No. 33049 *Tax Commissioner of the State of West Virginia v. MBNA America Bank, N.A.*

FILED
January 2, 2007
released at 3:00 p.m.
RORY L. PERRY II, CLERK
SUPREME COURT OF APPEALS
OF WEST VIRGINIA

Benjamin, Justice, dissenting:

In its opinion finding tax liability for an out-of-state corporation with no presence, tangible or intangible,[1] in West Virginia on income realized out-of-state by that corporation from accounts kept out-of-state, the majority, in its opinion, boldly goes where no court has gone before. In doing so, the majority relies not on bedrock constitutional principles or on established legal precedent, but rather on legal commentaries with thinly veiled state-favoring taxing agendas, a strained and inaccurate reading of the United States Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298,112 S.Ct. 1904, 111 L.Ed.2d 91 (1992), and a unilateral restatement of the important policy considerations which led to the inclusion of the Commerce Clause within the United States Constitution because, according to the majority opinion, the framers could not possibly have foreseen the future. The majority opinion gives legal sanction to a state taxing scheme which impermissibly burdens the interstate commerce of the nation. I therefore dissent.

There is no precedential support whatsoever for the conclusions reached by the

[1] See Majority Opinion, page 1 ("... MBNA has no real or tangible personal property ... in West Virginia.") and Note 11, page 12 (In the instant case, there is no claim that MBNA has intangibles in West Virginia that provide a sufficient nexus for tax purposes.")

majority decision. None. None at the state level. None at the federal level. Ignoring that our consideration here should be the effect of the tax in question on interstate commerce, rather than the type of tax it is, none of the rhetoric raised by the majority opinion explains why a state's imposition of a tax on an out-of-state corporation with no presence, tangible or intangible, on income realized from an out-of-state account does not adversely affect the nation's interstate commerce, an analysis identified by the United States Supreme Court as the cornerstone of constitutional jurisprudence. *Id.*; *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 112 S.Ct. 2251, 119 L.Ed.2d 533 (1992). The only state court decision on point with the specific credit card issues raised herein determined that the the State of Tennessee exceeded its taxing jurisdiction in attempting to collect taxes from an out-of-state corporation on income generated by out-of-state credit accounts. *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927, 121 S.Ct. 305, 148 L.Ed.2d 245 (2005);

State taxation of companies engaged in interstate commerce must comport with the Due Process and Commerce Clauses of the United States Constitution. In *Quill*, the United States Supreme Court emphasized that separate constitutional analyses are required in evaluating the validity of state taxes under each provision. *Quill*, 504 U.S. at 305 ("The two constitutional requirements differ fundamentally [and] reflect different constitutional concerns."). Though both the Due Process Clause and the Commerce Clause require an out-of-state taxpayer to have established a meaningful nexus with a given state to be the proper subject of taxation of that state, imposition of a tax on an out-of-state taxpayer may meet the less stringent nexus requirements of the Due Process Clause, yet fail to meet the more substantial nexus requirements of the Commerce Clause. *Id.* ("[W]hile a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause.")

Among the most fundamental precepts of state taxation from a Commerce Clause perspective is that there must be a "substantial nexus" between the interstate activity sought to be taxed and the taxing State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). Under *Complete Auto*, a state tax is permitted under the Commerce Clause if it (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. 430 U.S. at 279.[2] While I agree with my colleagues that the "substantial nexus" prong of this test is ripe for clarification by the United States Supreme Court, I disagree with them to the extent that the majority opinion finds insufficient guidance in the existing jurisprudence of the United States Supreme Court

[2] There is often overlap in the consideration of these four requirements. The "substantial nexus" requirement is said to protect against undue burdens on interstate commerce while fair apportionment is understood to guard against taxes which have the effect of "pass[ing] an unfair share of the tax burden onto interstate commerce." *Quill*, 504 U.S. at 313. In practical effect, the exercise of multiple taxation by several states under the apportionment standard may lead to apportionment issues which likewise should be considered under the "substantial nexus" standard.

to conclude that the State's present attempt to levy a tax on income realized outside the State by an out-of-state corporation with no presence, tangible or intangible, in the State violates the Commerce Clause.

Three years after deciding *Complete Auto,* the Supreme Court noted in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980), that for an application of state tax jurisdiction to be constitutional under the Due Process Clause, there must be: (1) nexus or some *minimal* connection between the taxing state and the activity from which the income is derived; and (2) a rational relationship between the income attributed to the taxing state and the interstate values of the enterprise. 445 U.S. at 436-7. These constitutional requirements were subsequently confirmed in *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 108 S.Ct. 1619, 100 L.Ed.2d 21 (1988), *Allied-Signal,* and *Quill*.

Reading *Complete Auto* and *Mobil Oil* together, one discerns two aspects to the consideration of nexus. First, there must be an adequate connection between the taxing state and the out-of-state corporation upon which a tax is being assessed; *i.e.*, a "presence" consideration. Second, there must also be an adequate connection between the taxing state and the event which gives rise to the claimed tax; *i.e.*, a "transaction" consideration.

Prior to the United States Supreme Court's decisions in *Allied-Signal* and *Quill*, some argued for a merging of the Due Process and Commerce Clause nexus considerations through application of a so-called "economic exploitation" nexus consideration. *Quill* establishes that, for Commerce Clause purposes, a higher presence nexus is required than the minimal nexus connection required for Due Process purposes. In other words, a corporation's "presence" may suffice for taxing jurisdiction under the minimal Due Process nexus test, but fail to meet the "substantial" higher presence nexus test required by the Commerce Clause.

We must assume that the United States Supreme Court chose its words carefully in setting forth the first prong of the *Complete Auto* test, that the tax in question is sought by the taxing state to be applied "to an activity" with a substantial nexus with the taxing state. Even if the majority opinion was correct, which I believe it was not, that MBNA's interstate activities constitute a sufficiently high showing of presence to permit taxing jurisdiction under the "substantial" nexus test of the Commerce Clause, the majority opinion simply reaches the question of whether the State of West Virginia may seek to tax MBNA as an out-of-state corporation. The majority opinion completely fails to consider the effect of the tax on interstate commerce. On this second question of whether a state can impose tax on income generated out-of-state, the majority opinion likewise fails. Here, there is no question but that the credit card accounts which give rise to MBNA's income are located outside West Virginia.

I must admit to being intrigued by the majority opinion's description of its nexus requirement as a "significant economic presence test" as much for its vagueness as for its embodiment as the antithesis of the "bright line" standards set forth by the United States Supreme Court in *Quill* and *National Bellas Hess v. Department of Revenue of Illinois*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), *overruled, in part, by Quill*. The reality is that by endorsing a nexus standard which permits West Virginia to assess a tax on an out-of-state corporation with no property, tangible or intangible, in this state on income realized from credit accounts maintained and serviced in another state, the majority merges the nexus requirements of the Due Process Clause and the Commerce Clause and effectively returns to the merged nexus jurisprudence of 1967, in *Bellas Hess*, albeit with the minimal due process requirements now carrying the day for nexus determination rather that the physical presence requirement of *Bellas Hess*. While MBNA may meet the minimal nexus requirement for it to be on notice from a due process basis that it may be subject to taxation, the majority opinion fails to show how the out-of-state credit account, which is the basis for the income sought to be taxed, meets the substantial nexus requirements of *Complete Auto* and *Quill*. Indeed, one might seriously question the due process basis for West Virginia's attempted actions herein.[3]

[3] One might well argue that the State of West Virginia, under the facts of this case, is attempting to engage in extraterritorial taxation. "Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S.Ct. 2933, 2939, 77 L.Ed.2d 545, 552 (1983) (quoting *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315, 102 S.Ct.3103, 3108, 73 L.Ed.2d 787, 794 (1982)).

The majority opinion attempts mightily to distinguish between forms of taxes, such as sales and use taxes on the one hand, and income and franchise taxes on the other hand, in attempting to defend its disregard for the substantial nexus standards required in *Quill*. The majority's argument appears to be that because the instant case concerns the taxation of income realized by an out-of-state corporation from accounts in Delaware and because *Quill* instead involved use and sales taxes from purchases made by purchasers within the taxing state with delivery of goods to occur also within the taxing state, this Court is at liberty to disregard those parts of *Quill* with which it disagrees. This argument is not persuasive. In so disregarding the substantial nexus requirements of *Quill* because *Quill* involved use and sales taxes, it is interesting that the majority opinion nevertheless fully embraces the precedent of the United States Supreme Court in *Complete Auto*, a case which also involved use and sales taxes – not income taxes. Perhaps the real dichotomy here may not be between sales and income taxes, with the relevant question being when is a tax not a tax, but how the limitations set forth in the United States Constitution can be avoided to provide the State with a better opportunity to expand its taxing opportunities.

The reality is that the United States Supreme Court has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved. Rather, the United States Supreme Court has focused instead on the effect of the tax which the taxing state seeks to levy on interstate commerce, regardless of the type of tax.[4] Indeed, there is no immediately clear doctrinal foundation which can be observed for distinguishing sales and use tax collection on sales between states from income taxes sought to be collected from out-of-state companies for income realized from out-of-state intangible accounts simply because the out-of-state corporation availed itself of the United States mails and other forms of interstate communication.[5]

The jurisprudential reality is that the United States Supreme Court has never held in any state tax case that the nexus requirements of the Commerce Clause can be satisfied in the absence of a taxpayer's physical presence in the taxing state. The principles of *stare decisis* are no less relevant to state taxes in general, than they are to sales and use taxes particularly, when Congress has the ultimate power to prescribe the appropriate law in this area. *See*, *Quill*, 504 U.S. at 316-17. Cases decided by the United States Supreme Court both before and after *Quill* have made it clear that a substantial nexus is required for the

[4] In *Tyler Pipe Industries v. Washington State Department of Revenue*, 479 U.S. 1015, 107 S.Ct. 664, 93 L.Ed.2d 717 (1986), the tax in question was a business and occupation tax. The Court framed the nexus question as whether the activities performed in the taxing state on behalf of Tyler Pipe was significantly associated with Tyler Pipe's ability to establish and maintain a market for its sales. This case involved the imposition of a direct tax, similar to the income tax at issue herein.

[5] In *Quill*, the Supreme Court while noting that it had not "in our review of other types of taxes, articulated the same physical presence requirement that *Bellas Hess* established for sales and use taxes," stated that "silence does not imply repudiation of the *Bellas Hess* rule." *Quill*, 504 U.S. at 314. In *Bellas Hess*, the Supreme Court described its decision in *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), a case involving a corporation physically present in the taxing state, as the Court's "furthest constitutional reach to date" of subjecting a corporation to state taxing. *Bellas Hess*, 386 U.S. at 757.

imposition of *any* state tax on an out-of-state corporation. *See, Allied-Signal*, 504 U.S. at 778 ("The constitutional question in a case such as *Quill Corp.* is whether the State has the authority to tax the corporation at all."); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981) ("Under this threshold test, the interstate business must have a substantial nexus with the State before *any* tax may be levied on it.") It would be a strange constitutional doctrine that would countenance one nexus standard for sales and use taxes under the Commerce Clause, and a more relaxed nexus standard for corporate net income and other state taxes.[6]

In the first place, it does not appear that the differences between the use tax collection obligation and liability for income taxation are so significant as to justify different rules under the Commerce Clause. It is certainly difficult to see distinctions that give effect to physical presence as a necessary element for "substantial nexus" for some taxes and not for others. Arguably, the collection of use and sales taxes involves no more complexity than the determination of individual state income tax liability for a multistate corporation involved in interstate commerce where each taxing state has separate laws and seeks to maximize the

[6] Contrary to the apparent contempt held by some for the benefits of "bright line" rules which avoid undue burdens on interstate commerce by the demarcation of a discrete realm of commercial activity that is free from interstate taxation, one might consider not only the settled expectations of taxpayers, but also the benefit to the national economy that such "bright lines" have been in the development of that economy over the last several decades. Surely interstate commerce is as worthy of protection from improper income and other taxes as it is from sales and use taxes. *See, Quill*, 504 U.S. at 315.

definition of that which each such state contends may be taxed from out-of-state.[7] Arguably, if taxes should be treated differently under the Commerce Clause based on what the taxing state claims to tax rather than on the tax's actual impact on interstate commerce, one might well argue that something more than a due process minimal nexus standard should be considered for non-transactional taxes such as income taxes. Under such an argument, one might be tempted to argue that the minimum nexus standard for due process considerations in cases such as *Quill*, which involved transactions which had a tangible connection with a given state, were not intended to also apply to income taxes which a taxing state sought to apply to income generated by accounts located outside the taxing state. As this endeavor demonstrates, the same speculation which the majority employs to attempt to differentiate "substantial nexus" standards based on tax types could be alternatively applied in any number of ways not so attractive to taxing states. Absent precedential support for differentiating "substantial nexus" standards based upon tax types, this Court should resist the State's invitation for us to speculate based on semantics and, instead, focus on the effect which the state tax has on interstate commerce – here, attempting to levy an income tax on an out-of-state corporation with no property, tangible or intangible, in West Virginia where the income

[7] Assume for the moment that a Delaware bank maintains a credit account for a customer with a Weirton, West Virginia mailing address. Assume further that that customer travels to Steubenville, Ohio and, using his credit account, makes a sizeable electronic purchase with the intent of paying for his purchase over several months. At the end of the month, the customer electronically pays a portion of his credit account balance from his place of employment using funds he has in his Pittsburgh, Pennsylvania bank account. In such a scenario, which fully involves the interstate nature of today's economy, how should the Delaware bank maintain its records for determination of income taxes?

in question was generated from credit accounts held outside of this state.

The majority opinion also claims that a variety of changes – changes which it claims were not of a type which could be foreseen by the framers of the United States Constitution – support their extension of state tax jurisdiction into a realm considered by all others to be unconstitutional. Initially, I note some measure of foreboding anytime a court invokes the "foreseeability of the framers'" as a basis for a decision – fear not because the rule of *stare decisis* is about to be followed by the court, but rather because the court is about to engage in some form of legislative activism for which the only support is political, not legal.[8] Here, the rationale for the majority's "economic exploitation" nexus approach, which might more accurately be termed a "tax it if you can follow it, even if it is earned in another state" nexus approach, rings remarkably like the arguments set forth in Justice Fortas' dissent in *Bellas Hess*. In his dissent to the 1967 case, Justice Fortas advocated for an "economic exploitation nexus" test for state taxing jurisdiction. *Bellas Hess*, 386 U.S. at 761-62. Justice Fortas argued that Bellas Hess should be subject to the taxing jurisdiction of Illinois because of its "large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market." *Id.*, at 761. Furthermore, Justice Fortas argued that Bellas Hess enjoyed

[8] I must admit to some disdain for the rather elite nature of "foreseeability of the framers" arguments. Frequently, such invocations serve no purpose other than an attempt to excuse legislating from the bench. Other times, such invocations simply serve as the argument of last resort by courts searching for a legal basis to justify result-based decision-making. Caution should by necessity be the watchword when any court seeks to expand the power of the State on the basis of the "foreseeability of the framers" argument.

". . . the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein." *Id*., at 762. I find it remarkable that our Court now endorses this same position – a position which the United States Supreme Court has rejected.

Yet our Court has not been the only court to embrace Justice Fortas' arguments. So too did the North Dakota Supreme Court, in its decision in *Quill*. Therein, that state supreme court, also claiming changes in society and economy, stated that ". . . within the context of contemporary society and commercial practice, we conclude that the concept of nexus encompasses more than mere physical presence within the state, and that the determination of nexus should take into consideration all connections between the out-of-state seller and the state, all benefits and opportunities provided by the State, and should stress economic realities rather than artificial benchmarks." *State by and through Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 215 (N.D. 1991), *rev'd*, 504 U.S. 298, 112 S.Ct. 1904, 111 L.Ed.2d 91 (1992). As *Quill* demonstrates, when given the chance to again consider the "economic exploitation" nexus argument, the United States Supreme Court once again declined.

While the majority herein apparently believes, as did the North Dakota Supreme Court in *Quill*, that it may disregard the actual nexus decisions of the United States Supreme Court in favor of a theoretical nexus argument which favors the State's ability to reach out and tax income generated out-of-state by an out-of-state corporation with no presence, tangible or intangible, in West Virginia, I believe the sage reminder of Justice Scalia (joined in by Justices Kennedy and Thomas) should serve as a reminder of our duty in considering this case:

> We have recently told lower courts that "[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S.Ct. 1917, 1921, 104 L.Ed.2d 526 (1989).

Quill, 490 U.S. at 303. We would do well to follow the precedent that is applicable herein and not attempt to anticipate an overruling by the United Supreme Court of its prior jurisprudence. The taxes in question are unconstitutional.