2d 240 (1981), where we held that,

> A state tax on interstate commerce will not be sustained unless it: "(1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate; and (4) is fairly related to the services provided by the State." *Maryland v. Louisiana*, [451] U.S. [725], [754], 101 S.Ct. 2114, 2133, 68 L.Ed.2d 576 (1981).[7] (Footnote added).

The current issue deals solely with the "substantial nexus" prong of the *Complete Auto* test. Specifically, we are asked to decide whether the substantial nexus standard can only be met by showing that the putative taxpayer has an actual physical presence in the taxing state. In answering this question, we must consider the Supreme Court's decisions in *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), *overruled, in part, Quill supra,*[8] and *Quill,* the Court's most recent pronouncement on state tax jurisdiction.

*Bellas Hess* involved an attempt by Illinois to require a mail-order business to collect and pay use taxes on goods purchased within the state. National Bellas Hess (hereinafter "National") was incorporated in Delaware and had its principal place of business in Missouri. It had neither outlets nor employees in Illinois. Twice a year, National mailed

[7]This test is referred to in *Maryland v. Louisiana* as the *Complete Auto* test and is generally known by that name. Therefore, we refer to it as the *Complete Auto* test in this opinion.

[8]*Quill* overruled *Bellas Hess* to the extent that *Bellas Hess* held that a showing of the taxpayer's physical presence in the taxing state was necessary to sustain the constitutionality of a sales and use tax against a challenge under the Due Process clause.

catalogues to the company's customers in Illinois. Orders for merchandise were mailed by customers to National's Missouri plant, and the ordered items were mailed to the customers either by mail or common carrier. National challenged the Illinois use tax levied against it on the basis, *inter alia*, that it created an unconstitutional burden on interstate commerce. The Supreme Court held that Illinois had no power to impose the use tax on National. The Court based its decision in part on the undue burden placed on interstate commerce by compliance with a host of administrative regulations governing the collection of sales and use taxes.

In 1992, the Supreme Court reaffirmed in *Quill* its *Bellas Hess* holding to the extent that *Bellas Hess* held that a showing of the taxpayer's physical presence in the taxing state was necessary to sustain a sales and use tax against a challenge under the Commerce Clause.[9] Quill was a Delaware corporation with offices and warehouses in Illinois, California, and Georgia. It sold office equipment and supplies, and solicited business through catalogs, flyers, advertisements in national periodicals, and telephone calls. Customers received their ordered merchandise from Quill through mail or common carrier. Despite the fact that Quill had no employees in North Dakota, and that its tangible property in North Dakota was "either insignificant or nonexistent," 504 U.S. at 302, 112 S.Ct. at 1907, Quill was required to collect a use and sales tax from its North Dakota customers and

[9]*See* fn. 8, *infra.*

remit it to the state. Quill challenged imposition of the tax on the ground that North Dakota did not have the power to compel it to collect a use tax from its North Dakota customers.

In addressing this issue, the Supreme Court first indicated that in determining the propriety of a state use tax on an out-of-state corporation "the nexus requirements of the Due Process and Commerce Clauses are not identical." 504 U.S. at 312, 112 S.Ct. at 1913.[10] The analysis under the Due Process Clause, explained the Court, is comparable to that used in determining whether a State can exercise personal jurisdiction over a person. Specifically, there must be "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." 504 U.S. at 306, 112 S.Ct. at 1909 (*quoting Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)). This is in order to ensure that imposition of a duty to collect a use tax on an out-of-state corporation does not offend traditional notions of fairness. Further, the Court found that the minimum connection is satisfied where the business "is engaged in continuous and widespread solicitation of business within a State[] [because] [s]uch a corporation clearly has fair warning that [its] activity may subject [it] to the jurisdiction of the foreign sovereign." 504 U.S. at 308, 112 S.Ct. at 1911 (internal quotation marks and citations omitted). The

[10]"*Quill* . . . was the first [Supreme Court] decision to bifurcate the Due Process and Commerce Clause analyses used to determine a state's jurisdiction to tax under the U.S. Constitution." Christina R. Edson, *Quill's Constitutional Jurisprudence And Tax Nexus Standards In An Age Of Electronic Commerce* 49 Tax Lawyer 893, 894 (Summer 1996).

Court concluded that the Due Process Clause does not require physical presence in a State for the imposition of a duty to collect a use tax.

The Commerce Clause and its nexus requirement, in contrast, explained the Court, "are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. . . . Accordingly, we have ruled that [the Commerce] Clause . . . bars state regulations that unduly burden interstate commerce." 504 U.S. at 312, 112 S.Ct. at 1913. (Citations omitted). "Thus, 'the substantial nexus' requirement is . . . a means for limiting state burdens on interstate conference." 504 U.S. at 313, 112 S.Ct. at 1913. The *Quill* Court ultimately concluded that for purposes of imposing on an out-of-state business the duty of collecting use and sales taxes on in-state customers, the *Complete Auto* substantial nexus prong would best be determined by application of a "bright-line, physical-presence requirement." 504 U.S. at 317, 112 S.Ct. at 1916.

The major question left open by the Supreme Court's opinion in *Quill* is the one that now confronts us: Does the physical presence requirement applicable to determining the constitutionality of requiring out-of-state mail-order houses to collect use taxes on in-state sales under the Commerce Clause extend to other types of state taxes? MBNA's position is that *Quill* extends to the business franchise and corporation net income taxes at issue. The Tax Commissioner posits, on the other hand, that physical presence is not a requirement of the substantial nexus standard in regards to the taxes at issue.[11]

After careful consideration of the parties' arguments, the relevant legal authority, and the Court's reasoning in *Quill,* we conclude that *Quill's* physical-presence requirement for showing a substantial Commerce Clause nexus applies only to use and sales taxes and not to business franchise and corporation net income taxes. There are several reasons for our conclusion. First, we agree with the Tax Commissioner that a close reading of *Quill* indicates that its reaffirmation of the *Bellas Hess* physical-presence test for use and sales taxes under the Commerce Clause is grounded primarily on *stare decisis.* For example, the Court in *Quill* notes that "[w]hile contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases." *Quill,* 504 U.S. at 311, 112 S.Ct. at

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[11]The Tax Commissioner cites several cases to this Court in support of its position that *Quill's* physical-presence requirement applies only to sales and use taxes including *Lanco, Inc. v. Director of Taxation,* 379 N.J.Super. 562, 879 A.2d 1234 (2005); *A&F Trademark, Inc. v. Tolson,* 167 N.C.App. 150, 605 S.E.2d 187 (2004), *cert. denied,* __ U.S. __, 126 S.Ct. 353, 163 L.Ed.2d 62 (2005); *Secretary, Dep't of Revenue, State of La. v. Gap (Apparel), Inc.,* 886 So.2d 459 (La.App. 2004); and *Geoffrey, Inc. v. S.C. Tax Com'n,* 313 S.C. 15, 437 S.E.2d 13 (1993). We find the persuasiveness of these cases to be limited, however, because the primary issue in each case is whether a state has jurisdiction to impose a state income tax on foreign corporations with no physical presence in the taxing state but whose intangibles, such as a trademark, are used in the state by a licensee. These courts reason, in part, that the intangibles located in the state provide a sufficient nexus for income tax purposes. In the instant case, there is no claim that MBNA has intangibles in West Virginia that provide a sufficient nexus for tax purposes.

1912. The Court further indicated that "the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry. The interest in stability and orderly development of the law that undergirds the doctrine of *stare decisis* therefore counsels adherence to settled precedent." *Id.*, 504 U.S. at 317, 112 S.Ct. at 1916 (internal quotations and citation omitted). Finally, the Court concluded that "the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law." *Id.*

This reasoning is supported by several legal commentators. *See* John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 Wm. & Mary L.Rev. 319 (October 2003) (arguing that the *Quill* Court relied on *stare decisis* rather than defending the physical presence test on the merits); Richard D. Pomp & Michael J. McIntyre, *State Taxation of Mail-Order Sales of Computers After Quill: An Evaluation of MTC Bulletin 95-1*, 11 State Tax Notes 177, 179-80 (July 15, 1996) (maintaining that *Quill* is essentially a political decision responding to concerns about retroactivity and the practical consequences of overruling *Bellas Hess*); Michael T. Fatale, *State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard*, 54 Tax Lawyer 105, 113 (Fall, 2000) (opining that "[a] primary basis for the [*Quill*] holding was the Court's conclusion that the mail order industry had grown in large part in reliance on *Bellas Hess*[,] [and] [b]ecause the *Bellas Hess* rule had become the 'basic framework' of a sizable industry) (footnotes omitted). Thus, because *Quill's* physical-presence test for sales and use taxes was based in large part on the mail order industry's reliance on *Bellas Hess*, we are not compelled to apply *Quill's* physical presence standard to the present circumstances.

Second, the Supreme Court appears to have expressly limited *Quill's* scope to sales and use taxes. First, the *Quill* Court noted that "[a]lthough we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule." *Quill*, 504 U.S. at 314, 112 S.Ct. at 1914. Also, the Court commented that "although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.*, 504 U.S. at 317, 112 S.Ct. at 1916. We believe that a reasonable construction of this language clearly implies that *Quill* applies only to sales and use taxes and not to other types of state taxes.[12]

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[12]One legal commentator has interpreted these portions of the *Quill* opinion to mean that,

> the Commerce Clause's physical presence requirement was not necessarily applicable to other tax types nor dictated by sound Commerce Clause jurisprudence and that the Court was motivated by principles of stare decisis flowing from *Bellas Hess*. It appears the Court intentionally left itself open for future decisions involving other types of taxes. Therefore, *Quill's* physical presence requirement may not apply to future non-use tax collection decisions.

(continued...)

Third, the *Bellas Hess* and *Quill* courts based their decisions in part on the fact that compliance with administrative regulations in the collection of sales and use taxes places an undue burden on interstate commerce. Specifically, the *Bellas Hess* Court explained:

> In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.
>
> . . . For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government.
>
> The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

*Bellas Hess,* 386 U.S. at 758-760, 87 S.Ct. at 1392-1393 (internal quotation marks and footnotes omitted). According to the Court, at the time *Bellas Hess* was decided, local sales taxes were imposed by over 2,300 localities, many of them accompanied by a use tax,

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[12](...continued)
Edson, 49 Tax Lawyer at 925.

utilizing several different rates. *Id.,* 386 U.S. at 759 fn. 12 and fn. 13, 87 S.Ct. at 1393 fn. 12 and fn. 13.[13]

The *Quill* Court likewise recognized the potential burden on interstate commerce posed by North Dakota's sales and use taxes.

> North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000- plus taxing jurisdictions.

*Quill,* 504 U.S. at 313 fn. 6, 112 S.Ct. at 1913 fn. 6, *citing Bellas Hess,* 386 U.S. at 759-760, 87 S.Ct. at 1393 (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations") (additional citation omitted).

In contrast to the sales and use taxes described in *Bellas Hess* and *Quill,* the franchise and income taxes at issue in this case do not appear to cause the same degree of compliance burdens. As noted above, the task of collecting taxes and remitting them to the

[13]In Edson, 49 Tax Lawyer at 911, it is noted that in 1996, when that article was written, there were over 6,100 state and local jurisdictions that imposed sales taxes using varied tax rates.

government demands knowledge of a multitude of administrative regulations, including various deductions and tax rates, as well as record-keeping requirements. Also, as a general matter, sales and use taxes must be remitted to the government on a more frequent basis than income and franchise taxes. For example, in West Virginia vendors are charged with the duty of collecting from purchasers the consumer sales and service tax and paying the tax to the Tax Commissioner on a monthly basis. This entails making out and mailing to the Commissioner a return for the preceding month on a prescribed form showing the total gross proceeds of the vendor's business during that time, the gross proceeds of the vendor's business upon which the tax is based, the amount of the tax for which the vendor is liable, and any further information necessary in the computation and collection of the tax which the Commissioner may require. *See* W.Va. Code § 11-15-16 (2003). In contrast, income and franchise taxes are paid by the business entity itself so that no collection duties are involved. Also, income and franchise taxes are generally paid annually. *See e.g.*, W.Va. Code § 11-23-9 (1996) (persons subject to business franchise tax shall make and file an annual return) and W.Va. Code § 11-24-13 (1993)[14] (requiring annual filing of corporation net income tax return).[15]

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[14]We note, however, that taxpayers whose liability for these taxes exceeds a specified amount are charged with paying estimated taxes for the taxable year on a quarterly basis. *See* W.Va. Code § 11-23-13 (1987).

[15]Of course, administrative regulations involved in the payment of any type of tax most likely would not be a concern today due to the common use of computers and the availability of specialized software.

Finally, we believe that the *Bellas Hess* physical-presence test, articulated in 1967, makes little sense in today's world. In the previous almost forty years, business practices have changed dramatically. When *Bellas Hess* was decided, it was generally necessary that an entity have a physical presence of some sort, such as a warehouse, office, or salesperson, in a state in order to generate substantial business in that state. This is no longer true. The development and proliferation of communication technology exhibited, for example, by the growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there. For this reason, we believe that the mechanical application of a physical-presence standard to franchise and income taxes is a poor measuring stick of an entity's true nexus with a state.

Accordingly, we now hold that the United States Supreme Court's determination in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), that an entity's physical presence in a state is required to meet the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.

Rather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for

Commerce Clause purposes. At least one legal commentator has suggested such a test and to some degree defined its parameters. *See* Edson, 49 Tax Lawyer at 943. According to this commentator, a substantial economic presence standard "incorporates due process 'purposeful direction' towards a state while examining the degree to which a company has exploited a local market." *Id.* Further, "[a] substantial economic presence analysis involves an examination of both the quality and quantity of the company's economic presence." *Id.*, 49 Tax Law. at 944. Finally, under this test, "[p]urposeful direction towards a state is analyzed as it is for Due Process Clause purposes," and the Commerce Clause analysis requires the additional examination of "the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.*, 49 Tax Law. at 945. We find this rationale persuasive and will apply it in determining the constitutionality of the taxes at issue.

First, however, we must address several objections proffered by MBNA to the application of any standard other than physical presence. Initially, MBNA contends that a greater nexus requirement should be applied to the imposition of direct taxes such as those at issue because such taxes are actually more burdensome. This is because sales and use taxes merely require an entity to collect the tax from consumers and remit the tax money to the government, thus suffering the administrative complications and inconvenience but not the cost of the tax. In sharp contrast, says MBNA, franchise and income taxes not only have compliance burdens but also must be paid from the entity's own pocket. For support, MBNA cites *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977), in which the Supreme Court distinguished between a use tax and a direct tax and implied that a higher Commerce Clause standard would be required to support the imposition of a direct tax.[16]

We do not agree with MBNA's argument on this issue. Notably, the Supreme Court's comment in *National Geographic Society* was dicta in that it was not necessary to the decision in that case. In contrast, the *Bellas Hess* and *Quill* Courts placed significant weight on the fact that there are substantial compliance burdens attached to the collection of sales and use taxes. Therefore, we reject MBNA's claim that the imposition of direct taxes is a greater burden than the duty to collect taxes so that the *Bellas Hess/Quill* physical-presence test should also apply to the imposition of the direct taxes at issue.[17]

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[16]Specifically, the Court in *National Geographic Society* reasoned that,

> The case for the validity of the imposition upon the out-of-state seller enjoying such services of a duty to collect a use tax is even stronger. The out-of-state seller runs no risk of double taxation. The consumer's identification as a resident of the taxing State is self-evident. The out-of-state seller becomes liable for the tax only by failing or refusing to collect the tax from that resident consumer. Thus, the sole burden imposed upon the out-of-state seller by statutes [imposing a use tax] is the administrative one of collecting it.

430 U.S. at 558, 97 S.Ct. at 1391 (citations omitted).

[17]MBNA notes that in *Western Maryland Ry. Co. v. Goodwin*, 167 W.Va. 804, 826, n. 3, 282 S.E.2d 240, 253 n. 3 (1981), this Court quoted with approval a party's brief for the
(continued...)

MBNA also argues that adoption of any substantial nexus requirement short of showing actual physical presence is in fact simply applying a Due Process minimum contacts standard in violation of *Quill* which expressly held that the Due Process and Commerce Clause analyses are separate. We disagree. The Due Process Clause requires merely some minimum connection between a state and the person, property or transaction it seeks to tax. In contrast, a substantial nexus under the Commerce Clause requires that an entity's contacts with the taxing state be more frequent and systematic in nature. Additionally, an entity's exploitation of the market must be greater in degree than under the Due Process standard so that its economic presence can be characterized as significant or substantial. In sum, although a substantial economic presence standard is by nature more elastic than the bright-line physical presence test, we are convinced that when properly applied, a greater nexus is required under the substantial economic presence standard that under the minimum contacts analysis.

Finally, MBNA avers that the only case from a foreign jurisdiction that is factually on point with the instant case is *J.C. Penney Nat'l Bank v. Johnson,* 19 S.W.3d

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[17](...continued)
proposition that "the form of the tax is irrelevant to the due process questions of nexus and state benefits." This statement does not inform our present analysis for several reasons. First, it is dicta. Second, it was prior to the Supreme Court's bifurcation of Due Process and Commerce Clause analyses. Finally, it was prior to the distinction made by the *Quill* Court between the test to be used in determining the constitutionality of sales and use taxes versus other types of state taxes.

831 (Tenn.Ct.App. 1999), in which the Tennessee appellate court applied the physical-presence test to Tennessee's attempted imposition of income taxes on an out-of-state credit card company. While we acknowledge that *J.C. Penney* is factually on point and addresses the same issue as the one before us, for the reasons set forth above we reject the reasoning in *J.C. Penney*, and decline to apply it to the instant case.[18]

We now turn our attention to the facts of the instant case to determine whether MBNA had a substantial nexus with this State during the time period in question. The record shows that MBNA continuously and systematically engaged in direct mail and telephone solicitation and promotion in West Virginia. Further, in tax year 1998, MBNA had significant gross receipts attributable to West Virginia customers in the amount of $8,419,431.00, and in tax year 1999, MBNA had significant gross receipts attributable to its West Virginia customers in the amount of $10,163,788.00. In light of these facts, this Court has no trouble concluding that MBNA's systematic and continuous business activity in this State produced significant gross receipts attributable to its West Virginia customers which

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[18]MBNA also argues that physical presence has been a base-line fact in every tax nexus case decided by the Supreme Court since *Complete Auto.* In other words, says MBNA, the Supreme Court has never upheld a finding of nexus in any case involving a state tax where the putative taxpayer had no in-state presence. It is equally true, however, as noted by the Commissioner, that no Supreme Court decision has applied the *Bellas Hess* physical presence requirement to a state income tax. Thus, we are not persuaded by MBNA's argument.

indicate a significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto.*[19]

Finally, prior to concluding, we simply wish to acknowledge the great challenge in applying the Commerce Clause to the ever-evolving practices of the marketplace. James Madison, Benjamin Franklin, and the other Framers at the Constitutional Convention who adopted the Commerce Clause lived in a world that is impossible for people living today to imagine. The Framers' concept of commerce consisted of goods transported in horse-drawn, wooden-wheeled wagons or ships with sails. They lived in a world with no electricity, no indoor plumbing, no automobiles, no paved roads, no airplanes, no telephones, no televisions, no computers, no plastic credit cards, no recorded music, and no iPods. Likewise, it would have been impossible for the Framers to imagine our world. When they fashioned the Commerce Clause, they could not possibly have foreseen the complex and varied ways that commerce is conducted today, especially via the internet and electronic commerce. It would be nonsense to suggest that they could foresee or fathom a time in which a person's telephone call to his or her local credit card company

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[19]MBNA also asserts that the circuit court confused the first prong of the *Complete Auto* test with the fourth prong in determining the validity of the taxes at issue. We need not decide this issue because this Court's analysis is based entirely on the "substantial nexus" prong of *Complete Auto.* It is axiomatic that "[t]his Court may, on appeal, affirm the judgment of the lower court when it appears that such judgment is correct on any legal ground disclosed by the record, regardless of the ground, reason or theory assigned by the lower court as the basis for its judgment." Syllabus Point 3, *Barnett v. Wolfolk,* 149 W.Va. 246, 140 S.E.2d 466 (1965).

would be routinely answered by a person in Bombay, India, or that a consumer could purchase virtually any product on a computer with the click of a mouse without leaving home. This recognition of the staggering evolution in commerce from the Framers' time up through today suggests to this Court that in applying the Commerce Clause we must eschew rigid and mechanical legal formulas in favor of a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense. This is what we have attempted to do herein.

## IV.

## CONCLUSION

In conclusion, for the reasons set forth above, we affirm the June 27, 2005, order of the Circuit Court of Kanawha County and conclude that West Virginia's imposition of its business franchise and corporation net income taxes on MBNA for the tax years 1998 and 1999, did not violate the Commerce Clause.

Affirmed.