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The Constitutionality of Federal Preemption of State Taxation of Internet Transactions

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THE CONSTITUTIONALITY OF FEDERAL PREEMPTION OF STATE TAXATION OF INTERNET TRANSACTIONS

INTRODUCTION

With the global expansion of the Internet, the business world has found the "information superhighway" a very useful tool in marketing and selling their products.[1] The Internet allows access to new buyers not otherwise purchasing goods and services due to geographical constraints.[2] With the expanding use of the Internet as a business tool for selling products, states have become more aggressive in ensuring Internet businesses comply with their tax laws. This is due to several factors. First, states view the Internet as a new source of tax revenue on sales not previously made in the state through other mediums.[3] Next, states are concerned that not taxing the Internet will lead to a large loss of revenue as companies change from doing business through catalogs, magazines, and stores to the Internet.[4] For these reasons, taxation of Internet transactions is viewed as vital to a state's interest.[5]

States tax purchases through sales and use taxes.[6] A levy on privilege of using, within taxing state, property purchased outside the state, if the property would have been subject to the sales tax had it been purchased at home. Such tax ordinarily serves to complement sales tax by eliminating incentive to make

1. Wendy R. Leibowitz, *Taxman Has Interest In Internet Biz*, THE NAT'L L.J., March 16, 1998, at B1.

2. Wendy Grossman, *Connected: Why The Net Won't Deliver World Peace*, THE DAILY TELEGRAPH, Dec. 9, 1997, at 10.

3. Frank James, *Lawmakers Introduce Pre-emptive Bill In Bid To Keep Cyberspace Tax-free*, CHI. TRIB., Mar. 14, 1997, at 11.

4. Shawn Zeller, *The Squabble Over Internet Taxes*, THE NAT'L J., Dec. 13, 1997, at 2520.

5. Doug Sheppard, *League Of Cities Marks Internet Tax Freedom Act for Extinction*, 98 TAX NOTES TODAY, Mar. 10, 1998, at 46-5.

6. Sales Tax - A state or local level tax on the retail sale of specified property or services. It is a percentage of the cost of such. Generally, the purchaser pays the tax, but the seller collects it, as an agent for the government. Various taxing jurisdictions allow exemptions for purchases of specified items, including certain foods, services, and manufacturing equipment. If the purchaser and seller are in different states, a use tax usually applies. BLACK'S LAW DICTIONARY 1339-40 (6th ed. 1990).

Use tax - A sales tax that is collectible by the seller where the purchaser is domiciled in a different state. A tax on the use, consumption, or storage of tangible property, usually at the same rate as the sales tax, and levied for the purpose of preventing tax avoidance by the purchase of articles in a state or taxing jurisdiction which does not levy sales tax or has a lower rate.

major purchases in states with lower sales taxes; it requires resident who shops out-of-state to pay use tax equal to sales tax savings. BLACK'S LAW DICTIONARY 1544 (6th ed. 1990). To impose a use tax on a nonresident purchaser, a state must meet the requirements of the Due Process Clause and the Commerce Clause of the United States Constitution.[7] To meet the requirements of the Due Process Clause, a person or entity must have "minimum contacts" with the taxing jurisdiction.[8] To meet the requirements of the Commerce Clause, (1) a person or entity must have "a sufficient nexus" with the taxing jurisdiction; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to services provided by the state.[9] Due to differing interpretations of "minimum contacts" and "sufficient nexus", especially in light of the recent case of *Quill v. North Dakota*,[10] there is significant controversy as to whether states can tax nonresident purchasers of goods and services through the Internet.[11]

For this reason, legislation called the "Internet Tax Freedom Act", has recently been passed which imposes a three year moratorium on all state and local taxation of Internet transactions.[12] Congress asserts it has jurisdiction to impose this ban, under Article I, Section 8, of the United States Constitution,[13] because the Internet is inherently a matter of interstate commerce.[14] Congress also asserts there is a need for this legislation due to state and local governments imposing "inconsistent and inadministrable" taxes on Internet transactions.[15] Congress asserts that a single transaction could be subject to more than 30,000 taxing jurisdictions throughout the United States.[16]

States argue that a moratorium on state and local taxation of the Internet would violate their 10th Amendment rights,[17] as defined in the recent cases of *United States v. Lopez*[18] and *New York v. United States*.[19] The states argue that

7. Nat'l. Bella Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 756-57 (1967).

8. Miller Bros. Co. v. Md., 347 U.S. 340, 344-45 (1954).

9. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

10. Quill Corp. v. N.D., 504 U.S. 298 (1992).

11. Doug Sheppard, *Proposed Internet Act a Natural for Debate at Electronic Commerce Seminar*, 14 STATE TAX NOTES, Feb. 9, 1998, at 455.

12. Internet Tax Freedom Act, Pub. L. No. 105-277 (Title XI of the Omnibus Consolidated and Emergency Appropriations Act of 1998).

13. U.S. CONST. art. I, § 8, cl. 3 (Authorizes the Congress "[t]o regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes[.]").

14. H.R. 4328, at § 2(1); S. 442 at § 2(1).

15. H.R. 4328, at § 2(4); S. 442, at § 2(4).

16. H.R. 4328, at § 2(7); S. 442 at § 2(7).

17. Doug Sheppard, *National League of Cities Airs Concerns About Proposed Internet Act*, 14 STATE TAX NOTES, Jan. 26, 1998, at 271.

18. United States v. Lopez, 514 U.S. 549 (1994)(In Gun-Free School Zones Act of 1990, 18 U.S.C. §922(2)(1)(A) (1988), Congress made it a federal offense to possess a firearm in a school zone).

a moratorium on state and local taxation of the Internet would invade the rights of the states to perform one of their basic functions as states, to raise revenue to fund state functions.[20]

This Comment will examine why Congress became involved in state and local taxation of the Internet and the constitutional issues involved with federal preemption of state taxation of the Internet. First, the history of the Internet will be discussed. Second, this comment will address the constitutional issues involved with Internet taxation under the Due Process Clause and the Commerce Clause. Third, arguments for and against preemption of state and local taxation of the Internet will be set forth. Finally, this Comment will advocate why the "Internet Tax Freedom Act" is an invalid use of congressional power to preempt state taxation of the Internet.

HISTORY OF THE INTERNET

The Internet began with early research on packet switch networks and a computer system called ARPANET.[21] The first ARPANET system, which was intended for use in the Department of Defense, linked four computer systems together in 1969.[22] In 1972, electronic mail was introduced to the system and the innovation of an "open-architecture" system was introduced which would allow each computer to stand on its own and interact with the Internet.[23] In the early 1980's, the Internet was introduced to vendors for use by the public and the first Internet user workshop took place in 1985.[24] The "World Wide Web" was created in 1994.[25] From then on, the Internet has grown almost exponentially, with an estimated 19,500,000 host sites in July 1997[26] and 40-60 million users.[27] Internet sales in 1997 were estimated to be $8 billion.[28] Additionally, it is estimated that sales in the year 2000 will be $220 billion.[29] The Internet is the most visible symbol of multimedia; including video, data, and audio trans-

19. New York v. United States, 505 U.S. 144 (1992)(In the Low-Level Radioactive Waste Policy Amendments Act of 1985 (Pub. L. No. 99-240, 99 Stat. 1942, 42 U.S.C. § 2021), Congress asserted authority under Commerce Clause to regulate state disposal of radioactive waste).

20. *See* Sheppard, *supra* note 5.

21. BARRY M. LEINER, ET. AL., A BRIEF HISTORY OF THE INTERNET, 1 (1997)(*See* http://www.isoc.org/internet-history).

22. *Id.* at 3.

23. *Id.*

24. *Id.* at 12.

25. *See* LEINER, *supra* note 21 at 14.

26. NETWORK WIZARDS, INTERNET DOMAIN SURVEY (July 1997)(*See* http://www.nw.com/zone/WWW/report.html).

27. *See* Leslie Miller, *Net Surfers Becoming More Mainstream, Survey Shows*, USA TODAY, Aug. 14, 1996, at D1; Leslie Miller, *1 in 4 Now Using the Net*, USA TODAY, Dec. 11, 1997, at 1A.

28. *See* Leibowitz, *supra* note 1.

29. *See* Leibowitz, *supra* note 1.

missions over one pathway to a user.[30] The Internet is a high-speed network of computers linked by wireless systems to virtually anywhere in the world.[31] With this expansive growth and the ability to reach new users, the Internet has much potential for different uses in the business world.

For these many different reasons, and due to the dramatic increase in the use of the Internet for businesses, the issue of state taxation of transactions over the Internet has become a very hot topic in recent politics.[32]

THE CONSTITUTIONAL PROBLEM WITH STATE TAXATION OF THE INTERNET

A use tax reaches sales made outside state borders, by resident purchasers, where a sales tax cannot be imposed.[33] A use tax puts in-state and out-of-state sellers on a level playing field by imposing an equal tax on equivalent transactions.[34] However, to impose a use tax, states must meet standards prescribed by the Due Process Clause and the Commerce Clause of the United States Constitution.[35] Several recent United States Supreme Court cases have set the requirements to comply with these standards.[36]

To comply with the requirements of the Due Process Clause, a taxpayer must have "minimum contacts" with the taxing jurisdiction.[37] Minimum contacts require "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax".[38] Applying the principles of *Burger King Corp. v. Rudzewicz*, in *Quill Corp. v. North Dakota*, the Supreme Court has held that if any foreign corporation purposefully avails itself of the benefits of a forum state, "it may subject itself to the state's in personam jurisdiction even if it has no physical presence in the state".[39] Under this test, the Due Process Clause is not the issue in taxation of the Internet.

In order to comply with the requirements of the Commerce Clause, the test set forth in *Complete Auto Transit, Inc. v. Brady*,[40] as clarified in the recent case of Quill,[41] must be met. Complete Auto established a four-prong test for

30. *See* 47 U.S.C. § 230(e)(1) (1997) (for definition of the Internet); *see also* Edmund Lee, *Cyber-Whaa?*, THE VILLAGE VOICE, Jan. 21, 1997, at 24; LEINER, *supra* note 21.

31. *See* 47 U.S.C. § 230(e)(1) (1997).

32. *See* Sheppard, *supra* note 5.

33. *See* BLACK'S LAW DICTIONARY 1544 (6th ed. 1990).

34. *Id.*

35. *Nat'l Bella Hess, Inc.*, 386 U.S. at 756-57.

36. *See Quill*, 504 U.S. at 298; *see also* Goldberg v. Sweet, 488 U.S. 252 (1989); Oklahoma Tax Comm'n. v. Jefferson Lines, Inc., 514 U.S. 175 (1995).

37. International Shoe Co. v. Washington, 326 U.S. 310 (1945).

38. *Miller Bros.*, 347 U.S. at 344-45.

39. 504 U.S. at 307-08.

40. 430 U.S. at 274.

41. 504 U.S. at 298.

deciding whether a state use tax meets or violates the Commerce Clause.[42] This test requires a tax to meet the following four requirements to be valid under the Commerce Clause: "(1) the tax is applied to an activity with a "substantial nexus" with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to the services provided by the state."[43] Due to differing concerns of the Commerce Clause,[44] the Commerce Clause test has been interpreted to be a more comprehensive test than that of the Due Process Clause.[45] Taxation of the Internet is concerned with whether or not a business that has no contact with the state, except through the use of the Internet, is subject to a duty to collect and pay taxes.[46] In determining this, the two tests set forth above for the Due Process Clause and the Commerce Clause are the determining factors.

A "BRIGHT-LINE" RULE IS SET

The requirement for "physical presence" to acquire a "substantial nexus" under the Commerce Clause was first expressed in *National Bella Hess, Inc. v. Department of Revenue of Illinois*.[47] This case held that it was unconstitutional for any state to impose a use tax collection duty on a seller whose only connection with customers in the taxing state was by common carrier or mail.[48]

Later, in *Quill v. North Dakota*, the Supreme Court held that the rule of National Bella Hess, Inc. was still valid when it held it is unconstitutional to impose a tax collection obligation on an out-of-state mail-order house with no "physical presence" in the taxing state.[49] In *Quill*, the taxpayer was a Delaware corporation with offices and warehouses in Illinois, California, and Georgia.[50] Quill sold office equipment and supplies through catalogs and flyers and had sales of $1 million in North Dakota to 3000 customers.[51] It delivered all of its orders via mail or common carrier from out-of-state locations.[52]

The Court found that the taxpayer, Quill, had met the requirements of the Due Process Clause since it had "purposely directed" its activities at North

42. 430 U.S. at 279.

43. *Id.*

44. 504 U.S. at 312 (the Commerce Clause is concerned with state regulation of the national economy to secure a national market unimpeded by state-imposed burdens across state lines).

45. *Id.* at 312-13.

46. *See generally* Dave Lesher, *Political Odd Couple Back Internet Tax Ban*, L.A. TIMES, June 9, 1997, at A3.

47. 386 U.S. at 758.

48. *Id.*

49. 504 U.S. at 312.

50. *Id.* at 302.

51. *Id.*

52. *Id.*

Dakota.[53] But the Court also found that, for purposes of the Commerce Clause, Quill did not have a "sufficient nexus" with North Dakota since the test for nexus was narrower than the minimum contacts test for the Due Process Clause.[54] The Court held that "physical presence" was needed to impose a duty of taxation upon an entity.[55] Since Quill had no offices, warehouses, or employees in North Dakota, and it had no other physical presence in the state, it was not subject to a use tax collection duty.[56] The Court held that a common carrier or the mail system does not give a taxpayer the "physical presence" needed to be subject to a use tax collection duty.[57]

Quill sets forth a bright-line "physical presence" requirement before a state can impose a duty on an out-of-state business to collect use taxes on sales.[58] But the fundamental issue *Quill* does not answer for purposes of taxing the Internet, is "What is considered physical presence?". Does having computers in a state give a taxpayer sufficient nexus? Does using a service provider (which would be considered a taxpayer's agent) for Internet services give a taxpayer nexus with a state? Service providers, such as "CompuServe, Inc.", have mainframes and computer systems in every state.[59] Therefore, does this mean since a business has an Internet services contract with a provider this gives the business a "sufficient nexus" in a state?

NEXUS BY AGENCY

In the first case to set forth a possible end run around the "physical presence" test of *Quill*, the Supreme Court held that an out-of-state mail-order seller did have sufficient contacts with the state of California, through an agent, to be subject to a use tax collection duty.[60] In *National Geographic Society*, a nonprofit scientific and educational corporation maintained two offices in California that made solicitations for the company's magazine.[61] However the offices performed no activities related to the separate mail-order business.[62] All orders were mailed from California to the Washington, D.C. office and the magazines were delivered by mail.[63] California asserted that the offices were enough to provide a nexus between the out-of-state seller and the state to im-

53. 504 U.S. at 312.
54. *Id.* at 312-13.
55. *Id.* at 314.
56. *Id.* at 301-02.
57. *Id.*
58. 504 U.S. at 314-18.
59. *State Should Be Able To Tax On-Line Computer Services, MTC Official Says*, 118 BNA DAILY TAX REPORTS, June 20, 1995, at D3 [hereinafter *State Should Be Able*].
60. Nat'l Geographic Soc'y v. California Board of Equalization, 430 U.S. 551, 562 (1977).
61. *Id.* at 552.
62. *Id.*
63. *Id.*

pose use tax collection liability.[64] The society argued its only contacts were by means of a common carrier or the mail and that the offices played no part in its mail-order activities.[65] Therefore, they asserted they did not have enough presence to allow the state to impose use tax collection liability on them.[66]

The Court held that the requisite nexus was present since the out-of-state sales were arranged by the society's in-state local agents.[67] The Court held that a "slight presence" would not be enough to allow a state to impose a collection obligation, but the maintenance of a continuous relationship with the state constituted a sufficient nexus to allow the imposition of a use tax collection obligation.[68] Among the many cases cited by the Court for their "agency theory" of nexus were *Scripto, Inc. v. Carson*,[69] *Standard Pressed Steel v. Washington Revenue Department*,[70] *Felt & Tarrant Manufacturing Co. v. Department of Revenue of Washington*,[71] and *General Trading Co. v. Tax Comm'n. of Iowa*.[72].[73] These cases all found a sufficient nexus with a state through the connections of agents. In fact, in Standard Pressed Steel, the Court found a sufficient nexus merely through one employee in a state.[74]

In the application of this theory to the world of the Internet, the states can assert a broad interpretation of what constitutes a sufficient nexus through an agent. States can apply the agency theory through commercial online services to find a sufficient nexus wherever the service provider has computer systems providing transmission services to a business on the Internet. Since the service provider is the in-state distributor of information for the business, the state can assert that the information services provider is the agent of the business and find nexus with almost any state.

For example, suppose some business contracts with CompuServe, Inc. to provide Internet services for their company and CompuServe, Inc. has locations in all fifty states.[75] Since the Internet does not have barriers, the information on the webpage is transmitted to all fifty states via CompuServe com-

64. *Nat'l Geographic Soc'y*, 430 U.S. at 553-54.

65. *Id.* at 560.

66. *Id.*

67. *Id.* at 556.

68. *Nat'l Geographic Soc'y*, 430 U.S. at 556.

69. 362 U.S. 207 (1960)(holding that a corporation without an office or place of business in Florida, but with ten broker-agents who solicited sales, had nexus with the state).

70. 419 U.S. 560 (1975)(holding a business with one home-based employee in the taxing state, has nexus with the state).

71. 306 U.S. 62 (1939)(holding a business which has office or employees in the taxing state, but has agents that solicite orders within the state, has nexus with the state).

72. 322 U.S. 335 (1944)(holding a Minnesota corporation solicited business in Iowa, with no other contacts with the taxing state, has nexus with the state).

73. 430 U.S. at 556-57.

74. 419 U.S. at 562.

75. *State Should Be Able*, *supra* note 59, at D3.

puter systems. Subsequently, one customer in each of the fifty states buys a product from the business which is shipped via a common carrier. Through the agency theory of nexus, CompuServe physical presence through computer systems in all fifty states would allow all states to assert a duty on the business to collect use taxes. This would be the result despite the fact that the business has no other contacts with the state other than the one customer.

As indicated above, the use of the agency theory of nexus allows for almost unlimited liability for any communications over the Internet and imposes liability for use taxes on any online company.

NEXUS THROUGH DELIVERY

The most important case in favor of the states' efforts to tax Internet transactions is *Goldberg v. Sweet*.[76] In *Goldberg*, the question was whether taxation of a telephone call that originated or terminated in a state, and was charged to an in-state billing address and telephone number, was contrary to the Complete Auto test.[77]

The Supreme Court relied mostly on the fair apportionment prong of the Complete Auto test in its opinion which requires a tax to be both internally and externally consistent.[78] To be externally consistent, a state must only tax that portion of revenue that reflects the in-state component of the activity.[79] To be internally consistent, a tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result.[80]

The Court referred to the nexus issue and expressed doubt as to whether a sufficient nexus to tax a call existed in states through which the electronic signal of the telephone call traveled.[81] The Court found only two states had a sufficient nexus to tax the call: the originating state and the delivery state. This nexus only existed when the call was charged to a service address within the state of origin.[82] Therefore, the Court concluded the risk of unfair apportionment was virtually nonexistent since there was the presence of a credit for taxes paid to other states.[83]

Therefore, in the context of nexus, *Goldberg* stands for the proposition that any state has a substantial nexus to tax a transaction where (1) the service originates or terminates in the state; and (2) the service is charged to an address

76. 488 U.S. 252 (1989).
77. *Id.* at 257.
78. *Id.* at 261.
79. *Id.* at 262.
80. 488 U.S. at 261.
81. *Id.* at 262-63.
82. *Id.* at 263.
83. *Id.* at 263-64.

within the state.[84] This theory of nexus can be called "nexus through delivery".[85]

Another case which uses the test set forth in *Goldberg is Oklahoma Tax Comm'n. v. Jefferson Lines, Inc*.[86] In *Jefferson Lines*, a common carrier did not collect a state sales tax on bus tickets sold in Oklahoma for interstate travel originating in Oklahoma.[87] The state of Oklahoma asserted a tax was due on the entire bus ticket, without apportionment to other states through which the bus traveled.[88]

The Supreme Court held the tax constitutional under the Commerce Clause by concluding that there was no risk of multiple taxation by other states since the sale had taken place in Oklahoma.[89] The Court cited *Goldberg* holding that the state in which the sale is consummated is the state which has the necessary nexus to collect a tax on the transaction.[90] Therefore, the Court relied on the nexus prong of the Complete Auto test in finding that a sales tax on interstate transportation, although unapportioned, which is paid at the point of origination is constitutional.[91] Again, the Court used a two-part test in finding a substantial nexus.[92] First, there must be a billing address in the state of origination.[93] Second, the service must originate or terminate in that state.[94]

In the context of the Internet, the *Goldberg* standard sets forth a useful test to determine whether a state has a sufficient nexus to allow taxation of a transaction by the state. Under the *Goldberg* test, a billing address would be required.[95] Since businesses providing goods or services via the Internet could always require a billing address before those services or products are provided to a customer this element is easily met. Many businesses providing goods and services over the Internet already require the customer to provide some sort of identification for billing purposes, i.e. credit verification. This would be no different if an additional use tax is collected as part of the consideration paid at the time of a transaction.

Credit cards are the main method of payment on the Internet. During a transaction, the customer gives the company the credit card information and

84. 488 U.S. at 263.

85. Scot R. Grierson, *Sales and Use Tax Nexus On The Information Superhighway: Constitutional Limits*, 70 TAX NOTES 1683, 1689 (1996).

86. 514 U.S. 175 (1995).

87. *Id.* at 178.

88. *Id.*

89. *Id.* at 184.

90. *Id.*

91. 514 U.S. at 184-85.

92. *Id.*

93. *Id.*

94. *Id.*

95. *Goldberg*, 488 U.S. at 263-63.

authorization to charge the card in exchange for goods or services provided in the future. At the same time, the company can request the required information for payment of an applicable sale or use tax. Therefore, the transaction would meet the first part of the *Goldberg* test.

Next, under the *Goldberg* test only two states would have a possible taxable nexus with the business. These are the state where the transmission begins (business location) and the state where the transmission ends (customer). In the case of the Internet, the tax would be paid to the state in which the sale occurred, i.e., the customer's state. Since the tax would only allow for payment for that portion of the tax attributable to the in-state transaction, the tax would meet the Commerce Clause test.

Therefore, if the *Goldberg* test is used for the Commerce Clause, a use tax on Internet transactions would be constitutional and would be workable to ensure businesses carry out their obligations to collect use taxes due a state.

THE HISTORY OF FEDERAL PREEMPTION AND THE 10TH AMENDMENT

Federal preemption[96] involves the Commerce Clause which delegates the power to Congress to regulate commerce among the several states.[97] The development of congressional power to preempt a field also has intertwined within it the development of 10th Amendment jurisprudence.

The Supreme Court resurrected the 10th Amendment in 1976 in *National League of Cities v. Usery*.[98] The Court held the application of minimum wage and overtime provisions of the Fair Labor Standards Act to state and local government employees violated the 10th Amendment.[99] The Court struck down Congress' exercise of its Commerce Clause powers and declared invalid the Congressional attempt to regulate "States as States".[100] *National League of Cities* represented a resurrection of the 10th Amendment's capacity to set limits on congressional power under the Commerce Clause.

The holding in National League of Cities gradually eroded. The erosion began in *Hodel v. Virginia Surface Mining & Reclamation Ass'n.*[101] where the Court rejected a 10th Amendment challenge to the Surface Mining Control and

96. Federal Preemption - The U.S. Constitution and acts of Congress have given to the federal government exclusive power over certain matters such as interstate commerce and sedition to the exclusion of state jurisdiction. Occurs when federal law so occupies the field that state courts are prevented from asserting jurisdiction. BLACK'S LAW DICTIONARY 612 (6th ed. 1990).

97. U.S. CONST. art. 1, § 8, cl. 3 (Authorizes the Congress "[t]o regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes[.]").

98. 426 U.S. 833 (1976).

99. *Id.* at 851-52.

100. 426 U.S. at 845.

101. 452 U.S. 264 (1981).

Reclamation Act of 1977.[102] This Act created a federal regulatory scheme for surface mining on nonfederal lands.[103] The Court held that for legislation to come under the protection of the *National League of Cities* proscription three requirements must be met.[104] First, there must be a showing that the statute regulates the "States as States".[105] Second, federal regulation must address matters that are "attributes of state sovereignty".[106] Third, it must be apparent that compliance with federal law would directly impair states' ability "to structure integral operations in areas of traditional government functions".[107] The Court found that the federal statute did not regulate "States as States" and that the federal statute only regulated private individuals' activities on their lands.[108]

Another case further curtailed the holding in National League of Cities, *FERC v. Mississippi*,[109] a case that involved regulation of public utilities, traditionally an area of state concern.[110] The Court held that utility rates affect interstate commerce and, therefore, congressional regulation of rates was properly within the Commerce Clause.[111] The Court also held the states' 10th Amendment challenge was preempted by Congress. This was so because the requirement that state agencies follow federally created standards was only a condition to continuing state involvement in those areas subject to federal preemption.[112]

In *EEOC v. Wyoming*,[113] the Age Discrimination in Employment Act was raised as a defense to Wyoming's law requiring mandatory retirement for park rangers at age 55.[114] The Court held the federal act was a valid exercise of Congress' Commerce Clause powers.[115] The Act satisfied the first prong of the *Hodel* test by regulating "States as States".[116] Skipping the second prong, the Court found that the Act did not directly impair Wyoming's ability to structure internal operations in areas of traditional government function.[117] There-

102. *Id.* at 268.
103. *Id.* at 268-69.
104. *Id.* at 287-88.
105. 452 U.S. at 286.
106. *Id.* at 286-87.
107. *Id.* at 287-88.
108. *Id.* at 290-91.
109. 456 U.S. 742 (1982).
110. *Id.* at 745-46.
111. *Id.* at 758.
112. *Id.* at 764-65.
113. 460 U.S. 226 (1983).
114. *Id.* at 234-35.
115. *Id.* at 243.
116. *Id.* at 237.
117. 460 U.S. at 239.

fore, the Court upheld the Act as a valid use of the Commerce Clause by Congress.[118]

National League of Cities[119] was finally overruled in *Garcia v. San Antonio Metropolitan Transit Authority*.[120] This case allowed the Fair Labor Standards Act to be applied to state and local government employees.[121] In *Garcia*, the Court found *Hodel's* three prong test to be unworkable.[122] Particularly, they found the third prong of the test, requiring a finding of impairment of the state's ability "to structure internal operations in areas of traditional government function", impossible to apply.[123] The Court concluded that what constituted "traditional" and "integral" state governmental functions was hard to define and that the states' interests were adequately protected by the national political process and Congress.[124] Therefore, *Garcia* expresses the philosophy that the 10th Amendment is a statement of political policy without the force of an affirmative prohibition on congressional action.

After *Garcia*, the Court delineated states' rights under the 10th Amendment in *New York v. United States*.[125] This case involved the Low-Level Radioactive Waste Policy Amendments Act of 1985, a federal law concerning radioactive-waste policy. Specifically, this law forced states to enter into regional compacts for the disposal of low-level radioactive waste.[126]

Congress' objective was to force states to develop disposal sites and take action for disposal of the waste.[127] Congress forced compliance through three incentives.[128] The first incentive was monetary, and allowed states to impose a surcharge on waste received from other states.[129] The second incentive permitted states to impose additional surcharges and ultimately deny access to sites within their borders when other states failed to comply with the federal mandates.[130] The third incentive was a "take title" provision that required states not in compliance with the federal mandate to take title to waste generated within their state and thereby become liable as the owner.[131]

118. *Id.* at 243.
119. 426 U.S. 833 (1976).
120. 469 U.S. 528, 531 (1985).
121. *Id.* at 533.
122. *Id.* 546-47.
123. *Id.* at 539-40.
124. *Id.* at 546-50.
125. 505 U.S. 144 (1992).
126. 505 U.S. at 144; *see also* Low-Level Radioactive Waste Policy Amend. Act, 42 U.S.C. § 2021 (1988).
127. 505 U.S. at 150.
128. *Id.* at 152-54.
129. *Id.* at 152-53.
130. *Id.* at 153.
131. *Id.*

The Court held the "take title" incentive a violation of the 10th Amendment.[132] The Court found the framers chose a Constitution that conferred upon Congress only the power to regulate individuals, not states.[133] The Court found Congress lacked the power to require states to enact and enforce a federal regulatory program.[134] Therefore, this coercive remedy was unconstitutional and an unacceptable exercise of Congress' Commerce Clause power to regulate interstate commerce.[135] New York is a landmark decision because it is the first time the 10th Amendment was held to limit federal action under the Commerce Clause since *National League of Cities*.

Several years after New York, the Court decided *United v. Lopez*,[136] which concerned a federal statute criminalizing possession of a firearm within a school zone under the Gun-Free School Zones Act of 1990.[137] The Court held the statute invalid since it regulated conduct with an insignificant connection with interstate commerce.[138] The Court found that "the possession of a gun in a local school zone is in no sense an economic activity that might, through repetition elsewhere, substantially affect any sort of interstate commerce".[139]

Lopez was the first invalidation of a federal statute that regulated private conduct. The Court, in *Lopez* and *New York*, curbed erosion of state powers by halting the expansion of Commerce Clause powers by Congress. The majority opinion in *Lopez* reaffirmed Congressional power under the Commerce Clause in three areas: (1) channels of interstate commerce; (2) instrumentalities of interstate commerce; and (3) those activities having a "substantial relation" to interstate commerce.[140]

The most recent case concerning Congress' ability to compel states to act is *Printz v. United States*.[141] This case concerned the Brady Handgun Violence Prevention Act, which required the Attorney General to establish a national system for instant background checks of prospective handgun purchasers.[142] The Act commanded the "chief law enforcement officer" of each local jurisdiction to conduct background checks, in the interim, until a national system was operative.[143]

132. 505 U.S. at 177.
133. *Id.* at 178.
134. *Id.* at 176.
135. *Id.* at 177.
136. 514 U.S. 549 (1994).
137. *Id.* at 551; Gun-Free School Zones Act, 18 U.S.C. § 922 (1990).
138. 514 U.S. at 567-68.
139. 514 U.S. at 567.
140. *Id.* at 558-59.
141. 117 S. Ct. 2365 (1997).
142. Brady Handgun Violence Prevention Act, 19 U.S.C. § 922 (1993).
143. 117 S. Ct. at 2368-69; 19 U.S.C. § 922 (1993).

The petitioners in *Printz* filed actions challenging the Act's constitutionality concerning the requirement for states to provide background checks under federal mandate until a federal system could be developed.[144] The Court held the interim provision commanding the states to conduct background checks was unconstitutional.[145] The Court concluded that the historical understanding and practice, in the structure of the Constitution, and the Court's jurisprudence contained no evidence that the federal government could command the state, in the absence of a specific constitutional provision, to act under the direction of Congress.[146] The Court found the structure of the Constitution revealed a principle establishing a system of "dual sovereignty".[147] They concluded the states retained a residual and inviolable sovereignty reflected throughout the text of the Constitution. [148] The Court also found the Brady Act's mandate that state officials enforce federal law constitutionally invalid, under Article I, Section 8, as a law "necessary and proper"[149] to the execution of Congress' Commerce Clause power.[150] In reference to *New York v. United States*, the Court held that a law which violates a state's sovereignty is not a law "proper for carrying into execution" powers delegated within the Necessary and Proper Clause.[151]

Finally, the Court held the federal government may not compel the states to enact or administer a federal regulatory program, since the federal government was compromising the structural framework of "dual sovereignty".[152] This statement was made in reference to the Court's opinion in New York.[153] *Printz* only directed state law enforcement officers to participate in the federal regulatory scheme temporarily,[154] but the Court found this temporary mandate unconstitutional.[155]

These cases demonstrate that Congress should not be allowed to preempt state and local taxation of the Internet, even through a temporary moratorium, due to 10th Amendment and Commerce Clause concerns.

144. 117 S. Ct. at 2369-70.

145. *Id.* at 2383-84.

146. *Id.*

147. *Id.* at 2376 (*citing* Gregory v. Ashcroft, 501 U.S. 452, 457 (1991); Tafflin v. Levitt, 493 U.S. 455, 458 (1990)).

148. *Id.* at *2376* (citing THE FEDERALIST NO. 3 (James Madison)).

149. U.S. CONST. art. I, § 8 (providing that Congress may "[. . .] make all Laws which shall be necessary and proper for carrying into Execution the foregoing powers").

150. 117 S. Ct. at 2378-79.

151. *Id.* at 2379.

152. *Id.* at 2378-79.

153. *Id.* at 2383.

154. 117 S. Ct. at 2369.

155. *Id.* at 2384.

FEDERAL PREEMPTION AND CYBERSPACE

As the Supreme Court stated in *Printz*, "federal commandeering of state governments is such a novel pheonomenom that this court's first experience with it did not occur until the 1970's".[156] In the case of the Internet, Congress wants to compel the states to implement, by legislative or executive action, a federal regulatory program which would prohibit all taxation of the Internet for a proscribed period of at least three years.[157]

As seen in *New York* and *Printz*, a federal regulatory scheme which commands state agencies to enforce federal law, such as refusing to tax Internet transactions, is prohibited by the 10th Amendment and current Commerce Clause jurisprudence. This is the case even though the prohibition is temporary. In *Printz*, the local implementation of federal law was to persist for a shorter period than the three year term currently in the Internet Tax Freedom Act.

In *Printz*, the government's brief even admitted the constitutional line is crossed when Congress compels states to make law in their sovereign capacities.[158] To preempt state taxation and the states' ability to raise revenue for the activities of the government goes directly to the core of state sovereignty. Whether the old test, under *National League of Cities*, or the new law found in *Garcia*, *New York*, and *Printz* is employed, it is unconstitutional to curb a state's ability to tax transactions that have a nexus with the state.

Another argument against preemption of state taxation of the Internet is that under the current state and local tax systems, states allow credits for taxes paid to other states. Although state tax systems compute the liability differently, they meet the Complete Auto test for internal and external consistency and would not allow taxes to be paid in two states on the same transaction. The states allow for apportionment of the tax base among the states, which would lead to an allocation of taxable income to each state based upon the required nexus. Therefore, double taxation is not a reasonable argument in favor of the Internet Tax Freedom Act.

Finally, under *Goldberg*, a usable standard has already been set forth by the Supreme Court which allows taxation of a transaction in the state in which the billing address is situated and the goods or services are delivered. To comply with *Goldberg*, when companies are paid they must request the necessary information to verify the source of the income and the required state for payment of the sales or use tax. In this way, the company would have the necessary information to fulfill its obligation for collection and payment of use taxes to the applicable state.

156. *Id.* at 2379.

157. Internet Tax Freedom Act, Pub. L. No. 105-277 (Title XI of the Omnibus Consolidated and Emergency Appropriations Act of 1998).

158. 117 S. Ct. 2380 (*citing* brief for United States 16).

As the Court stated in *Jefferson Lines*, "it has long been settled that the sale of tangible goods has a sufficient nexus to the state in which the sale is consummated to be treated as a local transaction, taxable by that state".[159] So in addressing the interstate providing of services, the Court recently held that a state in which an interstate telephone call originates or terminates establishes the requisite Commerce Clause nexus to tax a customer's purchase of that call, as long as the call is charged or billed to a service address, or paid by the addressee, within the taxing state.[160] Therefore, Internet services would be no different from an interstate telephone call for which the Court explicitly found in *Jefferson Lines* that a useable test is available. In that case the Court stated:

"Although our decisional law on sales of services is less developed than on sales of goods, one category of cases dealing with taxation of gross sales receipts in the hands of a seller of services supports the view that the taxable event is wholly local. Thus we have held that the entire gross receipts derived from sales of services to be performed wholly in one State are taxable by that State, notwithstanding that the contract for performance of the services had been entered into across state lines with customers who reside outside the taxing State.".[161]

Thus, the Court states that multiple taxation cannot occur because the taxable event, i.e., agreement, payment, and delivery of the services, can only occur in one state. Therefore, in the case of an information service provider, i.e., the Internet, which uses telecommunications, the extension of the *Goldberg* analysis is appropriate.

Jefferson Lines and *Goldberg* set forth a usable test requiring the seller of goods or services to consumers to acquire nexus with the consumer's home state, through a billing address, since that is where the goods or services are purchased.

CONCLUSION

Based upon the analysis of the Court's holdings in *Goldberg* and *Jefferson Lines*, an appropriate test has been set forth by the Court for use with the Internet in determining whether or not a state established the necessary nexus to compel collection of a use tax by those providing goods or services to customers within the state.

Since this test is available, and based upon the Court's Commerce Clause and 10th Amendment jurisprudence, Congress cannot preempt the field of state sales and use taxation of the Internet and compel the states, or local jurisdictions, to not tax transactions with the requisite nexus.

159. Oklahoma Tax Comm'n. v. Jefferson Lines, Inc., 514 U.S. 175, 184 (1995)(*citing* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940)).

160. Goldberg v. Sweet, 488 U.S. 252, 263 (1989).

161. 514 U.S. at 188.

This is true even though the Internet Tax Freedom Act is only a three year moratorium on state and local taxation of the Internet. Based on *Printz*, any unconstitutional use of Commerce Clause power through a state mandate is prohibited, whether it be permanent or temporary. Therefore, the attempt by Congress to preempt taxation of the Internet, by use of the Internet Tax Freedom Act, is an unconstitutional use of the Commerce Clause power and a violation of the states' 10th Amendment rights.

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