GOOD SPIRITS OR SOUR GRAPES?: REACHING A TAX COMPROMISE FOR DIRECT-TO-CONSUMER WINE SELLERS UNDER *QUILL*, THE 21ST AMENDMENT, AND THE DORMANT COMMERCE CLAUSE IN LIGHT OF *GRANHOLM V. HEALD*

I. INTRODUCTION

A. *Roadmap*

This article discusses state authority to regulate and tax alcohol under the 21st Amendment and the Dormant Commerce Clause in the context of *Granholm v. Heald*[1] and specifically whether, in light of *Granholm*, a state can condition the right to sell wine directly to consumers via the Internet upon the payment of state sales tax. The noteworthy *Granholm* decision is essentially a hollow victory for small wineries because the Internet Tax Freedom Act ("ITFA") pre-empts both the e-commerce field and large wineries' rallying to consent to taxation via the Streamlined Sales Tax Project ("SSTP").

Two cases will largely guide the discussion of the tax implications for the future of small wineries that wish to direct-ship into out-of-state markets. First, the recent U.S. Supreme Court decision in *Granholm* could open the door to legalizing interstate direct wine shipment to consumers.[2] The second case that will guide the discussion is *Quill Corp. v. North Dakota*,[3]

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1. 544 U.S. 460 (2005).

2. *See id.* at 492-93 (holding that a state which allows direct shipment of in state liquor may not "ban" or "severely limit" the direct shipment of out-of-state liquor to consumers within the state without showing that such discrimination is "demonstrably justified").

3. 504 U.S. 298, 313 (1992) (holding that the Commerce Clause's nexus requirements for taxation of out-of-state goods are for the purpose of "limiting state burdens on interstate commerce" and thus it is possible for an out-of-state business to

which is the leading U.S. Supreme Court case regarding state jurisdiction to tax out-of-state businesses doing business in the state. This paper will also discuss the 21st Amendment and the Commerce Clause to underscore the applicable law.

Additionally, this article will address two possible readings of *Granholm*. A *broad reading* of *Granholm* is that the decision confined *all* alcohol and 21st Amendment-related regulation to the Commerce Clause, not just direct-shipment rules.[4] A *narrow reading* supports the proposition that states cannot discriminate against out-of-state wineries in direct-shipment laws *only*.[5]

Finally, this article asks whether there is any room for compromise. Through discussions of the history and future of both the ITFA and SSTP, as well as Justice Kennedy's potentially binding statements in *Granholm* regarding state authority to condition direct shipment upon the payment of state sales tax, this article asks: "If there is room for compromise, what should that compromise be?"

B. *Overview of* Granholm v. Heald

Granholm marks the end of a decades long effort to overturn protective state laws that prevent out-of-state wineries from shipping directly to consumers.[6] It was consolidated from two cases: *Heald v. Engler*[7] and *Swedenburg v. Kelly*.[8] The Court held that the 21st Amendment does not nullify the Commerce Clause with respect to liquor; therefore, state liquor regulations are limited by the Commerce Clause.[9] Because states are not free to violate the Commerce Clause, they cannot discriminate against out-of-state wineries.[10]

The actual *Granholm* ruling did not change any specific law or legalize direct-shipping in all states; it merely held that in-state and out-of-state wineries must be treated equally.[11] The

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have the necessary "minimum contacts" with a state under a Due Process analysis, yet still fall outside of that state's taxing power).

4. *See infra* Part III.

5. *Id.*

6. Tony Mauro, *Wineries Toast Supreme Court Ruling on Interstate Sales*, LEGAL TIMES, May 17, 2005, *available at* http://www.law.com/jsp/article.jsp?id=1116246913481; *see also* John Hinman & Deborah Steinthal, *U.S. Wine Market Liberalization by 2015, Perfect Storm Forming*, PRACTICAL WINERY & VINEYARD, Nov./Dec. 2005.

7. 342 F.3d 517 (6th Cir. 2003), *aff'd sub nom.* Granholm v. Heald, 544 U.S. 460 (2005).

8. 358 F.3d 223 (2d Cir. 2004), *rev'd sub nom. Granholm*, 544 U.S. 460.

9. *Granholm*, 544 U.S. at 486-89.

10. *Id.* at 484-85.

11. *Id.* at 486-89.

Court found that laws of the type at issue in *Granholm* "deprive citizens of their right to have access to the markets of other [s]tates on equal terms."[12] Also, "[t]he perceived necessity for reciprocal sale privileges risk[ed] generating the [interstate] trade rivalries and animosities . . . the Commerce Clause [was] designed to avoid."[13] Foreclosing on the state's main justification for discriminatory laws, the Court declared that such laws were not necessary to advance state interests in preventing underage access to alcohol and collecting revenue.[14] However, this does not mean that state wine markets are now automatically and uniformly open to out-of-state wines. States still must decide whether to "level up," and welcome out-of-state wineries as direct-shippers, or to "level down," and prohibit all wineries from direct shipment.[15]

While it seems that small wineries would benefit greatly from *Granholm* because the Court affirmed that discriminatory direct-to-consumer shipment laws are unconstitutional, states and wineries may conclude that this is not the great opportunity it appeared to be.

II. BACKGROUND

A. *Why Wine Is Different from Other Goods*

The wine debate stems from the temperance movement of the 1800s and 1900s.[16] Moreover, "[n]o other commodity has been the focus of not one, but two, constitutional amendments that have been ratified in the past 100 years with the intention of regulating its role in the American economy and society."[17] Congress passed "the 18th and 21st Amendments, as well as numerous alcohol-related laws and regulations, [which] have

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12. *Id.* at 473.

13. *Id.*

14. *Granholm*, at 489-91. This is not to say that the argument is moot. The state must put forth concrete evidence that a discriminatory regulation is necessary. *Id.* at 489. The Commerce Clause requires "more than mere speculation to support discrimination against out-of-state goods." *Id.* at 492. The state must demonstrate that its law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at 489; *see also* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

15. *Granholm*, 544 U.S. at 475.

16. *See* Alan E. Wiseman, Ph.D. & Jerry Ellig, Ph.D., *Legislative Action and Market Responses: Results of Virginia's Natural Experiment with Direct Wine Shipment* (Dec. 2005), http://www.mercatus.org/repository/docLib/MC_RSP_RP-DirectWineShipment_051224.pdf.

17. *Id.*

been consistently marked by intense political maneuverings by various interest groups that pursued their goals through legislative and regulatory means."[18]

What makes wine and alcohol particularly different from other goods is the relationship of the 21st Amendment to the Commerce Clause. Whereas most goods that cross state lines are assumed to have an interstate character, it is arguable that alcohol was divested of its interstate character and thus not subject to the Commerce Clause[19] which "is considered to be a primary contributor towards the development of America's unified national economy . . . [and is] 'one of the Constitution's central pillars in the protection of markets.'"[20] The interstate character of wine is the subject of many cases from which courts promulgated conflicting rules.[21] The constant attention to wine's character and the congressional and state struggle to define and divide powers makes wine politics unique.

Arguments fueling the *Granholm* litigation centered on whether direct-shipment laws were the type of protectionism the Commerce Clause was meant to avoid, or whether state authority to regulate alcohol under the 21st Amendment was as broad as many states suggested. The plaintiffs argued that the

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18. *Id.* at 4.

19. *See* discussion *infra* Part II.C.2.

20. Wiseman & Ellig, *supra* note 16, at 2.

21. *See, e.g.*, Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 582 (1986) (finding that requiring a "merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce"); Bacchus Imps. Ltd. v. Dias, 468 U.S. 263, 268, 273 (1984) (reinforcing that the "cardinal rule of Commerce Clause jurisprudence is that '[n]o State . . . may impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business,'" and that economic protection will not be tolerated even for liquor goods) (internal citations omitted); California v. La Rue, 409 U.S. 109, 118-19 (1972) (reasoning that liquor control regulations were presumptively valid under the 21st Amendment); Dep't of Revenue v. James B. Beam Distilling Co., 377 U.S. 341, 345-46 (1964) (holding that even the 21st Amendment could not save a state law imposing a discriminatory tax); Duckworth v. Arkansas, 314 U.S. 390, 396 (1941) (upholding a state law regulating the transportation of liquor because it was a local concern and Congress had not yet exercised its power to regulate); Fla. Dep't of Bus. Regulation v. Zachy's Wine & Liquor, 125 F.3d 1399, 1405 (11th Cir. 1997) (affirming the dismissal of the state's complaint to enjoin defendant out-of-state, mail-order wine retailers from violation of Florida's liquor law because it lacked a proper federal cause of action for subject matter jurisdiction); People's Super Liquor Stores, Inc. v. Jenkins, 432 F. Supp. 2d 200, 222 (D. Mass. 2006) (declining to dismiss plaintiffs' Dormant Commerce Clause claim because the 21st Amendment could not "rescue" the residency requirement); Dickerson v. Bailey, 212 F. Supp. 2d 673, 694 (S.D. Tex. 2002) (determining that "Texas' ban on direct importation of wine violate[d] the [D]ormant [C]ommerce [C]lause"); Glazer's Wholesale Drug Co. v. Kansas, 145 F. Supp. 2d 1234, 1247 (D. Kan. 2001) (finding that because a "residency requirement constitute[d] nothing more than 'mere economic protectionism,'" the 21st Amendment could not "save" it from a finding that it is "an impermissible limitation on interstate commerce").

Commerce Clause gives the federal government the universal right to regulate interstate commerce.[22] But, as one commentator stated:

> This is clearly an issue of protectionism, at odds with the Commerce Clause . . . . The high court has an [sic] historic chance to end the legacy of Prohibition and rule in favor of direct-shipping. It should not be a felony, as it is in some states, to buy a bottle of premium wine and ship it to your own home.[23]

Twenty-four states countered that the 21st Amendment gave them power to control alcohol sales, which included placing restrictions on the importation of liquors from out-of-state.[24]

B. *Development of Wine Business and Industry Regulations*

1. The Wine Business

Wine is part of the $162 billion grape and grape product industry.[25] There are now wineries in all 50 states producing "$11.4 billion in winery sales revenues."[26] In New York and Michigan, the states that served as the battlefield for *Granholm*, the industry contributes $6 billion and $764 million to the states' economies respectively.[27] Additionally, the wine and grape industry has been a major contributor in the tax realm, paying $9.1 billion in federal and $8 billion in state taxes annually.[28]

Not only has wine made its mark as a viable and lucrative industry, but its recent year-to-year growth is astounding. In 2005, there were 4,929 wineries—a 70% increase from the 2,905 in 2000.[29] Production has also increased. In 1999, America's

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22. Brief of Respondent-Appellee at 14, Granholm v. Heald, 544 U.S. 460 (2005) (No. 03-1116).

23. Steve Stanek, *Supreme Court Asked to Uncork Online Wine Sales*, THE HEARTLAND INSTITUTE (Jan. 1, 2005), *available at* http://www.heartland.org/PrinterFriendly.cfm?theType=artId&theID=16225 (*quoting* K. Lloyd Billingsley, editorial director of the Pacific Research Institute and author of *Wine Wars: Defending E-Commerce and Direct-shipment in the National Wine Market*, in a statement issued with the report).

24. *Id.*

25. Press Release, *National Study of Economic Impact of U.S. Wine Industry: Grapes and Grape Products Contribute $162 Billion to Economy* (Jan. 17, 2007) http://www.winebusiness.com/news/dailynewsarticle.cfm?dataId=46237.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

wine production was about 531 million gallons a year, worth an estimated $17 billion.[30] According to the Wine Institute, annual consumption of wine in the United Stated grew 63% from 1991 to 668 million gallons in 2004.[31]

Further, "wine . . . [is] truly an economic catalyst with tremendous growth potential in all 50 states."[32] Not only do "wineries revitalize and support local economies in rural communities,"[33] but they also generate 'wine country' tourism which impacts state economies throughout the country.[34]

Moreover, with over 14,000 web pages dedicated to wine and the wine industry,[35] it seems clear that wine is a major market force. The leading Internet wine portal has a virtual wine store that offers more than 400 wines representing 90 wineries and 60 North American regions.[36] Plus, "American wine consumers are buying more higher-priced wine than ever, with all price points $8 and above showing double-digit growth in the 34 months [prior to January 2007]."[37] These facts demonstrate that the wine industry has started to take notice of American consumer's Internet spending habits; it is time for the courts to follow suit.

2. Three-Tier System for Wine Distribution

From the continued growth and success of the industry, it is unmistakable that any force that can control the wine industry is in a position of significant power with potential for great profit.

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30. *The Status and Prospects of American Wine Production: Hearing Before the Subcommittee on Livestock and Horticulture of the Committee on Agriculture,* 106th Cong. 106–33 (1999).

31. THE WINE INSTITUTE, *Strong Sales Growth in 2004 for California Wine As Shipments Reached New High,* http://www.wineinstitute.org/communications/statistics/Sales2004-2.htm (last visited Feb. 10, 2007).

32. Press Release, *supra* note 25 (quoting Congressman Mike Thompson of St. Helena, CA, co-chair of the Congressional Wine Caucus).

33. *Id.* (citing Congressman George Radanovich of Mariposa, CA, co-chair of the Congressional Wine Caucus).

34. *Id.* Economists refer to this as the "multiplier effect," which is the "ability of a one-dollar shift in the aggregate nominal demand schedule to induce a change of more than one dollar in the equilibrium level of nominal national income." GEORGE E. OLDHAM, DICTIONARY OF BUSINESS & FINANCE TERMS 155 (1993).

35. *AppellationAmerica.com Enters 2007 as Leading Internet-Wine Portal,* BUSINESS WIRE (San Francisco), Dec. 28, 2006 *available at* http://digital50.com/news/items/BW/2001/07/14/20061228005222/appellationamerica-com-enters-2007-as-leading-internet-wine-portal/print (naming Appellation America as the leading Internet wine portal).

36. *Id.*

37. Cyril Penn, *Sales of Expensive Wines Booming,* SAN FRAN. CHRONICLE, Jan. 19, 2007, at F-2, *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2007/01/19/WIGRINJJRN1.DTL&feed=rss.wine.

This is exactly the position that wholesalers seek to protect by demanding enforcement of the three-tier distribution system.[38]

The "three-tiered" system is the most common form of regulation.[39] The three-tiered system is one "in which producers of alcohol cannot sell their products directly to consumers. They must sell their products to licensed wholesalers, which in turn must sell to licensed retailers, which sell to the consumer."[40] Florida's scheme, described in *Bainbridge v. Turner*,[41] is representative of the system in force in most states prior to *Granholm*.

> First, it requires three vertical layers of distribution (manufacturer, distributor, and vendor) and mandates that no layer in the vertical hierarchy act in the capacity of another. . . . Second, it allows only the last link . . . the vendor, the ability to sell directly to consumers. An exception to the vertical quarantine is carved out for in-state wineries, which are allowed to receive vendors' permits. Vendors . . . are allowed to ship directly to consumers so long as the vendor uses vehicles that it owns or leases.[42]

Direct-shipment regulation has existed since the repeal of the 18th Amendment.[43] All 50 states regulate the sale of alcohol in some form, although the introduction of the 21st Amendment "led to wildly diverse regulatory standards for alcohol distribution across states. . . . By 1940, forty-three states had some form of alcohol trade barriers, and . . . these discriminatory regulations . . . insulated in-state industries from out-of-state

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38. Lloyd C. Anderson, *Direct-shipment of Wine, the Commerce Clause and the Twenty-first Amendment: A Call for Legislative Reform*, 37 AKRON L. REV. 1, 3 (2004); *see also* North Dakota v. United States, 495 U.S. 423, 447 (1990) (Scalia, J., concurring in judgment) ("The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler.").

39. Anderson, *supra* note 38, at 3. The organization of the three-tier system has been called "unquestionably legitimate," *North Dakota*, 495 U.S. at 432; however, it is debatable as to whether the system remains constitutional after *Granholm*. *See* Costco Wholesale Corp. v. Hoen (*Costco II*), 407 F. Supp. 2d 1247, 1250-51 (D. Wash. 2005) (holding the three-tier system in Washington unconstitutional).

40. Anderson, *supra* note 38, at 3.

41. 311 F.3d 1104, 1104 (11th Cir. 2002).

42. *Id.* at 1106-07 (internal citations omitted).

43. Vijay Shanker, Note, *Alcohol Direct Shipment Laws, the Commerce Clause, and the Twenty-First Amendment*, 85 VA. L. REV. 353, 355 (1999).

competition."[44] Further, "[b]y the 1980s, virtually every state had adopted some form of the three-tier distribution system."[45]

State wine shipment laws generally apply one of three approaches: (1) reciprocity; (2) direct-shipment; or (3) anti-direct-shipment.[46] Five states employ reciprocity,[47] allowing direct-shipping to its adult consumer citizens from another state so long as that foreign state allows it to do so in return.[48] This mutually beneficial relationship is the key feature of reciprocity laws.[49] Twenty-eight states employ direct-shipment-friendly laws,[50] opening their markets to direct shipment from wineries in any state, regardless of whether the home state receives a mutual benefit, so long as they meet certain minimum criteria.[51] Before *Granholm*,[52] these states usually imposed some sort of requirement, other than reciprocity, on wineries, including physical presence or license requirements.[53] Seventeen states are anti-direct-shipment[54] that disallow direct-to-consumer shipments altogether.[55]

After the 21st Amendment, the wholesale market became very competitive due to its rapid expansion.[56] Recently, however, wholesale distribution companies have been consolidating to obtain greater market share thus concentrating industry power to relatively few firms.[57] As a result, the number of licensed

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44. Wiseman & Ellig, *supra* note 16, at 7-8.

45. *Id.* at 8; *see also* FTC, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 3, 5-7 (2003), http://www.ftc.gov/os/2003/07/winereport2.pdf.

46. *See* FTC Report, *supra* note 45, at 7-8.

47. THE WINE INSTITUTE, *Direct-shipment Laws by State for Wineries, State Shipping Laws*, http://www.wineinstitute.org/shipwine/ (last visited Mar. 4, 2007).

48. Lauren Dunnock, *"Quaffable, But Far From Transcendent": Maryland's Twenty-First Century Prohibition*, 36 U. BALT. L. REV. 271, 274-75 (2007); *see* FTC Report, *supra* note 45, at 7-8.

49. *See* Clayton L. Silvernail, Comment, *Smoke, Mirrors and Myopia: How the States Are Able to Pass Unconstitutional Laws Against the Direct Shipping of Wine in Interstate Commerce*, 44 S. TEX. L. REV. 499, 504 (2003).

50. THE WINE INSTITUTE, *supra* note 47.

51. Dunnock, *supra* note 48; *see also* Silvernail, *supra* note 49, at 504.

52. The system at issue in *Granholm* is a limited direct-shipment system. However, the holding is more broad as it applies to discrimination against foreign states in interstate commerce.

53. Silvernail, *supra* note 49, at 503-504.

54. THE WINE INSTITUTE, *supra* note 47.

55. Silvernail, *supra* note 49.

56. *See* Duncan Baird Douglass, Note, *Constitutional Crossroads: Reconciling the Twenty-first Amendment and the Commerce Clause to Evaluate Regulation of Interstate Commerce in Alcoholic Beverages*, 49 DUKE L.J. 1619, 1621 (2000).

57. In 1999, "five distributors in the United States [represented] 31 percent of the entire national wine, spirits and beer distribution." *Hearing on Status and Prospects of American Wine*, *supra* note 30, at 30.

wholesalers is "now approximately one-third of what they were in 1984."[58]

Meanwhile, the number of wineries with small production capacities, "often family-owned wineries[,] has skyrocketed."[59] The tripling of small wineries combined with the shrinking distribution market means that many small wineries are unlikely to produce the volume necessary to meet minimums required for wholesale distribution.[60] As small wineries must rely on direct shipment for sales, they are keenly invested in direct-shipment regulation.[61] A system prohibiting direct shipment, thus requiring use of the three-tiered system, effectively closes off the market to small wineries both in-state and out-of-state.

Moreover, "[w]holesaler market power creates an obvious conflict of interests between the wholesaler and the producer, because the wholesale price that maximizes the wholesaler's profits is higher than the wholesale price that maximizes the producer's profits."[62] Wholesalers sensed that direct-shipment poses a threat to their market power and insisted that states enforce their distribution rules prohibiting alcohol importation if not through licensed wholesalers.[63] After *Granholm*, wholesalers are demanding that states level down to disallow direct-shipment altogether via a state's semi-autonomy under the 21st Amendment.[64]

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58. David P. Miranda, *Computers & The Law, Supreme Court Permits Internet Wine Sales*, N.Y. ST. B.A. JOURNAL, Feb. 2006, *available at* http://www.nysba.org/Content/NavigationMenu/Publications19/Bar_Journal/Bar_Journal_Archive/2006_Archive/journal_february_06_miranda.pdf.

59. Anderson, *supra* note 38, at 3; *see also* Miranda, *supra* note 58 (noting that "the number of small wineries in the U.S. tripled over the last 30 years, currently exceeding 3,000").

60. Miranda, *supra* note 58.

61. *Id.*; *see also* Hinman & Steinthal, *supra* note 6 (detailing producers' strategies).

62. Wiseman & Ellig, *supra* note 16, at 8 (citing Benjamin Klein, *The Economics of Franchise Contracts*, 2 J. CORP. FIN. 9, 13 (1995)).

63. Tom Shelton, President and CEO of Joseph Phelps Vineyards speaking as representative of Napa Valley Vintners Association said: "[F]ive [wholesalers] in the United States today currently represent 31 percent of the entire national wine, spirits and beer distribution. Twenty-five [wholesalers] represent more than 61 percent of that same distribution. This is an oligopoly. And this oligopoly is now seeking protection through Federal courts. And it is something that we must resist at all costs." *Hearing on Status and Prospects of American Wine*, *supra* note 30, at 30.

64. *See* Wine & Spirits Wholesalers of America, Inc., *Craig Wolf Named New President & CEO of Wine & Spirits Wholesalers of America, Inc.*, PR NEWSWIRE, Nov. 13, 2006 (stating that "the WSWA is a national trade association representing the wholesale tier of the wine and spirits industry and supports government policies that ensure sales and deliveries of alcohol are conducted only by those licensed by the state and in compliance with state and federal law").

C. *Brief History of Federal Law Governing Liquor*

The *Granholm* Court interpreted the 21st Amendment as restoring the same power to the states that they had under the Wilson and Web-Kenyon Acts.[65] Current jurisprudence holds that such Acts were subject to the limitations of the Dormant Commerce Clause.[66] The Wilson Act authorized states to treat out-of-state liquor the same as in-state liquor.[67] Courts now think it clear that neither the 21st Amendment nor the Wilson and Webb-Kenyon Acts removed all Commerce Clause limits on state authority to regulate interstate liquor shipments.[68] However, at the time, that was debatable. So long as the intention of the 21st Amendment was to restore the power distribution to the same status as under the two Acts and not to give the states any *additional* power, then it becomes necessary to precisely determine the scope of these first Congressional movements.

1. Prohibition

Leading up to Prohibition, "Americans became convinced that consumption of alcohol would undermine the health and moral strength of the nation and that it must be eliminated."[69] Then, "[i]n 1869, the Prohibition Party was founded in response to this concern."[70] Prohibition intended to reduce alcohol consumption by eliminating the businesses that manufactured, distributed, and sold it.[71] The party believed that if liquor was

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65. Granholm v. Heald, 544 U.S. 460, 484 (2005).

66. *See* Gregory A. Castanias, *The Supreme Court's Granholm v. Heald Decision: What It Means for Interstate Wine Shipping*, JONES DAY COMMENTARY, June 2005, http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S2297, at 3.

67. *See* Vance v. W.A. Vandercook Co., 170 U.S. 438, 455-56 (1898) (holding that the Wilson Act could not authorize a state to interfere with the interstate shipment of liquor for personal use); *see also* Rhodes v. Iowa, 170 U.S. 412, 421-23, 426 (1898) (interpreting the Wilson Act narrowly so state power to regulate did not vest until the alcohol arrived at its final destination thus requiring that in-state and out-of-state alcohol be treated equally).

68. The purpose of the Webb-Kenyon Act was to "remove the impediment existing as to the States in the exercise of their police powers regarding the traffic or control of intoxicating liquors within their own borders." Asheesh Agarwal and Todd Zywicki, *The Original Meaning of the 21st Amendment*, 8 GREEN BAG 2D 137, 139 (2005) (quoting 49 CONG. REC. 760). Further, "there is no room for doubt that it was enacted simply to extend that which was done by the Wilson Act." *Id.* (citing Clark Distilling Co. v. Western Md. Ry., 242 U.S. 311, 323-24 (1917)) (footnote omitted).

69. Anderson, *supra* note 38, at 5.

70. *Id.*

71. Sidney J. Spaeth, *The Twenty-First Amendment and State Control Over Intoxicating Liquor: Accommodating the Federal Interest*, 79 CALIF. L. REV. 161, 168-69 (1991).

no longer publicly available, the churches could persuade Americans to give up alcohol altogether.[72] The Prohibition Party succeeded in its political goals with the ratification of the 18th Amendment.[73] Prohibition "completely prohibited liquor distribution, consumption, and production until the repeal of the Eighteenth Amendment by the Twenty-First Amendment in 1933."[74]

2. Wilson Act of 1890

State rights to prohibit or regulate the domestic sale of alcohol became a focal point in 1890. Under the Wilson Act,[75] state regulation of alcohol could begin only after a person took possession of the alcohol.[76] Cases leading up to the Wilson Act blurred the once "clear" line between interstate and domestic alcohol regulation,[77] and "[l]ater in the century . . . *Leisy v. Hardin* undercut the theoretical underpinnings of *License Cases*."[78] Under *Leisy*, a state could not interfere with the sale of imported alcohol in its original package.[79] This decision caused confusion, and alcohol importers easily circumvented it by keeping alcohol in its original package. The *Leisy* "original package" loophole did not last long. Congress enacted the Wilson Act of 1890 to resolve the quandary,[80] and provided that keeping

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72. *See id.* at 169-70.

73. *See* Robert L. Jones III, Note, *Well-Aged and Finally Uncorked: The Supreme Court Decides Whether the Twenty-First Amendment Grants States the Power to Avoid the Dormant Commerce Clause,* 28 U. ARK. LITTLE ROCK L. REV. 483, 496 (2006).

74. *Id.*

75. Wilson Act of 1890, 27 U.S.C. § 121 (2000).

76. *Id.; see also* Heyman v. S. Ry. Co., 203 U.S. 270 276 (1906) ("[T]he general principle is that goods moving in interstate commerce cease to be such commerce only after delivery and sale in the original package. . . ."); Adams Express Co. v. Kentucky, 206 U.S. 129, 135-36 (1907).

77. *See* Justin Lemaire, Note, *Unmixing a Jurisprudential Cocktail: Reconciling the Twenty-First Amendment, The Dormant Commerce Clause, and Federal Appellate Jurisprudence to Judge the Constitutionality of State Laws Restricting Direct Shipment of Alcohol,* 79 NOTRE DAME L. REV. 1613, 1616-17 (2004) (summarizing the history of intoxicating liquor regulatory cases leading up to the Wilson Act).

78. Craig v. Boren, 429 U.S. 190, 205 (U.S. 1976) (citation omitted). The *License Cases* were cases in which the United States Supreme Court upheld Massachusetts, Rhode Island, and New Hampshire statutes which regulated and taxed the sale of alcoholic beverages that had been brought in from other states. William Glunz, *Granholm v. Heald: The Twenty-First Amendment Takes Another Hit – Where do States Go from Here?*, 40 J. Marshall L. Rev. 651, 653 (2007).

79. Leisy v. Hardin, 135 U.S. 100, 124-25 (1890).

80. "[I]f a state prohibited the sale of domestically produced alcohol, the Wilson Act also allowed it to prohibit the sale of imports. Congress had, in effect, granted states the very permission to stop commerce in imported alcohol that was lacking in *Leisy*." Anderson, *supra* note 38, at 8.

alcohol in its original packaging would not exempt it from state regulation.[81]

A key feature of the Wilson Act was an anti-discrimination clause, which provided that states could regulate out-of-state alcohol "to the same extent and in the same manner as though such liquids or liquors had been produced in [the] State."[82] Thus, the clause combined imported and domestic alcohol laws by treating both equally.[83] At the time, states used the provision to assert state power, but discrimination turned out to be a constitutional issue more in favor of federalism than states' rights.[84] Although the Wilson Act closed the "original packaging" loophole, the alcohol industry quickly gained another foothold—direct-shipment: "[D]irectly shipping alcohol to the end-user avoided the state and local regulations because the state regulations attached only after delivery."[85] Under the Act, state law did not attach until the local recipient received the alcohol.[86]

In response, states argued that the Wilson Act divested imported alcohol in its original package of its interstate character, thereby subjecting it to the state prohibition against the sale of alcohol.[87] Though Congress' exclusive power over interstate commerce includes the power to divest certain articles of their interstate commercial character, in *In re Rahrer* the Court held that this is an improper application of that power.[88]

In *Rhodes v. Iowa*, the Court acknowledged that there was a passage in the text of the Wilson Act that seemed to divest alcohol of its interstate commerce status, but asserted that a literal interpretation of this passage would be inconsistent with the Wilson Act's purpose.[89] The Court reasoned that a literal interpretation would give states the power to prohibit importation and force goods to remain in another state in violation of the Commerce Clause.[90]

However, in *Clark Distilling Co. v. West Maryland Railway*, the court narrowed the ruling in *Rhodes* by holding that

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81. Wilson Act of 1890, 27 U.S.C. § 121.

82. *Id.* § 121.

83. Anderson, *supra* note 38, at 9.

84. *See id.* (interpreting the intent of Congress within the Wilson Act's anti-discrimination clause as limiting a state's power to within state borders, thus encouraging federalism over states' rights).

85. Jones, *supra* note 73, at 494.

86. *Id.*

87. *See, e.g., In re* Rahrer, 140 U.S. 545, 564 (1891).

88. *Id.* at 562, 564-65.

89. Rhodes v. Iowa, 170 U.S. 412, 419-20 (1898).

90. *Id.* at 420.

Congress has power to prohibit all shipment of alcohol, and that such all-encompassing power includes the lesser power to permit some prohibition by those states that choose to do so.[91] Thus direct shipment of imported alcohol was under state authority and could be prohibited.[92] This closed the direct-shipment loophole.

3. Webb-Kenyon Act of 1913

In response to the loophole under the Wilson Act, Congress enacted the Webb-Kenyon Act of 1913.[93] That statute extended the Wilson Act by permitting states to "regulate the in-state sale of liquor to 'any person interested therein, to be received, possessed, sold, or in any manner used.'"[94] The Webb-Kenyon Act prohibits "[t]he shipment or transportation . . . of any . . . intoxicating liquor of any kind from one State, Territory, or District into any other State, Territory, or District . . . intended . . . to be received, possessed, sold, or in any manner used . . . in violation of any law of such State, Territory, or District."[95]

In *Clark Distilling*, the Court read the Wilson Act's anti-discriminatory purpose into the Webb-Kenyon Act.[96] The court held that "the purpose [of the Webb-Kenyon Act] was to prevent the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in states contrary to their laws."[97] Scholars claim that the Webb-Kenyon Act removed all liquor regulation from the protection of the Dormant Commerce Clause, making the interstate distribution of alcohol immune from the Clause's power.[98] As noted above, in *Granholm*, the Court held that the purpose of the

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91. *See* Clark Distilling Co. v. W. Md. Ry., 242 U.S. 311, 331-32 (1917).

92. *Id.* at 324.

93. Webb-Kenyon Act of 1913, 27 U.S.C. § 122 (2000).

94. Scott F. Mascianica, Article, *Why All the Wine-ing? The Wine Industry's Battle with States over the Direct Shipment Issue,* 17 LOY. CONSUMER L. REV. 91, 95 (2004) (quoting the Webb-Kenyon Act).

95. Bainbridge v. Turner, 311 F.3d 1104, 1110 n.12 (11th Cir. 2002).

96. *See Clark Distilling*, 242 U.S. at 322-24. It should be noted that the Webb-Kenyon Act, unlike the Wilson Act, contained no anti-discrimination language. *Compare* Webb-Kenyon Act of 1913, 27 U.S.C. § 122, *with* Wilson Act of 1890, 27 U.S.C. § 121 (2000).

97. *Clark Distilling*, 242 U.S. at 324.

98. *See, e.g.*, Matthew Dickson, Note, *All or Nothing: State Reaction in the Wake of* Granholm v. Heald, 28 WHITTIER L. REV. 491, 503 (2006); Michael S. Greve, *Why Roe Won't Go*, 51 ST. LOUIS U. L.J. 701, 708-09 (2007).

21st Amendment was to repeal the 18th Amendment and return alcohol law to the days of the Webb-Kenyon and Wilson Acts.[99]

D. *Current Applicable Case Law and Limitations*

The Constitution limits state power to tax out-of-state businesses under both the Due Process Clause and Commerce Clause, and any tax imposed without jurisdiction under both is unconstitutional.[100] Notions of "fundamental fairness of governmental activity" and fair notice motivate Due Process concerns.[101] The Due Process jurisdictional test comes from *International Shoe Co. v. Washington*[102] and asks: are there enough minimum contacts[103] so that subjecting this person to jurisdiction would "not offend 'traditional notions of fair play and substantial justice'"?[104] Structural concerns about the effects of regulating the national economy motivate Commerce Clause interests.[105] The Commerce Clause gives Congress the power to make laws to regulate interstate commerce.[106] Further, "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States."[107] The Commerce Clause jurisdictional test comes from *Complete Auto Transit, Inc. v. Brady*[108] and was reiterated by *Quill Corp. v. North Dakota.*[109] The nexus test is based on the need for a free flow of goods within the national economy and relies on a bright-line physical presence test; when both tests are satisfied, a business has a

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99. *See supra* Part II.C.

100. *See* U.S. CONST. amend. V.; *id.* art. 1, § 8, cl. 3.

101. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992).

102. 326 U.S. 310 (1945).

103. The court in *Yahoo! Inc. v. La Ligue Contre Le Racisme Et L'Antisemitsme* summarized leading cases on purposeful availment to establish minimum contacts: "In *Quill Corp. v. North Dakota*, the Supreme Court held that when an out-of-state mail order company 'purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State.' And, in *Burger King*, the Court held that jurisdiction was proper on the grounds that defendants' business ties with the State of Florida were 'shielded by the benefits and protections' of Florida's laws." Yahoo! Inc. v. La Ligue Contre Le Racisme Et L'Antisemitsme, 433 F.3d 1199, 1231 (9th Cir. 2006) (citations omitted).

104. *International Shoe*, 326 U.S. at 316.

105. *See Quill*, 504 U.S. at 305, 309.

106. *Id.* at 309.

107. Freeman v. Hewit, 329 U.S. 249, 252 (1946).

108. *See* 430 U.S. 274, 287-89 (1977).

109. *See* 504 U.S. at 313-17.

"sufficient nexus" to fall under that state's sales tax jurisdiction.[110]

Thus, in order to satisfy this nexus test, the company must have some physical presence in the state, such as a sales representative, a storage facility, or a brick-and-mortar storefront.[111] Simply mailing a catalog or processing orders over the Internet will not suffice to create a physical presence: "[A] vendor whose only contacts with a taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."[112] While the *Complete Auto* Court discussed states' ability to tax interstate commerce, it also explicitly stated that any such tax is confined to the limits of the Commerce Clause.[113] As *Granholm* confirmed, the 21st Amendment was limited by the Dormant Commerce Clause,[114] and it follows that a tax on alcohol would be limited by the Dormant Commerce Clause as well.

Overall, it appears that states may have a difficult time taxing out-of-state wineries in any instance. While it is settled law that states can tax interstate commerce if the company has a physical presence, it is also settled law that a state cannot force an out-of-state winery to have a physical presence in the state in order to do business, because requiring physical presence is unconstitutional under *Granholm*, as such a requirement would discriminate against out-of-state wineries.[115] It follows that any state law that would require a physical presence could not subject the company to state tax because those laws are discriminatory.[116]

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110. In practice, the ban on discriminatory taxes on electronic commerce means that transactions arranged over the Internet are to be taxed in the same manner as mail order or telephone sales. Under the current judicial interpretation of nexus as applied to mail-order sales, a state cannot require an out-of state seller to collect a use tax from the customer unless the seller has a physical presence in the taxing state, (use tax is the companion tax to the sales tax, applicable to interstate sales). Congress or the Supreme Court would need to act to grant or approve the states' ability to require out-of-state tax collection, whether the transaction was arranged over the Internet or by mail-order, telephone, or other means. *See* John R. Luckey, State Sales Taxation of Internet Transactions, Congressional Reseach Service Report for Congress (Jan. 10, 2001) *available at* http://www.ncseonline.org/nle/crsreports/economics/econ-98.cfm.

111. *See Quill*, 504 U.S. at 315.

112. *Id.* at 299 (summarizing *Complete Auto*, 430 U.S. at 274).

113. *Complete Auto*, 430 U.S. at 285.

114. Granholm v. Heald, 544 U.S. 460 (2005).

115. *Id.* at 475 ("New York's in-state presence requirement runs contrary to our admonition that States cannot require an out-of-state firm 'to become a resident in order to compete on equal terms.'") (quoting Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1963)).

116. *See id.* at 475, 477.

1. *Quill's* Jurisdictional Nexus Test

Quill is an important case for e-businesses, because of their similarities to mail order businesses.[117] Common characteristics include "the ability to sell in many states without having a physical presence there . . . [and] only hav[ing] customer contact either through the mail or computer."[118] The issue in *Quill* was whether a mail order company with facilities in several states but no personnel and no warehouses in North Dakota had a substantial nexus so that North Dakota could require vendors to collect and remit taxes on out-of-state sales.[119] In *Quill*, "[T]he Supreme Court reaffirmed the 'bright line test' for 'substantial nexus' . . . holding that a company must have a physical presence within a taxing jurisdiction before a state can require the collection of state sales and use taxes."[120]

However, not only did *Quill* clarify the constraints, the *Quill* Court distinguished between them.[121] Due Process requires that a company have sufficient minimum contacts with a state in order to be subjected to taxation by the state.[122] For instance, the Kansas Supreme Court has summarized the issue:

> [T]he Commerce Clause requires a taxing state to have a substantial nexus with an out-of-state business to impose use tax collection and remittance duties. Substantial nexus requires a finding of physical presence in the taxing state. . . . Mail-order sales without more are a 'safe harbor' for out-of-state vendors. . . . A slightest presence is not sufficient to establish a substantial nexus . . . .

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117. Joseph R. Feehan, Comment, *Surfing Around the Sales Tax Byte: The Internet Tax Freedom Act, Sales Tax Jurisdiction and the Role of Congress*, 12 ALB. L.J. SCI. & TECH. 619, 625-26 (2002).

118. *Id.*

119. *See* Matthew G. McLaughlin, Comment, *The Internet Tax Freedom Act: Congress Takes a Byte Out of the Net*, 48 CATH. U. L. REV. 209, 223 (1998).

120. Sean P. Nehill, Comment, *The Tax Man Cometh? An Argument for the Taxation of Online Purchases*, 13 COMMLAW CONSPECTUS 193, 194-95 (2004).

121. The *Quill* Court specifically delineated a difference between sufficient minimum contacts in order to satisfy the Due Process Clause and such contacts that would satisfy the Commerce Clause requirements when it overruled the due process holding in *National Bella Hess*. *Quill*, 504 U.S. at 308, 312; *see also* Nat'l Bella Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753 (1967). The Court affirmed the Commerce Clause holding in *National Bella Hess*, stating that a tax that is constitutional under the Due Process Clause could still be held unconstitutional under the Dormant Commerce Clause. *Quill*, 504 U.S. at 313 & n.7.

122. *See, e.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978).

> but some states have found that 'more than a slightest presence' is sufficient.[123]

The physical presence requirement within the substantial nexus prong of the *Complete Auto* test need not be substantial; it need only be "demonstrably more than a 'slightest presence.'"[124]

In light of e-commerce, the substantial nexus test loses some traction due to the Internet's "shapeless nature."[125] Many companies with an online presence are not required to collect sales tax on their online transactions.[126] Scholars have argued that this jurisdictional test gives Internet companies a "distinct advantage" over their counterparts with a physical presence.[127] Thus, it seems that the extent of any such advantage would be fairly minimal; therefore, narrow exceptions to the status quo seem appropriate and are likely to apply when taxing Internet wine sales.

2. The Shift from Complete Auto & Bacchus to Quill

"By the 1970s, the Court began to show signs that the limits on state [regulatory] power were going to continue shrinking. This era culminated in the landmark *Bacchus Imports Ltd. v. Dias* case, setting forth the greatest limitation on states' 21st Amendment regulatory powers."[128]

This shift was a long time coming, because "[f]rom 1873 until 1977, the Court applied the rule that a state may not directly tax interstate commerce. . . . The Court, however, allowed taxes that were deemed to have only an indirect burden on interstate commerce."[129] Significantly, in 1977, with *Complete Auto Transit Inc. v. Brady*, the Court began to veer sharply away from this

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123. *In re* Intercard, Inc., 14 P.3d 1111, 1122 (Kan. 2000) (citation omitted).

124. *Id.*; *see also* Orvis Co., Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954, 960-61 (N.Y. 1995).

125. *See* Eric A. Ess, Comment, *Internet Taxation Without Physical Representation?: States Seek Solution to Stop E-Commerce Sales Tax Shortfall*, 50 ST. LOUIS U. L.J. 893, 894 (2006). ("[T]he Internet . . . allows e-tailers to be physically present in only one state while selling goods in every other state and internationally.") (footnote omitted).

126. *See* Nehill, *supra* note 120, at 194-95.

127. *See, e.g.*, *id.* at 195; *see also* Walter J. Baudier, iBrief, *Internet Sales Taxes from Borders to Amazon: How Long Before All of Your Purchases are Taxed?*, 2006 DUKE L. & TECH. REV. 5 ¶¶ 13-14 (explaining why states' raising their sales tax rates to compensate for lost sales tax revenues from Internet sales would still provide a tax preference to Internet retailers).

128. Matthew B. Millis, Note, *Let History Be Our Guide: Using Historical Analogies to Analyze State Response to a Post-*Granholm *Era*, 81 IND. L.J. 1097, 1105 (2006) (referring to Bacchus Imps., Ltd. v. Dias, 468 U.S. 263 (1984)).

129. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 434 (2d ed. 2002).

position.[130] By 1984, with the *Bacchus Imports* case, the course was even clearer: state regulatory taxes based on the 21st Amendment fell within the scope and limitations of the Commerce Clause.[131]

Complete Auto was the first case in which the Court stopped applying the seemingly arbitrary historical direct/indirect burden approach and developed a test similar to the state-regulation-of-interstate-commerce test.[132] In *Complete Auto*, Mississippi tried to tax Complete Auto, an out-of-state carrier that delivered automobiles to dealers throughout the state.[133] Mississippi employed the common argument that the state had jurisdiction to tax Complete Auto because "[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden."[134] Complete Auto challenged the tax on constitutional grounds, arguing that it violated the Commerce Clause.[135]

The *Complete Auto* four-part test determines if a state tax violates the Commerce Clause.[136] A tax is constitutional when: (1) it is applied to an activity with a substantial nexus to the taxing state; (2) it is fairly apportioned to tax only the activities connected to the taxing state,[137] (3) it does not discriminate against out-of-state businesses;[138] and (4) it is fairly related[139] to services provided by the state.[140]

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130. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288-89 (1977) (overruling Spector Motor Serv. v. O'Connor, 340 U.S. 602 (1951).

131. *See Bacchus Imps.*, 468 U.S. at 275-76.

132. *See* Barringer v. Griffes, 1 F.3d 1331, 1335 (2d Cir. 1993); *Complete Auto*, 430 U.S. at 279-88 (discussing the developments and issues inherent in the *Spector* rule).

133. *See Complete Auto*, 430 U.S. at 276-77.

134. *Id.* at 279 (citing Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

135. *See id.* at 278.

136. *Id.* at 279.

137. Fair apportionment means that a state tax may be applied only to the portion of a company's business that is actually connected to the taxing state. The fair apportionment requirement is rarely an issue because the "connection" to the taxing state is assumed to be physical which means that this factor is rolled into the first factor, the substantial nexus requirement. *See* 68 AM. JUR. 2D *Sales and Use Taxes* § 189 (2006).

138. State laws discriminating against interstate commerce are per se invalid. Fulton Corp. v. Faulkner, 516 U.S. 325, 331 (1996) (citing Or. Waste Sys., Inc. v. Dep't of Envtl Quality of Or., 511 U.S. 93, 99 (1994)). States may not impose a tax that provides an advantage for local businesses. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 329 (1977).

139. States may tax out-of-state businesses if the states provide some benefit in return. Toomer v. Witsell, 334 U.S. 385, 399 (1948) (implying that a state could levy taxes against out-of-state businesses in proportion to the increased enforcement burden they impose).

140. *Complete Auto*, 430 U.S. at 279.

In *Bacchus Imports*, the Supreme Court "made a substantial move towards reconciling the Twenty-First Amendment with the [D]ormant Commerce Clause."[141] The *Bacchus Imports* Court "[struck] down Hawaii's discriminatory law that imposed a twenty percent tax on out-of-state labor," but exempted locally produced alcoholic beverages from Hawaii's Liquor Tax.[142] The Court also determined that "state laws that constitute mere economic protectionism," without any other legitimate state purpose would not be "entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor."[143] In striking down the Hawaii law, "the Court began with a 'cardinal rule of Commerce Clause jurisprudence . . . that [n]o State . . . "may impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."'"[144] The Court rejected Hawaii's claims that the tax was not discriminatory against interstate commerce for the reason that no out-of-state competition existed in that particular segment of the alcohol industry,[145] and that the laws were created to promote local industry.[146] Over the next two decades courts across the nation relied on *Bacchus Imports* to strike down laws discriminating against out-of-state businesses — the 21st Amendment could no longer save them.[147] The *Bacchus Imports* holding ended the days of states' freely regulating alcohol without regard to the Commerce Clause.[148]

E. *Limitations of the Dormant Commerce Clause*

Article I, Section 8 of the Constitution enumerates Congress' specific powers,[149] and Article IV authorizes congressional action.[150] This authority is not plenary. The Commerce Clause describes the scope of congressional power and restricts congressional action to matters that relate to "regulat[ing]

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141. Dickson, *supra* note 98, at 496.

142. *Id.*; *see also* Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 273 (1984).

143. *Bacchus Imps.*, 468 U.S. at 276.

144. Brannon P. Denning, *The Maine Rx Prescription Drug Plan and the Dormant Commerce Clause Doctrine: The Case of the Missing Link[age]*, 29 AM. J.L. & MED. 7, 15 (2003) (alterations in original) (internal quotation marks omitted) (quoting *Bacchus Imps.*, 468 U.S. at 268).

145. *Bacchus Imps.*, 468 U.S. at 268-69.

146. *Id.* at 271.

147. Dickson, *supra* note 98, at 497.

148. Prior to *Bacchus Imports*, "the Court maintained in most cases that the states retained the sole power to regulate alcohol within their borders." Millis, *supra* note 128, at 1106.

149. *See* U.S. CONST. art. I § 8.

150. *See id.* art. IV.

Commerce . . . among the several States."[151] Constitutional law jurisprudence has simplified this to mean that Congress holds exclusive power to regulate interstate commerce.[152] One check on federal power is the 10th Amendment, which reserves any non-delegated rights in favor of the states.[153] Yet courts have long inferred a limitation on the commerce power of states, known as the Dormant Commerce Clause, from the Commerce Clause itself.[154]

The Court addressed the Dormant Commerce Clause in *Gibbons v. Ogden*,[155] when Chief Justice Marshall defined the outer limits of congressional power through the Commerce Clause. The Dormant Commerce Clause acts as an independent limit on state power, even if Congress has not enacted legislation in that field.[156] Not only are states prohibited from regulating interstate commerce, they are also forbidden from burdening interstate commerce.[157] Taxing interstate commerce is one of the many ways that states can burden commerce. States lack jurisdiction to impose even an equal tax on interstate commerce if the business has no physical presence in the state.[158] In other words, just as states cannot *regulate* commerce in a discriminatory manner, states also cannot *tax* interstate commerce in a discriminatory manner. While states are allowed to regulate interstate alcohol shipment under the 21st Amendment, the Dormant Commerce Clause prohibits states from doing so in a discriminatory manner. Thus, states cannot regulate or tax in a way that would materially burden interstate commerce. Legislation that has the intent or effect of favoring

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151. *Id.* art. I § 8.

152. *See* S. Ry. Co. v. Greene, 216 U.S. 400, 416 (1910) ("[G]iving to Congress the exclusive power to regulate interstate commerce.").

153. The Tenth Amendment to the U.S. Constitution specifies that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." U.S. CONST. amend. X.

154. *See* W. & S. Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648, 652 (1981) ("[T]he Commerce Clause contains an implied limitation on the power of the States to interfere with or impose burdens on interstate commerce."); *see also* 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787 at 625-26 (Max Farrand ed., Yale Univ. Press 1966).

155. In *Gibbons v. Ogden*, the court rejected any constraints on this plenary power:

> This power . . . is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the constitution. . . . [T]he sovereignty of Congress . . . is plenary as to those objects, the power over commerce with foreign nations, and among the several States, is vested in Congress as absolutely as it would be in a single government.

Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 197 (1824).

156. *Id.* at 236.

157. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (1935).

158. Nehill, *supra* note 120, at 194-95.

in-state economic interests over out-of-state interests, which discriminates against interstate commerce, is an illegitimate exercise of state power.[159]

1. Is the 21st Amendment Limited by the Dormant Commerce Clause?

The 21st Amendment gives the states broad power to regulate *inter*state alcohol in commerce similar to how they can regulate *intra*state alcohol in commerce. State power to regulate alcohol, though governed by different authorities throughout history, has always been limited by the Dormant Commerce Clause.

The *Granholm* Court interpreted the 21st Amendment as restoring the same power to the states that they had under the Wilson and Webb-Kenyon Acts.[160] *Granholm* expanded the scope of the Commerce Clause to limit state regulation of interstate commerce related to alcohol.[161] Granted, the 21st Amendment gives states broad power to regulate, but it does not supersede other provisions in the Constitution.[162]

In *Walling v. Michigan,* the United States Supreme Court held that "[a] discriminating tax imposed by a state operating to the disadvantage of the products of other states when introduced into the first-mentioned state, is, in effect, a regulation, restraint of commerce among the states, and, as such, a usurpation of the power conferred by the constitution upon the congress of the United States."[163] In short, states cannot burden interstate commerce through taxes. States lack jurisdiction to require out-of-state vendors to collect a sales or use tax when the vendor has no "physical presence" in the taxing state.[164] *Granholm* reaffirmed this general rule and applied the requirement to wineries. Now the question remains: "If states *must* treat all wineries equally, how *may* they treat the wineries?"

159. *Baldwin*, 294 U.S. at 527.
160. Granholm v. Heald, 544 U.S. 460, 462 (2005); *see* discussion *supra* Part II.C.
161. *See Granholm*, 544 U.S. at 493.
162. *See id.* at 486-87.
163. Walling v. Michigan, 116 U.S. 446, 455 (1886).
164. *Granholm*, 544 U.S. at 475.

2. Current Options: Level Up to Allow Direct-shipping from Any Winery; Level Down to Prohibit Direct-shipping from Any Winery

Though the Court left states with the option to either level up or level down,[165] cases indicate that leveling down is an unlikely option. In *Jelovsek v. Bredesen,* an interlocutory opinion filed shortly after *Granholm*'s decision, the district court confirmed that an individual, as distinct from a winery licensee, has standing to bring suit against a state with discriminatory shipment laws.[166]

Jelosevek was consolidated with the *S.L. Thomas Family Winery* suit, where the State of Tennessee contended that its laws deny direct shipment equally to all wineries; the court called the suit a de facto discrimination case based on differential inconvenience.[167] The court had already rejected this defense in *Huber Winery v. Wilcher*, in which the court held that the state's proposed leveling down to on-site sales for all wineries failed under the rule set forth in *Granholm* because of the greater burden of visiting a California winery relative to a local winery.[168] The *Huber Winery* opinion is significant because (1) it reviewed the state's laws through a "strict scrutiny" lens; and (2) it recognized that actual availability of wine from one area does not compensate for denying access to wines from other areas.[169]

Shortly after *Granholm*, several states enacted legislation regulating the direct shipment of wine from out-of-state wineries.[170] Initially, Virginia was a trendsetter, notably bucking the movement towards restriction and reciprocity when it opened its market and "legalized direct wine shipping to consumers from out-of-state sellers" in 2003, prior to the *Granholm* decision.[171] Research on Virginia's wine market

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165. *Id.* at 493.

166. Jelovsek v. Bredesen, No. 2:05-CV-181, 2006 U.S. Dist. LEXIS 40684, at *5 (E.D. Tenn. June 16, 2006) (order denying motion to dismiss), *dismissed*, 482 F. Supp. 2d 1013 (E.D. Tenn. 2007).

167. *See Jelovsek*, 482 F. Supp. 2d at 1013.

168. Huber Winery v. Wilcher, 488 F. Supp. 2d 592, 595-96 (W.D. Ky. 2006); *see also* Cherry Hill Vineyards, LLC v. Hudgins, 488 F. Supp. 2d 601, 615-16 (W.D. Ky. 2006).

169. *Huber Winery*, 488 F. Supp. 2d at 596-600.

170. Thirty-three states have passed direct-shipment legislation. "States that have passed DTC or SD legislation . . . include, among others, Arizona, California, Colorado, Connecticut, Idaho, Indiana, Kansas, Maryland, Michigan, New York, Ohio, Texas, Vermont, and Washington." Some states that reacted negatively by prohibiting all direct-shipment are Delaware, Kentucky, Louisiana, Mississippi and Virginia. Eric Berg, *Update on Direct Shipment of Wine to Other States*, Hatch & Parent Case Alert (August 2006).

171. Wiseman & Ellig, *supra* note 16, at 1, 9 & n.10.

showed that "while average bricks-and-mortar prices still exceeded average online prices in 2004, the size of the price difference decreased by nearly 40 percent compared to 2002, when direct-shipment was illegal."[172] "These findings are consistent with the hypothesis that removal of the interstate shipping ban increased competition in the bricks and mortar world, contributing to lower prices. More broadly, they illustrate how the elimination of interstate trade barriers . . . facilitates efficient markets."[173]

But is this competition really what states want?[174] Granted, an efficient and competitive market is beneficial for consumers, but if the sheer revenue from wine sales decreases at bricks-and-mortar outlets, then states might be expected to lose tax revenue as a direct result of the increased competition. However, the research is contrary to this expectation. One study "suggest[ed] that 'leveling the playing field' by banning all direct shipment would lead prices in bricks-and-mortar stores to be higher than they would be if direct shipment were legal."[175] Apparently, prices for the same wine were consistently about nine percent lower online than in bricks-and-mortar outlets.[176] Thus, it appears that consumers lose out when states prohibit direct shipment.

> Throughout the debate over the legalization of direct shipment, advocates for wholesaler interests have consistently argued that any highly desirable wine can easily find its way into the distribution network. . . . [Of the wines sampled, 12.5 percent] were not available in bricks-and-mortar stores . . . [w]hile there has been some increase in the percentage of wines available both online and offline following the legalization of direct shipment, the increase has not been substantial.[177]

In a related matter, in December 2005, just five months after *Granholm*, the Costco Wholesale Corporation won a landmark legal battle against the Washington State Liquor Control

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172. *Id.* at 5.

173. *Id.* at 1.

174. Though Virginia had taken a progressive approach to direct shipment early on, since the *Granholm* decision it is one of the few states to completely prohibit direct shipment. Berg, *supra* note 170.

175. Wiseman & Ellig, *supra* note 16, at 6.

176. *Id.* at 22.

177. Wiseman & Ellig, *supra* note 16, at 20-21 (citation omitted).

Board.[178] Questioning Washington's law allowing only in-state wineries to distribute,[179] Costco asserted that the state's mandatory three-tier distribution system injured the wholesaler's ability to do business and violated federal antitrust law.[180] Citing the recent precedent of *Granholm*, the *Costco II* court agreed that the state law allowing in-state beer and wine producers to ship directly to retailers while prohibiting out-of-state producers from doing the same violated the Commerce Clause.[181] But despite its holding in favor of Costco, the court sided with the state in suggesting that the appropriate judicial remedy would involve leveling *down* if the state legislature itself did not correct the problem.[182] The Washington Legislature, however, ultimately opted to level up.[183]

Considering the decisions following *Granholm*, it appears that courts may draw a distinction between wineries selling directly to consumers and wholesalers purchasing directly from wineries. Steering away from a blanket rule and treating the wholesale and retail industries differently seems to be the only way to reconcile these conflicting cases. Thus, if states are not allowed to level down with respect to wineries directly shipping

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178. In two separate suits, Costco Wholesale Corp. v. Hoen (*Costco I*), 407 F. Supp. 2d 1234 (D. Wash. 2005) and Costco Wholesale Corp. v. Hoen (*Costco II*), 407 F. Supp. 2d 1247 (D. Wash. 2005), Costco sought to invalidate several Washington state alcohol regulation laws, namely:

> 1) distributor price posting; 2) minimum wholesale markups; 3) credit law (Washington is a cash state, requiring retailers to pay cash on delivery for alcoholic beverages); 4) prohibition on quantity discounts and cumulative quantity discounts; 5) prohibition on direct delivery from out-of-state wineries to Costco warehouses.

Hinman & Steinthal, *supra* note 6, at 7 (predicting, before the court's ruling, that a win by Costco would mean that "*any* retailer in *any* state where in-state wineries have a right to ship directly to retail accounts in their own states should possess the same right").

179. WINEAMERICA, FROM THE PRESIDENT'S DESK NEWSLETTER (Jan. 2006), http://www.americanwineries.org/newsroom/newsletters/January%202006%20%20Newsletter.doc.

180. Kristen Millares Bolt & Dan Richman, *Costco Wins Rulings Over State's Beer, Wine Laws*, SEATTLE POST-INTELLIGENCER (Dec. 22, 2005), *available at* http://seattlepi.nwsource.com/business/253042_costco22.html.

181. *See Costco II*, 407 F. Supp. 2d at 1252, 1256; Bolt & Richman, *supra* note 180.

182. After considering the alternative remedies of leveling up versus leveling down, the court noted that while

> [W]ithdrawing the self-distribution privilege would impose financial hardships on Washington wineries, this remedy would appear to be more consistent with the intent of the Washington Legislature because it would impose less significant changes on the existing statutory and regulatory structure for beer and wine in the state.

Costco II, 407 F. Supp. 2d at 1256. The court stayed entry of its order pending treatment of the issue by the Washington State Legislature. *Id.*

183. WASH. REV. CODE §§ 66.20, 66.24.210 (2006).

to consumers, then it may not matter if a tax compromise is reached at all. At the moment only a few states[184] have decided to forbid direct shipment so the national tide could change.

While the consumer should be satisfied with the current trend, states are likely to fight back with greater vigor in an attempt to condition direct-shipment upon the payment of taxes. With California leading the charge to convince large wineries to agree to a consensual tax agreement, states may get what they want after all—assuming that the California tax scheme is constitutional.[185]

F. *Internet Commerce*

1. Overview of the Internet Tax Freedom Act

The Internet Tax Freedom Act ("ITFA") was signed into law in October, 1998 as part of the Clinton administration's effort to promote the use of the Internet in commerce, education, and at home.[186] Before Congress passed the ITFA, few states applied sales or other excise taxes to Internet activities.

> [U]nder Supreme Court rulings on sales tax jurisdiction, some companies could be taxed, while others could not and still others did not know their status. Large retailers with a physical presence in most states easily fell under the taxing jurisdictions of those states, while their smaller counterparts, even when selling the same or similar items, avoided the grasp of these taxing jurisdictions. . . . Congress decided to pass the ITFA in order to study and clarify the issue of taxes in cyberspace and to express Congress' feeling that the Internet should remain a "tariff-free zone."[187]

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184. FTC Report, *supra* note 45, at 7-8. States that currently forbid direct shipment include Alabama, Arkansas, Delaware, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Mississippi, Montana, New Jersey, Oklahoma, Pennsylvania, South Dakota, Tennessee, and Utah. United States map regarding state shipping laws, *available at* http://www.wineinstitute.org/shipwine (last visited Oct. 17, 2007).

185. *See* discussion *infra* Part III.A.2.

186. Internet Tax Freedom Act, Pub. L. No. 105-277, div. C, tit. XI, 112 Stat. 2681, 2681-719 to -726 (1998) (codified as amended at 47 U.S.C. § 151 (2000 & Supp. IV)); *see, e.g.*, Press Release, The White House, President Clinton and Vice President Gore: Putting People First in the Information Age (Nov. 8, 1999), 1999 WL 1018613.

187. Feehan, *supra* note 117, at 626 (footnote omitted).

2. The Business of Internet Commerce (E-Commerce[188])

Each year, "increasingly more people use the Internet to purchase goods and services."[189] Consumer Internet purchases are expected to exceed $144 billion annually and business related purchases will reach $1.3 trillion.[190] "From 1994-99, consumers doubled the amount of money they spent having wine shipped directly to them to around $500 million, or about three percent of the total spent on wine. According to some private estimates, online wine sales could account for five to ten percent of the market within a few years."[191]

Much is dependent upon the outcome of the movement to make ITFA permanent. Allowing wine sales via the Internet will give small wineries the opportunity to gain more market share and have more opportunities to research, develop and expand—which would lead to significant profits.[192] Local bricks-and-mortar or "Main Street" businesses are increasingly concerned with the success of Internet business and its impact on their business.[193] Main street businesses view a state sales tax as the natural answer to the problem because they feel that they are at a disadvantage as ITFA does not allow taxation of Internet sales.[194] State and local governments have also expressed concern over the effect that ITFA's moratorium has had on their ability to raise revenues.[195] Most states impose a general sales and use tax,[196] and about 35 percent of their revenue comes from

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188. Nehill, *supra* note 120, at 193.

189. Kevin J. Smith, *Internet Taxes: Congressional Efforts to Control States' Ability to Tax the World Wide Web*, 7 RICH. J.L. & TECH. 3, para. 1 (Fall 2000), *available at* http://www.law.richmond.edu/jolt/v7i1/article3.html.

190. *Id.*

191. FTC Report, *supra* note 45; *see also* Granholm v. Heald, 544 U.S. 460, 467 (2005).

192. *See* Castanias, *supra* note 66 ("[The *Granholm* holding] will better allow smaller wineries to advertise and ship via the internet, greatly expanding their market. . . . Even so, many larger winemakers in California and elsewhere have been making small-batch, limited edition wines that have not, to date, been available other than by direct sale at the winery, so *Granholm*'s promise of an expanded national marketplace may have benefits for them as well.").

193. Smith, *supra* note 189, para. 2.

194. *Id.*

195. *Id.* at para. 3.

196. *See, e.g.*, 9 B.E. WITKIN, CALIFORNIA TAX ch. 11, § 355 (10th ed. 2006) ("The chief purpose of the use tax is to reach property purchased from outside the state, where the taxable event of a sales tax (the sale) occurs outside the territorial boundaries of [the state] or is immune under the Commerce Clause"); *see also* Rich McKeown, Symposium, *Questioning the Viability of the Sales Tax: Can It Be Simplified to Create a Level Playing Field?*, 2000 B.Y.U. L. Rev. 165, 171 ("[T]he forty-six states that collect sales tax now impose a use tax."); 68 AM. JUR. 2D *Sales and Use Taxes* § 192.

taxes.[197] Those calling for a tax on Internet sales speculate that states will be forced to shift the tax burden or cut services.[198] Conversely, most businesses are in favor of extending ITFA's moratorium. "The business world takes a more positive view of the . . . internet tax moratorium. A recent survey of chief financial officers showed that 57 percent favored an extension . . . while only 16 percent opposed it."[199]

Since 2001, states have been looking to the success of online industries as the cause of falling revenue streams from sales tax. "The ease with which consumers and vendors are able to transact business over long distances has created a host of novel problems for state governments generally, and the amorphous nature of the Internet has had a particularly acute effect on taxation of retail sales."[200]

"The National Governor's Association and state governments adamantly argue they are losing billions, claiming twenty billion dollars in lost tax revenue due to Internet sales in 2003."[201] In 2004, the U.S. Department of Commerce reported that e-commerce was responsible for 1.7% of total domestic retail sales.[202] "[A]nalysts estimate that state and local governments lost $15.5 billion in taxes in 2004 and that losses will escalate to $21.5 billion in 2008."[203] Generally, it is agreed that the shift from purchasing at physical locations to purchasing via the Internet has affected the retail industry.[204] What is contested, however, is exactly how and to what extent the shift has affected the industry:

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197. Symposium, *Legal Potholes Along the Information Superhighway*, 16 LOY. L.A. ENT. L.J. 541, 573 (1996) (citing R. Scot Grierson).

198. *Electronic Commerce State Sales Tax Collection Plan Feasible, Internet Giants Tell Panel*, [Jan.-Mar.] Daily Rep. for Executives (BNA) (Feb. 9, 2006) (on file with author) (summarizing Enzi's stance that bill is not about taxes but economic growth and state programs).

199. Feehan, *supra* note 117, at 636; *see also* Press Release, RHI Management Resources, No Taxing Matter (Feb. 13, 2001), *available at* http://www.rhimr.com (follow "Press Room" hyperlink; then follow "2001" hyperlink; then follow "No Taxing Matter" hyperlink).

200. Ess, *supra* note 125, at 893-894.

201. Pamela Swidler, Note, *The Beginning of the End to a Tax-Free Internet: Developing an E-Commerce Clause*, 28 CARDOZO L. REV. 541, 548-49 (2006).

202. Nehill, *supra* note 120, at 193.

203. Baudier, *supra* note 127, at ¶ 12.

204. *See* Swidler, *supra* note 201, at 549-50 n.55 ("[C]ommentators calculated [a] $3.5 billion dollar revenue loss in 2003. . . . In a more recent study . . . the total loss estimate stood around $1.9 billion. According to this study, states would 'be seriously disappointed in the increase in state treasuries' that would result from changing the nexus standard or enforcing the tax.").

> Sales taxes are the largest single source of state and local tax revenue, with the general sales tax proceeds making up approximately one third of all state tax revenue. . . . While Internet sales have increased exponentially over the past several years, there is still debate over the amount states are actually losing. . . . On the other hand, many economists are skeptical about these high estimates, and claim that profits from enforcing the use tax are not worth the trouble and cost associated with ensuring individual or retailer compliance.[205]

Previously, Internet purchases were treated as *de minimis* and any efforts expended on collecting related taxes were thought to likely exceed the value of the tax collected.[206] The issue becomes far more complicated when interstate purchases are made via the Internet, in which case the purchaser is "required" to self-report[207] and remit his own tax at the end of each year.[208]

III. ANALYSIS

A. *Is* Granholm v. Heald *a Victory for Wineries At All?*

1. Victory Rings Hollow Once the Tax Gap Is Identified

That states must now treat all wineries equally regardless of their state of origin does not necessarily mean that direct-shipping will be allowed. Without revenue from state sales tax, states are more likely to prohibit direct-shipping. First, if states still believe, contrary to the Federal Trade Commission ("FTC") findings,[209] that direct-shipping encourages underage drinking, the states will insist upon banning direct shipment. Second,

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205. *Id.* at 548-49 (footnote omitted).

206. *See id.* at 549.

207. The e-Fairness Coalition claims that because many consumers do not understand their use tax responsibility, and compliance with use tax requirements is low, millions of Americans shopping online are violating the law. E-FAIRNESS COALITION, INTERNET TAX POLICY MYTHS AND FACTS (2006), http://www.e-fairness.org/myth/myth.htm (last visited September 28th 2007). However, the group advocates "taking the burden of paying the use tax off of the consumer and providing all merchants with equal sales tax collection responsibilities." *Id.*

208. *See* Nehill, *supra* note 120, at 198-200 (discussing the merits of remitting one's use tax).

209. FTC Report, *supra* note 45, at 14.

studies have shown that the market is more efficient when direct-shipping is allowed, and that as prices for off-line sales of wines drop, therefore states will collect less tax per item sold both on-line *and* off-line.[210] Third, states continue to argue that their local business will be hurt by artificially low pricing because on-line competitors do not have the physical costs of running a brick-and-mortar business.[211] The *Granholm* Court found that states provided little evidence for the claim that potential problems from Internet wine sales could not "be addressed by less restrictive steps such as requiring an adult signature on delivery."[212] The Court also rejected claims that the possibility of tax evasion was greater for out-of state wineries.[213]

Furthermore, the Court found that "the discriminatory regulations substantially limited the direct sale of wine to consumers, an emerging and significant business under the Commerce Clause . . . . In particular, the ability of small wineries to sell wine over the Internet has helped make direct-shipments more attractive."[214] Although approximately twenty-six states allowed some direct shipment of wine, only thirteen of those states had reciprocity laws permitting direct shipment from wineries outside the state.[215] The FTC determined that interstate direct shipping bans significantly impede the expansion of wine sales on the Internet.[216]

a. Concerns Regarding Under-Age Drinking When Purchaser Cannot Be Identified

The FTC researched the effect of online wine sales and concluded that states could significantly enhance consumer welfare by allowing direct-shipment as a purchase option.[217] In supporting e-commerce freedom, the FTC rebutted state claims that state laws advanced legitimate purposes, such as shielding minors from ordering wine online.[218] In fact, states' claims that

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210. *See* Wiseman & Ellig, *supra* note 16.

211. *See* Smith, *supra* note 189, at 2.

212. Miranda, *supra* note 58, at 28.

213. *See* Granholm v. Heald, 544 U.S. 460, 491- 92 (2005).

214. *Id.* at 467.

215. *Id.* at 467-68.

216. FTC Report, *supra* note 45, at 15.

217. *Id.*

218. Teenage Research Unlimited ("TRU") issued the results of a survey it conducted of 1,001 people aged 14-20 during early 2006. Two percent of respondents reported having purchased alcohol online. *See* TEENAGE RESEARCH UNLIMITED, RESEARCH FINDINGS: UNDERAGE ALCOHOL ACCESS & CONSUMPTION: INTERNET, PHONE, AND MAIL (Summer 2006), *available at* http://www.wswa.org/public/media/tru-research/TRUSurvey080206.pdf. The TRU survey (sponsored by wholesalers) does not distinguish

Internet wine sales will lead to alcohol in the hands of minors via negligence do not seem to have much foundation in reality. As for being willing to simply leave packaged wine on the doorstep after delivery, wineries say, "not only do we not wish to sell to minors, but our products are perishable. The last thing that [we] want is a $1,200 case of wine sitting on someone's doorstep in Florida in 90-degree heat."[219]

According to wineries, "[t]here is not a single winery . . . willing to sell to a minor in another State. We are . . . willing to adopt packaging requirements that would clearly show . . . [the package] contains alcohol and . . . requires a signature of an adult recipient."[220] Wineries are willing to add age verification at the point of sale, and distributors are working to develop technology that would cross-reference driver's license and credit card information to make the process more secure.[221] Also, wineries assert that they are willing to work only with shippers who will require age verification at the point of delivery.[222] Between the FTC study and wineries' dedication to protecting against under age drinking, this argument seems to be effectively extinguished.

b. Local Businesses Potentially Hurt By Competition

It is doubtful that local businesses would be hurt by competition. In fact, as noted above, it would seem that competition would make the market operate more efficiently.[223] Local wineries may have to raise their standards, but that should be the case in any market. Additionally, though wine price-points are rising,[224] the higher income demographic of wine buyers and drinkers makes it unlikely that the wineries would need to resort to price wars in order to attract consumers. Finally, wineries stick together.[225] Wineries are working as a unified force to do what is best for their industry as a whole,

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among different types of alcohol. It also does not indicate whether the availability of wine online has increased underage consumption above levels that otherwise would exist. Finally, FTC research to date has not found evidence that online shipment is likely to increase underage consumption of wine. *See* FTC Report, *supra* note 45, at 14.

219. *Hearing on Status and Prospects of American Wine, supra* note 30, at 31 (testimony of Tom Shelton, CEO of Joseph Phelps Vineyards).

220. *Id.*

221. *Id.*

222. *Id.*

223. *See supra* note 146 and accompanying text.

224. *See supra* note 31 and accompanying text.

225. *See Hearing on Status and Prospects of American Wine, supra* note 30, at 23.

which makes it improbable that wineries would be willing to resort to price wars.

> [T]he larger wineries need small wineries and vice versa. The larger are like the mother ship providing the energy for research dollars, political support, and spreading the positive health messages about wine. The smaller wineries are like the star fighters, providing and protecting image, consumer interests, and a high profile for . . . wines. When we stand back and take a look at the big picture, we are all in this together.[226]

Further, "[t]he U.S. wine industry has undertaken a unique exercise to work together to sustain the success that we have enjoyed thus far. This strategic planning process, called WineVision: American Wine in the 21st century, began more than a year ago [as of August 1999]."[227] WineVision further demonstrates that wineries support each other. In addition, WineAmerica has gathered wineries to join forces.

> WineAmerica and its 800 winery members support laws and regulations at the state and national level that resolve constitutional issues while recognizing that the states have a legitimate and substantial interest in the benefits to consumers, agriculture, manufacturing, tourism, and land use created by the growth of the wine industry.[228]

2. Small Winery v. Large Winery–Willingness to Monitor, Collect & Report Tax and How It Will Affect Business: Is This New Market Worth the Legal Hoops of Fire?

As evidenced from above, wineries stick together, but does this really mean anything with California at the helm? California wineries, which produce 90% of America's wine,[229] are quite willing to submit to out-of-state sales tax.[230] Can the smaller wineries afford to hold the party line? Other large traditional

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226. *Id.*

227. *Id.* at 54.

228. WINEAMERICA NEWSLETTER, *supra* note 179.

229. *Hearing on Status and Prospects of American Wine*, *supra* note 30, at 8.

230. *See* Edward Epstein, *Battle royal over wine shipped interstate: Winemakers want direct internet sales; distributors say no*, S. F. CHRONICLE, December 8, 2003, *available at* http://sfgate.com/cgi-bin/article.cgi?file=/c/a/2003/12/08/MNG1S3IB5J1.DTL&type.

retailers are also willing to submit to taxation.[231] Some online giants told the House Small Business panel that "[w]hether the federal government allows states to require businesses to collect taxes for remote Internet sales is a policy decision Congress will have to make, not a question of whether it can be done . . . . The ability and desire to do the collections are within the industry's capabilities . . . ."[232]

Some delegates have taken note of the impact that a tax on Internet sales would pose for small businesses, due to the 7,500 different tax jurisdictions in the United States.[233] Concerns include: the cost of contracting the sales tax collection out to another company; the expense of computer system upgrades and modifications; the difficulty of training employees on new systems; and the possibility that the off-the-shelf solution would not work properly.[234] These considerations are all simply daunting possibilities for small business owners.[235] Conversely, large Internet retailers such as Amazon.com "would not be hurt by a sales tax collection requirement, so long as the administrative burdens of collection were eliminated and . . . online competitors also would be required to collect."[236]

Member states[237] of the Streamlined Sales Tax Project ("SSTP") say it is entirely practicable to require out-of-state vendors to collect sales tax on remote sales under a more unified and simplified system of laws.[238] Proponents of the Sales Tax Fairness and Simplification Act ("STFSA") agree with a reformed sales tax plan and state that their bill "would help states reduce the burden on consumers and provide a mechanism that would allow them to systematically and fairly collect the taxes already owed to them. It would impose the taxes on in-store, catalog, and online retailers so that each has the same sales tax collection responsibilities."[239] While some large companies may criticize

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231. *See Electronic Commerce State Sales Tax Collection Plan Feasible, supra* note 198.

232. *Id.*

233. *Id.*

234. *Id.*

235. *Id.*

236. *Id.*

237. For member state descriptions, see Streamlined Sales Tax Project, *Frequently Asked Questions*, https://www.sstregister.org/sellers/Entry.aspx (last visited Nov.12, 2007) (listing Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, and West Virginia as "Full Member States" and Arkansas, Nevada, Ohio, Tennessee, Utah, Washington, and Wyoming as "Associate Member States").

238. *Electronic Commerce State Sales Tax Collection Plan Feasible, supra* note 198.

239. *Id.*

the Act's exemption for small businesses, other industry leaders concede that the exemption is at a level that is "arbitrary and far below established federal small business size standards."[240] The e-Fairness Coalition supports STFSA because of the Act's (1) decreased red tape and paper work; (2) exemption for businesses with revenue of less than $5 million; (3) "simplified" collection process; and (4) fairness for local merchants.[241]

It remains to be seen whether a system to monitor, collect and report taxes will ever be created and, if so, whether it will hinder the market. Currently, the possibility of collecting taxes after determining whether jurisdiction exists seems unrealistic and detrimental to the survival of small wineries. Finally, it is important to note one last danger—state sales tax is applied retroactively, which means a winery without a jurisdictional nexus at the time of sale might owe back taxes on all previous sales once the jurisdictional nexus develops.

B. *Interplay with the Internet Tax Freedom Act*

The original intent behind the Internet Tax Freedom Act has been extensively debated; there are two common themes: it is thought that (1) the original purpose of the legislation was to create a national policy to keep states from interfering with interstate Internet commerce,[242] and (2) the purpose of the Act was to protect the Internet so that it could continue to develop as a commercial and educational tool.[243]

The Act which "created a three-year moratorium on Internet taxes . . . did not forestall taxes on all Internet commerce, but rather prevented the creation of new taxes. States that already had a functioning tax on Internet access charges were not affected because of a 'grandfather' clause."[244] The moratorium

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240. *Id.*

241. *E-Fairness Coalition Supports Simplified Sales Tax System* [Jan.-Mar.] Daily Rep. for Executives (BNA) (Feb. 7, 2006) (on file with author).

242. Ess, *supra* note 125, at 904-906 ("The policy behind the ITFA was to ensure the survival of Internet commerce while in its infancy. Preventing onerous Internet access charges and discriminatory tax rates upon e-commerce vendors, the ITFA fostered a friendly environment for Internet commerce to blossom." (citing ITFA, Pub. L. No. 105-277, 112 Stat. 2681-719 (1998))).

243. *See* Timothy L. Fallaw, *The Internet Tax Freedom Act: Necessary Protection or Deferral of the Problem?* 7 J. INTELL. PROP. L. 161 (Fall 1999) (explaining that the Act "reflects a national policy decision to keep the Internet unfettered by state and local taxation during the critical early formation period").

244. Ess, *supra* note 125, at 904-905. *But see* Fallaw, *supra* note 243, at 179 ("All but eleven states are unable to utilize the grandfather provision of the Act and are therefore preempted from imposing virtually any taxes on potentially huge revenue-producing activities for the next three years.").

has been extended twice.[245] After the original moratorium expired on October 21, 2001, it was extended to November 1, 2003 with P.L. 107-75.[246] Congress subsequently passed P.L. 108-435, extending it an additional four years to November 1, 2007.[247]

"The ITFA bars three specifically identified categories of tax levies: (1) taxes on Internet access, (2) multiple taxes[248] on electronic commerce, and (3) discriminatory taxes on electronic commerce."[249] Significantly, "electronic commerce" is defined broadly. It includes "any transaction conducted over the Internet or through Internet access comprising the sale, lease, license, offer, or delivery of property, goods, services or information."[250]

In 2000, ITFA's originators called for its permanent extension.[251] Additionally, the New Economy Tax Simplification Act ("NETSA") was introduced which would have, if enacted, "prevent[ed] states from forcing out-of-state businesses to collect sales tax on their behalf."[252] The bill was expected to clarify the nexus problem.[253] However, the solution is never easy.

Shortly after ITFA was enacted, and before NETSA, Senator Ernest Hollings introduced a proposal in July 1999 that, if adopted, would create a five percent national Internet retail sales tax that the IRS would collect.[254] However, no action has been taken with this proposal.[255] Despite Hollings' attack against ITFA, it appears that there is far more support for making ITFA's tax moratorium permanent; in addition to the originators, four other political leaders have introduced legislation calling for a permanent moratorium.[256]

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245. Steven Maguire & Nonna A. Noto, Internet Tax Bills in the 109th Congress, Congressional Research Service Report for Congress (2006), *available at* http://italy.usembassy.gov/pdf/other/RL33261.pdf.

246. *Id.*

247. *Id.*

248. 68 AM. JUR. 2D *Sales and Use Taxes* § 180 (2006).

249. Smith, *supra* note 189, at 7; *see also* ITFA, Pub. L. No. 105-277, *supra* note 242.

250. ITFA, Pub. L. No. 105-277, *supra* note 242, § 1104.

251. *See* Doug Sheppard, *Cox, Wyden Propose Permanent Internet Tax Moratorium*, 18 STATE TAX NOTES 427, 427 (Feb. 7. 2000).

252. Press Release, Advisory Comm'n on Electronic Commerce, E-Commerce Comm'n Report Calls for Nexus Clarification (Apr. 17, 2000), http://www.ecommerce commission.org/releases/acec0417.htm.

253. *Id.*

254. *See* S. 1433, 106th Cong. (1999).

255. *See* Thomas (Library of Congress), http://thomas.loc.gov/cgi-bin/bdquery/z?d106:SN01433:@@@L&summ2=m&#major%20actions (last visited Jan. 2, 2008).

256. *See* S. 328, 106th Cong. (1999); *see also* S. 1611, 106th Cong. (1999); *see also Proposed U.S. Legislation Would Make Internet Tax Moratorium Permanent*, 19 TAX NOTES INT'L. 1424 (Oct. 11, 1999).

ITFA created the Advisory Commission on Electronic Commerce (ACEC) to study the tax effects of e-commerce.[257] "The ACEC's specific charge was to research state and local government efforts to collect sales and use taxes from remote vendors."[258] When the ACEC released its report in April 2000, it called for, among other things, an extension of the current moratorium on taxes.[259] While its initial goal did not garner the support necessary to become an official legislative recommendation, "the ACEC did propose that the states collaborate to simplify sales and use tax compliance."[260] This push toward simplification yielded the SSTP.

1. Does ITFA Preempt the Field of Internet Taxation?

Understanding limits on state regulatory and taxing power is essential to appreciating the significance of the ITFA and its likelihood for extension. If Congress has acted by passing a law within a specific field, assuming it is a lawful exercise of Congressional power, and the state has passed or attempted to pass a conflicting law in the same field, the state law is considered pre-empted.[261]

It is reasonable to believe that when Deborah Platt Majoras, Chairman of the Federal Trade Commission, expressed concern over the negative effects that would result from distorted competition due to restrictive government regulations on e-commerce, she was foreshadowing the stance that the FTC is likely to take on a permanent tax moratorium.[262] The FTC's likely stance on a permanent tax moratorium, combined with the number of Senators and Congressmen who support the ITFA, shows that ITFA is likely to be extended further or to become permanent. If this is accurate, and unless Congress or the Supreme Court carves out an exemption, then states cannot condition direct shipment upon payment of taxes so long as the field has been pre-empted, making those taxes illegal.

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257. ITFA, Pub. L. No. 105-277, *supra* note 242, § 1102(g)(1).

258. Ess, *supra* note 125, at 906.

259. *See* ADVISORY COMM'N ON ELECTRONIC COMMERCE, REPORT TO CONGRESS 2, 5, 19, 23 (2000), *available at* http://www.ecommercecommission.org/acec_report.pdf.

260. Ess, *supra* note 125, at 906.

261. 16A AM. JUR. 2D *Constitutional Law* § 241 (2006).

262. Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Remarks at The Progress & Freedom Foundation's Aspen Summit: The Fed. Trade Comm'n in the Online World: Promoting Competition and Protecting Consumers (Aug. 21, 2006) http://www.ftc.gov/speeches/majoras/060821pffaspenfinal.pdf.

The broad language of ITFA appears to pre-empt the entire field related to Internet taxation.[263] Field pre-emption exists when "either . . . the nature of the regulated subject matter permits no other conclusion, or . . . Congress has unmistakably so ordained."[264] "Where Congress has legislated . . . within its constitutional control and over which it has the right to assume exclusive jurisdiction and has manifested its intention to deal therewith in full, the authority of the states is necessarily excluded, and any state legislation on the subject is void."[265] Three factors indicate that IFTA should pre-empt any state law that conflicts with the act: Congress acted to regulate Internet commerce, Internet commerce is interstate due to its amorphous nature, and the constitutionality of such Act has not been successfully challenged. In this case, the state law that would be pre-empted is any state tax on the Internet or e-commerce. Additionally, since enactment of ITFA was partially in response to confusion caused by conflicting and overlapping taxes at state and local levels with widely varying tax rates, the area of law seems appropriate for Federal regulation.[266]

2. Is Internet Taxation the Correct Focus—Should the Topic Be Wine?

Even if the issue specifically involves the right to sell wine directly to consumers via the Internet, which is clearly federally regulated (even if only temporarily), it appears that pre-emption is still a valid concern. Historically, states have not been able to regulate where the federal government was involved, regardless of how minimal the involvement may be. In *Rice v. Santa Fe Elevator Corp.*, the Court held that the purpose of creating federal law was to eliminate parallel state and federal regulation of grain warehouses.[267] The multitude of different state alcohol regulatory schemes as well as congressional attempts at pseudo-regulation, and even the current Supreme Court ruling at bar, demonstrate the dual nature of alcohol regulation. When

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263. *See* Lawrence A. Hunter & George A. Pieler, *New.Economy@Old.Constitution: Internet Taxes and the Constitution*, 153 INST. FOR POLICY INNOVATION (2000), *available at* http://www.ipi.org (follow "Publications" hyperlink; then follow hyperlink to sort all IPI Publications by author; then follow New.Economy@Old.Constitution" hyperlink) ("The message of ITFA clearly is that the federal government is occupying the field of e-commerce and Internet taxation for now, subject to the sovereign authority of states acting on matters within their borders.").

264. Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142 (1963).

265. 16A AM. JUR. 2D *Constitutional Law* § 241 (2006).

266. Feehan, *supra* note 117, at 626-27.

267. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

combined with ITFA, the layers become so complex that co-existence could not possibly have been the intent. Additionally, if states were free to develop Internet-related law through their power to regulate alcohol through the 21st Amendment, it would seem to impede the ability of federal regulators to control and protect the Internet, which is exactly the purpose of the Act.[268]

C. *Interplay with the Streamlined Sales Tax Project*

While there were many supporters when ITFA was enacted, there were also a substantial number of dissenters. Among the dissenters were states that listened to retailers' complaints of "too many sales taxes . . . with too many variations and rates."[269] The SSTP was both a response to this complaint and a response to congressional concerns when it passed ITFA.[270] Presently, forty-two states are participating in the SSTP,[271] and twenty-one of them have begun implementing the recommendations.[272]

The SSTP was initiated in March 2000 by states trying to reduce the amount of work and quantity of expenditures required of businesses for the administration of state and local sales taxes.[273] The goals of the project include uniform definitions among tax laws, rate simplification, state level tax administration of all state and local sales and use taxes, uniform sourcing rules, simplified exemptions, uniform audit procedures, and finally, state funding of the system.[274]

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268. Smith, *supra* note 189, para. 10, at 178.

269. *See* Joe Huddleson, *Internet Taxation Issues Remain Unanswered,* THE TAX ADVISER (Feb. 1, 2001) *available at* http://www.thefreelibrary.com/_/print/PrintArticle.aspx?id=70639565.

270. *Id.*

271. STREAMLINED SALES TAX GOVERNING BOARD, INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY, (Jan. 2005), http://streamlinedsalestax.org/execsum0105.pdf; *see* Christina T. Le, Comment, *The Honeymoon's Over: States Crack Down on the Virtual World's Tax-Free Love Affair,* 7 HOUS. BUS. TAX. L.J. 102, Part V.B. (2005).

272. STREAMLINED SALES TAX GOVERNING BOARD, INC., STREAMLINED SALES TAX PROJECT: EXECUTIVE SUMMARY, (Jan. 2005), http://streamlinedsalestax.org/execsum0105.pdf.

273. *Id.*

274. *Id.* Perhaps Congress called for such a project because it considers a uniform tax plan necessary before it can even consider authorizing states to require online retailers to collect taxes on goods and services delivered in-state. *See* H.R. 1956, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h1956rh.txt.pdf (stating that "[n]o taxing authority of a State shall have power to impose, assess, or collect a net income tax or other business activity tax on any person relating to such person's activities in interstate commerce unless such person has a physical presence in the State during the taxable period with respect to which the tax is imposed."). The National Governor's Association is a leader in this effort. Swidler, *supra* note 201, at 563.

"In the 106th and 107th Congresses, a major controversy surrounding the bills to extend the original Internet tax moratorium involved the states' quest for sales and use tax collection authority."[275] Congress is unwilling to turn over the authority without restrictions; however, states might earn that authority by simplifying state sales tax systems to an acceptable level as deemed by Congress.[276] By the middle of November 2002, thirty-four states and the District of Columbia had agreed to such a system titled the Streamlined Sales and Use Tax Agreement ("The Agreement").[277] The Agreement establishes uniform definitions for taxable goods and services.[278] In order to take effect, the agreement requires that "at least [ten] states representing at least 20 percent of the combined population of the [forty-five] states with a state sales tax . . . petition for membership into the agreement and be found to be in conformance with the agreement."[279] By July 2003, 20 states, representing approximately 30 percent of the population of states with sales taxes, enacted legislation conforming with all or part of the Agreement.[280]

"In the 109th Congress, S. 2152 and S. 2153 would grant states which comply with the [SSUTA] the authority to require remote sellers to collect state and local taxes on interstate sales."[281] But it would not have led to the unrestrained authority to tax as the states may have hoped. Congress must consider and set the nexus standards under which a state is entitled to impose a Business Activities Tax ("BAT")[282] on an out-of-state entity with some business activities in the state.[283]

This interpretation neglects the context of Justice Kennedy's statement in *Granholm*: "New York . . . advance[s] a tax-collection justification for [its] direct-shipment laws. While their concerns are not wholly illusory, their regulatory objectives can be achieved without discriminating against interstate

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275. Nonna A. Noto, Internet Tax Bills in the 108th Congress, Congressional Research Service Report for Congress, at 7 (Oct. 14, 2003), *available at* http://www.ipmall.info/hosted_resources/crs/RL31929_031014.pdf.

276. *Id.*

277. *Id.* at 8; STREAMLINED SALES TAX GOVERNING BOARD, INC., STREAMLINED SALES AND USE TAX AGREEMENT (Dec. 2007), http://www.streamlinedsalestax.org/DOCUMENTS/SSTUA/SSUTA%20As%20Amended%2012-12-07.pdf [hereinafter SSUTA].

278. SSUTA, *supra* note 277, § 102.

279. Noto, *supra* note 275, at 8.

280. *Id.* at 8-9.

281. Maguire & Noto, *supra* note 245.

282. *Id.* (showing BAT includes things such as corporate net income tax, franchise tax, business and occupation tax, gross receipts tax).

283. *See* Maguire & Noto, *supra* note 245.

commerce. . . . New York could protect itself against lost tax revenue by requiring a permit as a condition of direct shipping."[284] Simply put, requiring all wineries to obtain a permit in order to do business in a state would cause wineries to purposefully avail themselves of the state's laws and protections, thus falling within the nexus required in order to tax.[285] If the statement is read the way many commentators have claimed it should be interpreted, then a scheme similar to Kennedy's supposed instruction would be submitting out-of-state companies to taxation without a jurisdictional nexus. Thus, it would be unconstitutional.

There are two theories for what constitutes the holding of a case: the theory of *ratio decidendi*[286] or "the reasoning necessary to reach the result;" and the theory that holdings are "predictions of what future courts will do."[287] In *ratio decidendi*, the holding is applicable to all manner of other situations and has further reach and significance than just the decision on the facts.[288] In the second theory, the holding is generally the rule that the courts predict will be extracted from the case in hindsight and applied to future cases.[289] In other words, the existing holdings are strong evidence of a court's future behavior.[290]

On its face, the payment of taxes does not seem necessary to the holding that states cannot discriminate against out-of-state wineries. If *Granholm* is read broadly, then all that is necessary to the holding is that there is no compelling state interest that cannot be advanced in a nondiscriminatory manner.[291] Thus, the above statement would be dicta. Although not binding, dicta by a Supreme Court Justice should be seriously considered.[292] If the Supreme Court actually considers that dicta in its decision-making process, federal appellate courts are bound "almost as firmly as by the court's outright holdings, particularly when a

284. Granholm v. Heald, 544 U.S. 460, 491 (2005).

285. *Id.*

286. Lawrence B. Solum, *Holdings*, LEGAL THEORY LEXICON, Oct. 12, 2003, http://legaltheorylexicon.blogspot.com/search?q=005. This theory is generally associated with legal formalism.

287. *Id.* This theory is generally associated with legal realism.

288. *Id.*

289. *Id.*

290. *Id.*

291. Granholm v. Heald, 544 U.S. 460 (2005).

292. 5 AM. JUR. 2D *Appellate Review* § 603 (2006).

dictum is of recent vintage and not enfeebled by any subsequent statement."[293]

However, if *Granholm* is read narrowly, then it can be confined to its facts where the specifics of the holding are necessary.[294] Essentially, an alternative reading states that "rationales, such as facilitating orderly market conditions, protecting public health and safety, and ensuring regulatory accountability"[295] are specifically unacceptable. If this is the case, then unraveling the tax-collecting justification is necessary to the holding and, thus, is not dicta.

If Kennedy's statement was actually part of the holding, then taxes could be viewed as an exception to the Commerce Clause as authorized through the 21st Amendment. This could be difficult to reconcile depending on how broadly courts read the *Granholm* holding in the future. A narrow reading of *Granholm* merely stands for the proposition that States cannot discriminate against out-of-state wineries in direct-shipment laws. A broad reading of *Granholm* stands for the proposition that all matters related to alcohol and the 21st Amendment are limited by the confines of the Dormant Commerce Clause. The narrow reading would allow states to abrogate the Commerce Clause and tax interstate commerce without special consent from the Supreme Court or Congress, while a broad reading would require special legislation to create a workable and constitutional tax scheme.

Looking at the Court's history, it is unclear which way future cases may be resolved. On one hand, the Court changed course in order to make the *Granholm* ruling. Such a change could be an anomaly, or it may be the sign of a new era in 21st Amendment and Commerce Clause jurisprudence. On the other hand, the Court has stated numerous times it has an interest in protecting local businesses as well, in order to have a balance of protections for intrastate and interstate commerce.

Congress and the Supreme Court are reluctant to pass laws disadvantaging local commerce. The dissent in *McLeod v. J.E. Dilworth Co.* asserts, "an interpretation of the Commerce Clause which puts local industry at a competitive disadvantage with interstate business [is warrantless]."[296] If there were a taxable event within the consumer's state it is arguable that the

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293. *Id.*; *see also* People v. Bell, 702 N.W. 2d 128 (Mich. 2005) (stating that judicial response to the dissent's argument does not render the response inappropriate or of no legal value).

294. *Granholm*, 544 U.S. at 492.

295. *Id.*

296. McLeod v. J.E. Dilworth Co., 322 U.S. 327, 334-35 (1944) (Douglas, J., dissenting).

Commerce Clause would "turn on practical considerations and business realities rather than on dialects."[297] Some may make the claim that not taxing out-of-state wineries is a disadvantage to local wineries. Though not preferred, this practice is not unconstitutional. The Commerce Clause only requires that states not discriminate against interstate commerce; there are no constitutional limits on regulation that indirectly creates a preference in favor of out-of-state commerce, as it does not threaten our multi-state economic structure to do so.

Congress seems equally reluctant to pass laws disadvantaging interstate commerce via the Internet. Where Congress could have given states power to regulate e-commerce in violation of the Dormant Commerce Clause, Congress chose not to grant this authority to the states. Instead, they did the opposite by enacting the ITFA.[298] The ITFA prevents local and state governments from imposing taxes that subject merchants and consumers of online commerce to taxation in multiple states and localities and protects against the imposition of any new taxes.[299] In addition, it prohibits taxation of goods and services sold *exclusively* on the internet.[300] This shows that Congress clearly does not want states to tax internet sales because it is afraid of how such taxes might chill internet technology development and e-commerce. For now, wineries appear to be safe from tax on internet sales under the ITFA of 1998, which is in effect through 2014.[301]

IV. CONCLUSION - A RECOMMENDATION FOR A TAX COMPROMISE

It is expected the *Granholm* ruling, in which Justice Kennedy declared states could not discriminate against other states in wine-shipment laws, will lead to a sharp increase in Internet wine sales.[302] But "don't pop those corks in celebration just yet,"[303] as states still must decide whether direct-shipping of Internet purchases will be universally allowed or prohibited

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297. *Id.* at 335.

298. *See generally* ITFA, Pub. L. No. 105-277, H.R. 4328, 105th Cong. (1998) (enacted).

299. *Id.*

300. *Id.* (emphasis added).

301. *Internet Tax Freedom Act Amendments Act of 2007*, P.L. No. 110-105, § 2 (2007).

302. Mauro, *supra* note 6.

303. Richard Santalesa, *The Supreme Court Opens a Case of Vintage Arguments*, PRENTICE HALL PROFESSIONAL AND TECHNICAL REFERENCE, May 25, 2005, *available at* http://www.phptr.com/articles/article.asp?p=169629&rl=1.

across the board.[304] Under the 21st Amendment, states retain the power to make this decision so long as the laws implemented are non-discriminatory.[305]

As state legislatures will be making this decision, it is important for the wine industry to take a collective stance and offer a compromise in order to persuade states to level up. In light of the current national efforts to simplify sales tax and provide realistic support for small businesses, it seems that agreeing to submit to a sales tax (within limits) would be the winning offer. If the wine industry holds firm in insisting that states should adopt laws permitting blanket direct-shipping without any benefit for the states, states are likely to strike back firmly by disallowing direct-shipment in toto. If this is the end result, then the *Granholm* victory will truly ring hollow.

Assuming that Internet sales are considered necessary to the success of small wineries,[306] and likewise a boon to large wineries,[307] it seems clear that wineries will stand unified in reaching a compromise to gain unfettered—or admittedly, possibly rather hindered—access to the market through any and all available avenues. Of 2,500 American wine retailers approximately 500 of them have websites, 250 of which are e-commerce enabled.[308] However, in 2004, less than one percent of wine purchases were made online, totaling less than $60 million.[309] With such a small percentage of current wine sales online, compared to the $162 billion industry,[310] the industry

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304. *See* Posting of Michael Stajer, CEO, WineCommune LLC, to Michael Stajer's Blog, *Short Term Implications of Granholm [sic] v. Heald*, http://www.michaelstajer.com/2005_05_01_michaelstajer_archive.html (May 19, 2005, 11:46 a.m.) ("The Court upheld a state's right to regulate shipment of wine as long as all the regulations applied evenly to both in and out of state wineries. . . . State's are likely to permit shipping but only if the winery obtains a necessary permit, complies with regulations designed to prevent shipping to minors, and collects sales taxes for that state.").

305. *See* Castanias, *supra* note 66 ("When a state law is struck down as unconstitutionally discriminatory, states have to cure the impermissible discrimination. But they usually have some discretion in deciding how to cure it. Since the wrong in *Granholm* was treating in-state and out-of-state wineries differently, the states have to change their laws to treat those two classes the same. That means that everyone may be allowed to ship wine on the same terms, or no one may be allowed to do so.").

306. Santalesa, *supra* note 303 (indicating that while the final outcome is uncertain, *Granholm* was a clear victory for small wineries).

307. Hinman & Steinthal, *supra* note 6.

308. Michael Stajer, *WineCommune LLC, Just How Much Wine is Sold Online?* (May 9, 2005), http://www.michaelstajer.com/2005_05_01_michaelstajer_archive.html.

309. Chris Rauber, *Wine.com Hopes Amazon Deal Will Boost Online Sales*, S.F. BUS. TIMES, May 4, 2005, *available at* http://sanfrancisco.bizjournals.com/sanfrancisco/stories/2005/05/02/daily26.html.

310. Press Release, *supra* note 25.

views the online marketplace as the last to conquer,[311] and it carries the most potential for small wineries to gain market share. The mere fact that Wine.com has reached an agreement with Amazon.com to be a featured partner on Amazon's site in order to increase consumer use of the Internet to purchase wine demonstrates that the wine industry is relying on states opening their markets to direct-shipment.[312]

That states each have the power to decide whether to open their markets "throws the ultimate resolution of this issue back to each state and to the states' political processes. The wineries' lobbies will face off with the wine distributors' lobbies to twist the arms of state legislatures."[313] Richard Santalesa, writing for Prentice Hall Professional and Technical Reference, expects that "states with strong wine industries [will] lean toward opening direct sales to all; because that means more tax dollars for state coffers, and in politics[,] taxes are the grease that keeps the machinery turning."[314] However, Miguel Estrada, D.C. partner at Gibson, Dunn & Crutcher, who represented New York liquor wholesalers and retailers in support of the state law in *Granholm*, vehemently disagreed in a May 2005 interview with *Legal Times*; he predicted that most states would close their markets.[315]

Ivy Brooke Erin Grey

311. Rauber, *supra* note 309 ("$22 billion wine industry is one of the largest remaining consumer categories to develop online.").

312. *Id.*

313. Santalesa, *supra* note 303.

314. *Id.*

315. Mauro, *supra* note 6; *see also* Castanias, *supra* note 66 (noting the differing tactics used by New York, Michigan, and Indiana).