

# GEOFFREY V. COMMISSIONER: THE FALL OF “TOYS R US” AND THE RISE OF “TAX R US”

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Corporate entities, like individual taxpayers, strive to minimize their tax exposure. To that extent, those with intangible properties, such as trade secrets, copyrights, patents, and trademarks, often incorporate a subsidiary in a state that does not tax royalty income generated by licensing intangibles.<sup>1</sup> These corporations then transfer ownership of intangibles to those subsidiaries ("intangible-holding company" or "IHC") whose sole business is to license the transferred intangibles to other affiliates across the country.<sup>2</sup> While the parent corporations must still pay tax on *their* income in *their* forum states,<sup>3</sup> the IHC's income which consists only of licensing royalties would not be taxed by the IHC's forum state under this arrangement.<sup>4</sup>

But states other than an IHC's forum state are also interested in taxing the IHC's royalty income. Indeed, many states have aggressively pursued through their court system's efforts to tax a non-domiciliary ("foreign") IHC's income. And about a dozen of them<sup>5</sup> have succeeded.

Imposing tax on a foreign corporation whose only link with the state is the presence of its intangible property presents serious constitutional issues. Under the Due Process Clause<sup>6</sup> and the Commerce Clause<sup>7</sup> of the United States Constitution, a state is prohibited from imposing its tax jurisdiction upon a foreign corporation which does not have sufficient involvement with the state.<sup>8</sup> And, when links with the state entails *only* the presence of its intangible property, the question of whether a

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1. Delaware is one such state. Del. Code Ann. tit. 30, § 1902(b)(8) (no tax on the income of a business whose only activity in the state is the ownership, maintenance, and management of intangible property). Michigan is another one such state. See *Kmart Props., Inc. v. N.M. Taxation & Revenue Dep't*, 131 P.3d 27, 31 (N.M. Ct. App. 2001) ("Michigan . . . does not tax income from royalty payments.").

2. See generally James A. Amdur, *State Income Tax Treatment of Intangible Holding Companies*, 11 A.L.R. 6th 543 (2006) (describing court holdings that preclude states from taxing IHC's income under due process and commerce clause concerns).

3. Note that a corporate entity's forum state is the state in which the corporate entity is incorporated, domiciled, and whose law under which the corporation is organized and protected. See CHARLES W. SWENSON ET AL., *STATE AND LOCAL TAXATION: PRINCIPLES AND PLANNING* 50-51 (2nd ed. 2003).

4. See Amdur, *supra* note 2, at 552-53.

5. Arkansas, Florida, Indiana, Iowa, Louisiana, Massachusetts, New Jersey, New Mexico, North Carolina, Oregon, and Wisconsin. See BNA Tax Management Portfolios, *Limitations on States' Jurisdiction to Impose Net Income Based Taxes*, TMSTATEPORT No. 1410 § 03.

6. U.S. CONST. amend. XIV, § 1 ("[N]o State shall . . . deprive any person of life, liberty, or property, without due process of law.").

7. U.S. CONST. art. 1, § 8, cl. 3 (authorizing Congress to "regulate Commerce . . . among the several States").

8. See, e.g., *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344, 347 (1954); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), *reh. denied* 430 U.S. 976.

foreign corporation has the constitutionally requisite involvement with the taxing state for tax purposes becomes even more difficult.

Part I of this Note provides background on two cases: *Quill v. North Dakota*, the Supreme Court case discussing the stringent requirements of the Commerce Clause (as compared to the Due Process Clause) and *Capital One v. Commissioner*, the Massachusetts case that distinguished *Quill* on the basis of the tax at issue and the main case on which the subject case of this Note relied. Finally, this Part also provides background on Massachusetts' law on corporate income tax.

Part II lays out the facts and the opinion of *Geoffrey v. Commissioner*. *Geoffrey* brings to question the constitutionality of Massachusetts' imposition of corporate income tax on a foreign corporation whose only connection with the commonwealth is the presence of its intangible property.

Part III of this Note provides a critique of *Geoffrey*. Specifically, the note argues that *Capital One* took leaps from *Quill* and other Supreme Court precedents, and that *Geoffrey*, in turn, took further leaps from *Capital One*. This Part also looks at other state court decisions and concludes that not all states agree with *Geoffrey*, and those that do agree with *Geoffrey* are factually distinguishable. Finally, policy arguments are made in this Part for insisting on *Quill's* physical presence test.

Part IV concludes this Note.

## I. BACKGROUND

### A. *Quill v. North Dakota – the Supreme Court's Take on the Due Process Clause and the Commerce Clause*

Constitutional issues relating to a state's authority to tax a foreign corporation arise under the Due Process Clause and the Commerce Clause. In order to pass constitutional muster, a state must show that its tax on foreign corporations meets the requirements of both clauses.

While both the Due Process Clause and the Commerce Clause have been invoked by courts to deny a state the right to tax a foreign corporation, they are "analytically distinct."<sup>9</sup> On the

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9. *Quill Corp. v. North Dakota*, 504 U.S. 298, 305 (1992). *See id.* at 312 ("Due process centrally concerns the fundamental fairness of governmental activity. Thus, . . . the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him . . . In contrast, the Commerce Clause and its nexus requirement are informed not so

one hand, the Due Process Clause limits a state's authority to assert tax jurisdiction<sup>10</sup> by requiring a "*minimum connection*" between the taxing state and the entity it seeks to tax.<sup>11</sup> On the other hand, the Commerce Clause, as the Supreme Court stipulated in *Complete Auto v. Brady*, "bars state regulations that unduly burden interstate commerce"<sup>12</sup> by requiring any tax imposed on foreign corporations to be "applied to an activity with a *substantial nexus* with the taxing State," "fairly apportioned," "not discriminat[ory] against interstate commerce," and "fairly related to the services provided by the State."<sup>13</sup>

In the landmark case of *Quill v. North Dakota*, the United States Supreme Court made it clear that the "substantial nexus" requirement of the Commerce Clause presents a much higher hurdle for a taxing state to overcome than does the "minimum connection" requirement of the Due Process Clause.<sup>14</sup> While the latter can be satisfied by, for example, the purposeful availment of a taxed entity to the benefits of the taxing state's economic market,<sup>15</sup> the former cannot. In particular, Commerce Clause's "substantial nexus" requirement demands more than the mere *economic* presence of a taxed entity in the taxing state—it requires *physical* presence of the same.<sup>16</sup> By sticking with the bright-line rule requiring physical presence of taxed entities in the taxing state, *Quill* reaffirmed *National Bellas Hess v. Department of Revenue*,<sup>17</sup> a case the Supreme Court decided twenty-five years earlier.

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much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.").

10. This limitation "does not derive from the specific language of the Due Process Clause itself; rather, it is a doctrine of judicial origin based on what is conceived to be an unstated but fundamental constitutional principle." BNA Tax Management Portfolios, *Limitations on States' Jurisdiction to Impose Net Income Based Taxes*, TMSTATEPORT No. 1410 § 02.

11. *Miller Bros. Co.*, 347 U.S. at 345.

12. *Quill*, 504 U.S. at 312.

13. *Brady*, 430 U.S. at 279.

14. *Quill*, 504 U.S. 298 at 312.

15. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472 (1985); see also *Quill*, 504 U.S. at 307-08 (affirming *Burger King's* holding).

16. *Quill*, 504 U.S. at 317-18. Thus, under the current state of law, "a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313.

17. *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 758 (1967) (striking down Illinois' imposition of sales tax collection obligation on a merchant who lacked physical presence in Illinois).

In sum, *Quill* significantly heightened the Commerce Clause (and diminished the Due Process Clause) as barriers against states' ability to collect tax from foreign corporations.

B. *Capital One v. Commissioner – the Massachusetts Court's Take on Use Tax and Income-Based Tax*

In the wake of *Quill*, differences between use tax and other types of taxes suddenly gained a curious amount of importance. This is because *Quill* deals with use tax, a type of tax that is imposed on the use of goods by an individual or a corporate entity.<sup>18</sup> And states which endeavor to avoid *Quill*'s restrictions on their authority to tax foreign corporations have distinguished *Quill* based on the type of taxes that are at issue.

The Massachusetts court, for example, has distinguished *Quill* on this very basis. In *Capital One Bank v. Commissioner*, Capital One, a Delaware bank whose commercial domicile is in Virginia, challenged Massachusetts' imposition of financial institution excise tax ("FIET"),<sup>19</sup> which is an income-based tax.<sup>20</sup> It alleged that, under *Quill*, Massachusetts's imposition of FIET on income generated from credit card businesses in Massachusetts is unconstitutional because the Bank did not have a physical presence in the commonwealth.<sup>21</sup> Indeed, Capital One "neither owned nor leased any real property in the Commonwealth"; it had "no employee, agent, or independent contractor . . . located in Massachusetts . . ."<sup>22</sup>

Despite Capital One's lack of physical presence in the commonwealth, the Massachusetts court held that the imposition of Massachusetts' income-based tax is consistent with the Commerce Clause.<sup>23</sup> Specifically, the Massachusetts court

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18. BLACK'S LAW DICTIONARY 1597 (9th ed. 2009). Use tax is imposed on products that are bought outside the taxing state; it is designed to compensate for sales tax that the taxing state would otherwise collect if the same products were sold inside the state's jurisdiction.

19. *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 81 (Mass. 2009) ("Pursuant to G.L. c. 63, § 2, 'every financial institution engaged in business in the commonwealth shall pay, on account of each taxable year, an excise measured by its net income determined to be taxable under [G.L. c. 63, § 2A,] at the [designated] rate.'").

20. *Id.* at 84 ("Nothing, however, in *Quill* suggested that physical presence is required for the imposition of other types of taxes, including an *income-based excise such as the FIET*." (emphasis added)). Income-based tax is a type of tax that is imposed on an individual or a corporate entity's net income. See BLACK'S LAW DICTIONARY 1596 (9th ed. 2009). And, corporate income tax is a tax levied on a corporate entity's net income. See SWENSON, *supra* note 3, at 49. It is imposed in all but six states: Michigan, Nevada, South Dakota, Texas, Washington, and Wyoming. See *id.*

21. *Capital One*, 899 N.E.2d at 81.

22. *Id.* at 77-78.

23. *Id.* at 86-87.

argued that *Quill's* physical presence test is expressly limited to use taxes and does not apply to income-based taxes.<sup>24</sup> To justify this conclusion, the Massachusetts court argued that use taxes are different from income-based taxes in that they place a heavier burden of "complicated obligations to local jurisdictions" on interstate commerce.<sup>25</sup>

Finally, *Capital One* held that, as an alternative to *Quill's* physical presence requirement, significant generation of income in the state constitutes the requisite nexus under the Commerce Clause for income-based tax purposes.<sup>26</sup>

### C. Massachusetts' Corporate Income Tax

Enacted in 1919, Massachusetts' corporate income tax (actually titled "excise tax") is imposed upon both domestic and foreign corporations.<sup>27</sup> To be exact, this tax levied on a corporation's (1) net income<sup>28</sup> (at a rate of 8.33 percent)<sup>29</sup> and (2)(i) tangible property not taxed locally<sup>30</sup> (at a rate of \$7.00 per \$1,000) or, in the case where the corporation has little or no tangible property in the commonwealth, (ii) allocated net worth (also at the rate of \$7.00 per \$1,000).<sup>31</sup>

Massachusetts' tax authority upon foreign corporations is set forth in Chapter 63, Section 39 of the General Laws of Massachusetts ("Section 39"). "[F]or the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges and immunities derived by reason of its

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24. *Id.* at 84.

25. *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 86 n.17 (Mass. 2009) (explaining that use taxes have "many variations in rates . . . , in allowable exemptions, and in administrative and record-keeping requirements"); *Id.* (explaining that income-based taxes are "typically paid only once a year . . . , to one taxing jurisdiction at the State level, and the payment of such an excise does not entail collection obligations vis-à-vis consumers").

26. *Id.* at 86-87 (concluding that *Capital One*, which did not have a physical presence in the commonwealth, had a "substantial nexus" with the commonwealth because *Capital One Banks* "were soliciting and conducting significant credit card business in the Commonwealth with hundreds of thousands of Massachusetts residents, generating millions of dollars in income for the *Capital banks*. . . . providing valuable financial services to Massachusetts consumers, . . . [and] using Massachusetts banking and credit facilities.").

27. John M. Tobin, *State Taxation*, 4 B.C. L. REV. 373, 373 (1963).

28. MASS. GEN. LAWS ANN. ch. 63, § 32(1), (3) (West 2008). Before it was repealed in 1962, Massachusetts' corporate income tax was initially imposed on "corporate excess" and net income. See Tobin, *supra* note 27, at 373.

29. MASS. GEN. LAWS ANN. ch. 63, § 39(3)(a)(2) (West 2008).

30. *Id.* at § 39(3)(a)(1).

31. *Id.* Note that Massachusetts requires a minimum corporate tax of \$400. *Id.* at § 39(3)(b).

existence and operation[,]” Section 39 “require[s] the payment of . . . excise to the commonwealth by foreign corporations.”<sup>32</sup> Under Section 39, a corporate income tax shall be imposed upon every foreign corporation for: (1) “[t]he qualification to carry on or do business in this state or the actual doing of business within the commonwealth,” (2) “[t]he exercising of a corporation’s charter or the continuance of its charter within the commonwealth,” and-or (3) “[t]he owning or using any part or all of its capital, plant or other property in the commonwealth . . . .”<sup>33</sup>

While Section 39 provides the basic rules for determining corporate nexus with Massachusetts, it does not set out specific examples or guidelines. Then, Massachusetts promulgated 830 MASS. CODE REGS. 63.39.1 (1993)<sup>34</sup> (“the Regulations”) which articulated the circumstances a foreign corporation is subject to the tax jurisdiction of Massachusetts under Section 39. In particular, the Regulations provide that “a foreign corporation<sup>35</sup> must file a return in Massachusetts and pay the associated excise if . . . the corporation owns property that is held by another in Massachusetts under a lease, consignment, or *other arrangement*.”<sup>36</sup>

However, the Regulations do not speak to Massachusetts’ tax authority upon a foreign corporation whose only connection with the commonwealth is the presence of its *intangible* property. Theoretically speaking, *Quill*’s physical presence test would bar the commonwealth completely from taxing on this basis. To that end, Massachusetts argued that licensing of trademarks by a foreign corporation to a domestic subsidiary would fit as one type of “other arrangement” under the Regulations, which would subject the foreign corporation to the commonwealth’s corporate excise tax jurisdiction.<sup>37</sup> To be sure, Massachusetts Department of Revenue clarified in 1996 that:

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32. *Id.* at § 39(3).

33. *Id.* at § 39(1)-(3).

34. The excise regulation was promulgated by the commissioner based on authority granted by the excise code. *See* MASS. GEN. LAWS ANN. ch. 62C, § 3 (West 2008) (providing that “[t]he commissioner may prescribe regulations and rulings, not inconsistent with law, to carry into effect the provisions of [MASS. GEN. LAWS ANN. ch. 63, § 39], which regulations and rulings, when reasonably designed to carry out the intent and purposes of said provisions, shall be prima facie evidence of their proper interpretation”).

35. Defined as any corporation that is not incorporated under Massachusetts law. *See* MASS. GEN. LAWS ANN. ch. 63, § 30(2) (West 2008).

36. 830 MASS. CODE REGS. 63.39.1(4)(d)(1) (2009) (emphasis added).

37. *See, e.g.,* *Geoffrey, Inc. v. Comm’r*, 899 N.E.2d 87, 91-92 (Mass. 2009).

A foreign corporation's intangible property used within Massachusetts will subject that corporation to the corporate excise when: (1) The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a licensure or franchise; and (2) The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); and (3) The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, is more than *de minimus*.<sup>38</sup>

## II. GEOFFREY V. COMMISSIONER

In *Geoffrey v. Commissioner*, the Supreme Court of Massachusetts ("the court") held that it does not violate the Commerce Clause to impose a corporate income tax on a foreign corporation whose only connection with the state was the presence of its intangible property.<sup>39</sup>

### A. *The Facts*

Toys "R" Us, Inc. ("Toys "R" Us"), a well-known toy and children's clothing corporation, formed Geoffrey, Inc. ("Geoffrey") in Delaware in 1984.<sup>40</sup> Toys "R" Us then transferred ownership of all its trademarks, trade names, and service marks (such as "Toys "R" Us," "Kids "R" Us," "Babies "R" Us," and the logo of "Geoffrey" the giraffe) to Geoffrey.

Geoffrey does not own or operate any Toys "R" Us retail stores.<sup>41</sup> Rather, its sole business is to license, in exchange for royalty payments, its intangible property to other Toys "R"Us subsidiaries.<sup>42</sup> Thus, except for its principal place of business (which was Wilmington, Delaware before January 1, 2000, and Paramus, New Jersey after January 1, 2000).<sup>43</sup> Geoffrey does not

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38. MASS. DEPT OF REVENUE, DIR. 96-2, CREATION OF NEXUS THROUGH THE IN-STATE OWNERSHIP AND USE OF INTAGIBLE PROPERTY (July 3, 1996).

39. *Geoffrey*, 899 N.E.2d at 92.

40. *Id.* at 89.

41. *Id.*

42. *Id.*

43. *Id.* at 89 n.3 (Mass. 2009); see also Brief for the Appellant at 4, *Geoffrey, Inc. v. Comm'r*, No. SJC-10106 (Mass. 2009) (indicating that Geoffrey carried out its activities principally (i) through its board of directors (which met annually in Delaware), (ii) through support services provided in New Jersey by Toys R Us in exchange for arm's-

have any employees, agents, offices, real property, or even licensing activities anywhere in the commonwealth of Massachusetts.<sup>44</sup>

Toys “R” Us-Mass, Inc. (“Toys R Us-Mass”) and Baby Superstore, Inc. (“Baby Superstore”), both Toys “R” Us subsidiaries and Massachusetts corporations, license trademarks from Geoffrey.<sup>45</sup> Pursuant to their licensing agreements, Geoffrey’s trademarks are used on signs and displays in affiliated retail stores throughout the commonwealth.<sup>46</sup>

Geoffrey refused to pay income tax in Massachusetts.<sup>47</sup> It argued that the imposition of such tax under Section 39 is unconstitutional as Commerce Clause’s “substantial nexus” requirement mandates, under *Quill*, physical presence of the taxed entity in the taxing state.<sup>48</sup>

### B. *The Opinion*

In a relatively short opinion, the court first held under *Capital One v. Commissioner*,<sup>49</sup> a case decided on the same day as *Geoffrey*, that the question of whether Massachusetts’ imposition of income tax on a foreign entity is consistent with the Commerce Clause “is *not* determined by the ‘physical presence’ test articulated in [*Quill*], but by the ‘substantial nexus’ test articulated in [*Complete Auto*].”<sup>50</sup>

The court then concluded that the imposition of Massachusetts’ corporate excise on Geoffrey who lacked physical presence in the commonwealth does *not* violate the Commerce Clause because Geoffrey had the requisite “substantial nexus” with the commonwealth under *Complete Auto*.<sup>51</sup> Specifically, *Geoffrey* pronounced that “substantial nexus can be established where a taxpayer domiciled in one State [for example, Delaware] carries on business in another State [for example,

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length service fees, and (iii) through outside trademark counsel located outside Massachusetts); *Geoffrey*, 899 N.E.2d at 89.

44. *Geoffrey*, 899 N.E.2d at 89.

45. *Id.* at 92.

46. *Id.* at 89.

47. *Id.* at 90-91.

48. *Id.* at 92; *see also id.* at n.9 (revealing that Geoffrey did not challenge Massachusetts’ imposition of corporate excise tax under the Due Process Clause. This could be because it is much harder to win on the Due Process Clause than on the Commerce Clause because the former can be met by Geoffrey’s “economic presence” in Massachusetts, whereas the latter cannot.).

49. *Capital One Bank v. Comm’r*, 899 N.E.2d 76 (Mass. 2009).

50. *Geoffrey, Inc. v. Comm’r*, 899 N.E.2d 87, 89 (Mass. 2009).

51. *Id.*

Massachusetts] through the licensing of its intangible property that generates income for the taxpayer."<sup>52</sup>

The court then went on to hold that Geoffrey's activities *did* establish a substantial nexus with Massachusetts (and that, therefore, the imposition of corporate excise tax on Geoffrey *did* comport with the Commerce Clause)<sup>53</sup> because:

Geoffrey encouraged Massachusetts consumers to shop at Toys "R" Us, Kids "R" Us, and Babies "R" Us through an implicit promise, manifested by the trademarks, that the products at those stores would be of good quality and value; Geoffrey relied on employees at [Toys R Us-Mass] to maintain a positive retail environment, including store cleanliness and proper merchandise display; and Geoffrey reviewed licensed products and materials that would be sold in the Commonwealth to ensure high standards and to maintain its positive reputation with Massachusetts consumers, thereby generating continued business and substantial profits.<sup>54</sup>

### III. A CRITIQUE OF *GEOFFREY*

#### A. *Capital One's Leap from Quill*

*Capital One*, the primary case on which *Geoffrey* relied, made leaps from *Quill*. First, *Capital One* flouted the long-recognized doctrine of *stare decisis*<sup>55</sup> when it sidestepped *Quill's* physical presence test for the Commerce Clause.<sup>56</sup> Since as early as the 1960's, the Supreme Court has maintained that the Commerce Clause is a very high bar against a state's

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52. *Id.* at 92. The court argued that this conclusion is consistent with those reached by Louisiana, Oklahoma, and South Carolina. *See id.* at 92.

53. *Id.* at 93.

54. *Id.*

55. *Cf. Quill Corp. v. North Dakota*, 504 U.S. 298, 320 (1992) (Scalia, J., concurring) ("We have long recognized that the doctrine of *stare decisis* has special force where Congress remains free to alter what we have done.") (internal quotation marks omitted).

56. *Cf. J. C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 842 (Tenn. Ct. App. 1999) ("The Commerce Clause requires a greater relationship than does the Due Process Clause. If we were to uphold the tax assessment against [the plaintiff-taxpayer], we believe that we would be unjustifiably overlapping the two clauses.").

authority to tax.<sup>57</sup> Although some have argued that *Complete Auto's* four-prong test "signaled a retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach,"<sup>58</sup> the Supreme Court made it clear that *Complete Auto's* four-prong test does not offset *Quill's* physical presence test.<sup>59</sup> Rather, the contact required for *Complete Auto's* "substantial nexus" is measured by *Quill's* "physical presence" in the taxing state.<sup>60</sup>

Second, *Capital One* made leaps from *Quill* by taking excerpts of *Quill* out of context to support its argument that *Quill* is limited to use tax only. Compare *Capital One's* rendition of *Quill*:

"[T]he Supreme Court stated in *Quill* that it had not, 'in [its] review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes.' *Id.* at 314 (stating that *Court's* Commerce Clause jurisprudence "now favors more flexible balancing analyses"). Moreover, when summarizing the precedent established in *Bellas Hess*, the Court reiterated that, in cases 'subsequent to *Bellas Hess* and concerning other types of taxes, [it had] not adopted a similar bright-line, physical-presence requirement. The language of the Supreme Court's decision in *Quill* explicitly emphasized, on more than one occasion, a narrow focus on sales and use taxes for the physical presence requirement, and suggested that this requirement was limited to those specific assessments and did not apply to the imposition of other types of State taxes."<sup>61</sup>

with *Quill* itself:

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57. See *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 758 (1967) (holding that physical presence of a business in the taxing state is not only sufficient, but also necessary, for tax jurisdiction under the Commerce Clause).

58. *Quill*, 504 U.S. at 314 (quoting *North Dakota v. Quill*, 470 N.W.2d 203, 214 (N.D. 1992)) (internal quotation marks omitted).

59. *Id.* at 317; see also *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 83-84 (Mass. 2009) (noting that *Quill* did "not repudiat[e] the *Bellas Hess* rule").

60. See *Quill*, 504 U.S. at 311 ("*Bellas Hess* concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause.>").

61. *Capital One*, 899 N.E.2d at 84 (some internal citations omitted) (emphasis added).

“[A]lthough *our Commerce Clause jurisprudence now favors more flexible balancing analyses*, we have never intimated a desire to reject all established ‘bright-line’ tests. Although *we have not, in our review of other types of taxes, articulated the same physical-presence requirement that Bellas Hess established for sales and use taxes*, that silence does not imply repudiation of the *Bellas Hess* rule.<sup>62</sup>

. . . .

In sum, although *in our cases subsequent to Bellas Hess and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement*, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law.<sup>63</sup>

*Capital One* misinterpreted *Quill* by concluding that “*Quill* explicitly emphasized . . . a narrow focus on sales and use taxes for the physical presence requirement.”<sup>64</sup> The author of this Note disagrees that *Quill* affirmatively limited the Commerce Clause’s physical presence test to only sales and use taxes. The point of the statement, “[a]lthough we have not . . . articulated the same physical-presence requirement . . . for sales and use taxes,”<sup>65</sup> is to make clear the phrase that immediately follows, “that silence does not imply repudiation of the *Bellas Hess* [physical presence] rule.”<sup>66</sup> Thus, what *Quill* affirmatively held is that the physical presence rule remains good law. It did not, however, affirmatively hold that the physical presence rule applies only to sales and use taxes.<sup>67</sup>

Of course, holding that a certain rule remains good law does not necessarily imply that the rule always applies to different

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62. *Quill*, 504 U.S. at 314 (emphasis added).

63. *Id.* at 317 (emphasis added).

64. *Capital One*, 899 N.E.2d at 84.

65. *Quill*, 504 U.S. at 314.

66. *Id.*

67. *Contra Capital One Bank v. Comm’r*, 899 N.E.2d 76, 84 (Mass. 2009) (adopting the Supreme Court’s narrow application of the physical presence requirement to sales and use taxes, and not to other types of State taxes).

situations.<sup>68</sup> As a countering example, the Supreme Court has applied *Complete Auto*, a case which dealt with gross-receipts tax (a tax akin to sales tax),<sup>69</sup> in many other cases that do not deal with gross receipt tax.<sup>70</sup>

*Capital One's* conclusion that *Quill* is limited to only use taxes and sales taxes is also without foundation. No constitutional, precedential, or legislative authority allows the Massachusetts court to distinguish *Quill* merely on the type of tax. The only support offered by the Massachusetts court for its extended reading of *Quill* is itself<sup>71</sup> and four other states<sup>72</sup> none of which have any persuasive effects.

Furthermore, *Capital One's* argument that income-based taxes should be subject to the "substantial nexus" requirement of *Complete Auto* – a case that deals with gross receipt / sales tax – but not the "physical presence" test of *Quill* – a case that deals with use tax – begs an unreasonable inference. The unreasonable inference would be that income-based tax is, for Commerce Clause purposes, more similar to gross receipt / sales tax than it is to use tax. This inference is unreasonable because use tax is in fact very similar to gross receipt / sales tax – it is the corollary thereto.<sup>73</sup> Both gross receipt / sales tax and use tax are

68. See, e.g., *Cerro Copper Prods., Inc. v. Alabama Dept. of Rev.* No. F., 94-444, 1995 WL 800114, at \*3 (Ala. Dept. Rev., Admin. Law Div. Dec. 11, 1995) ("If the Taxpayer does not have sufficient nexus with Alabama for sales and use tax purposes, which it clearly does not have under *Quill*, then it is incongruous that the Taxpayer would have 'substantial nexus' to be subject to Alabama's franchise tax."). *Contra Capital One*, 899 N.E.2d at 84-85.

69. Gross-receipts tax, like sales tax, is a tax imposed on the sale of goods and services. BLACK'S LAW DICTIONARY (8th ed. 2004). See also *Complete Auto Transit v. Brady*, 430 U.S. 274, 275 (1977) ("The taxes in question are *sales taxes* assessed by [Mississippi] against . . . Complete Auto Transit, Inc.") (emphasis added).

70. See, e.g., *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983) (reviewing whether California's corporate franchise tax under the unitary business principle satisfied the requirements of the Commerce Clause).

71. See *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 84 (Mass. 2009) (referencing a footnote in *Truck Renting & Leasing Ass'n, Inc. v. Comm'r*, 746 N.E.2d 143, 149 n.13 (Mass. 2001) which commented that *Quill* "did not extend this rule to other types of taxes").

72. *Id.* at 84 (citing an Illinois case, *Borden Chems. & Plastics, L.P. v. Zehnder*, 726 N.E.2d 73 (Ill. App. Ct. 2000), and an Ohio case, *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225 (Ohio 1996), *cert. denied*, 519 U.S. 810 (1996), as "declining to extend *Quill's* physical presence requirement to income-based taxation"); *id.* at 84-5 (quoting a West Virginia case, *Tax Comm'r of West Virginia v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 232 (W. Va. 2006), *cert. denied sub nom. FIA Card Services, N.A. v. Tax Comm'r of W. Va.*, 551 U.S. 1141 (2007) ("*Quill's* physical-presence requirement for showing a substantial Commerce Clause nexus applie[d] only to use and sales taxes and not to business franchise and corporation net income taxes.")).

73. *Quill Corp. v. North Dakota*, 504 U.S. 298, 302 (1992) ("As a corollary to its sales tax, North Dakota imposes a use tax upon property used for storage, use, or consumption within the State."). Even *Capital One* groups them together as "sales and

imposed on the purchase of retail goods, and they are typically assessed at the same rate.<sup>74</sup> The main difference between gross receipt / sales tax and use tax is only that while gross receipt / sales tax applies to in-state retail purchases, use tax applies to out-of-state retail purchases.<sup>75</sup> Thus, since gross receipt / sales tax and use tax are mirrored counterparts of each other, it is illogical to maintain that *Quill*, which dealt with use tax, does not apply to income-based tax, yet *Complete Auto*, which dealt with gross receipt / sales tax, does.

Finally, *Capital One* failed to justify why income-based taxes should be subject to a lower nexus standard than use taxes. The Massachusetts court's reasoning that income-based tax<sup>76</sup> imposes fewer burdens on the interstate commerce than does use tax<sup>77</sup> is not persuasive.<sup>78</sup> In fact, income-based tax can impose just as many "complicated obligations to local jurisdictions"<sup>79</sup> as use tax, if not more. Congress reported that "[m]any corporations operate in multiple tax jurisdictions which makes the state corporate income tax a relatively complex tax to administer . . . . At present, states do not use a uniform definition of taxable profits

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use tax" collectively. See, e.g., *Capital One*, 899 N.E.2d at 84 ("Quill explicitly emphasized . . . a narrow focus on sales and use taxes for the physical presence requirement . . .") (emphasis added); "Quill was based primarily on . . . the fact that the precedent established in *Bellas Hess* had engendered . . . circumstances that did not compel application beyond the context of sales and use taxes; the Supreme Court appeared to have expressly limited the scope of *Quill* to sales and use taxes; and . . . *Bellas Hess* and *Quill* were based, in part, on the fact that compliance with specific administrative regulations associated with the collection of sales and use taxes unduly burdened interstate commerce . . . ."

*Id.* at 85 (citing *MBNA Am. Bank, N.A.*, 640 S.E.2d at 232-233) (emphasis added).

74. SWENSON, *supra* note 3, at 12. For example, in Massachusetts, both use tax and sales tax are assessed at the rate of five percent of the price of purchased goods. See MASS. GEN. LAWS ANN. ch. 64I, § 2 at 79 (West Supp. 2009).

75. SWENSON, *supra* note 3, at 12.

76. See *Capital One*, 899 N.E.2d at 86 n.17 (explaining that income-based tax is less burdensome on the interstate commerce because "the possibility of owing taxes in multiple states, deciding where, when, with whom, and how transactions are structured can significantly impact . . . [the] local tax burden of businesses") (citing *MBNA Am. Bank, N.A.*, 640 S.E.2d at 226).

77. See *id.* (explaining that use tax is more burdensome on the interstate commerce due to "the many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements . . .") (quoting *Nat'l Bellas Hess v. Dep't of Revenue*, 386 U.S. 753, 759-60 (1967)).

78. Cf. *Kmart Props., Inc. v. Taxation & Revenue Dep't*, 131 P.3d 27, 36 (N.M. Ct. App. 2001) (finding that gross receipts tax does not unduly burden interstate commerce where there is physical presence or its functional equivalent).

79. *Capital One*, 899 N.E.2d at 86 n.17 (quoting *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 759 (1967)).

or use a uniform method of apportioning income.”<sup>80</sup> Indeed, states vary considerably in their nexus requirements,<sup>81</sup> throwback rules,<sup>82</sup> apportionment formulas,<sup>83</sup> and rates<sup>84</sup> for income-based taxes. Thus, it is untrue that income-based taxes are not as burdensome on corporate entities engaged in interstate commerce as use taxes.

*J.C. Penney National Bank v. Tennessee*, a case which has nearly identical facts as *Capital One* for purposes of analyzing a taxpayer’s physical presence, serves to illustrate *Capital One*’s reach.<sup>85</sup> Just like Capital One Banks in *Capital One*, J.C. Penney National Bank in *J.C. Penney* was a foreign bank whose principal place of business and commercial domicile were outside of the taxing state.<sup>86</sup> J.C. Penney National Bank challenged Tennessee’s imposition of franchise and excise taxes on income generated by credit card activities in the state as inconsistent with the Commerce Clause.<sup>87</sup> Agreeing with J.C. Penney National Bank, the Tennessee court held that J.C. Penney National Bank did not have a sufficient physical presence / substantial nexus with the state to warrant the imposition of the challenged taxes<sup>88</sup> – not based on the presence of its tangible credit cards in Tennessee,<sup>89</sup> not based on the presence of retail stores owned by its parent company which conducted no activities relating to the credit card business in Tennessee,<sup>90</sup> and not based on its credit card transaction activities outside of Tennessee.<sup>91</sup>

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80. STEVEN MAGUIRE, GOV’T & FIN. DIV., CONG. RESEARCH SERV., STATE CORPORATE INCOME TAXES: A DESCRIPTION AND ANALYSIS intro. at para. 3 (2006), available at [http://assets.opencrs.com/rpts/RL32297\\_20060630.pdf](http://assets.opencrs.com/rpts/RL32297_20060630.pdf).

81. *Id.* at 4-5.

82. *Id.* at 5.

83. *Id.* at 5-6.

84. *Id.* at 7-8 (ranging from zero percent in Wyoming, Nevada, Washington, and Ohio (recently repealed) to twelve percent in Iowa). Note that “South Dakota taxes only banks and financial institutions” and Texas taxes only “net taxable earned surplus” and adds a surtax of 0.25% on net taxable capital.” *Id.* at 8.

85. See *J.C. Penney Nat’l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999).

86. *Id.* at 832.

87. *Id.* at 834-35.

88. See *id.* at 842.

89. *Id.* at 840.

90. *Id.* at 840-41.

91. *J. C. Penney Nat’l Bank v. Johnson*, 19 S.W.3d 831, 841-42 (Tenn. Ct. App. 1999).

B. *Geoffrey's Leap from Capital One*

*Geoffrey* also made impermissible leaps from *Capital One*. It did so by concluding that Commerce Clause's "substantial nexus" requirement for income-based tax purposes can be established by "carr[ying] on business in [Massachusetts] through the licensing of its intangible property that generates income for the taxpayer."<sup>92</sup>

*Geoffrey* can be distinguished factually from *Capital One*. Unlike Capital One Banks in *Capital One* who targeted customers in Massachusetts, entered into agreements with Massachusetts residents, owned tangible goods such as credit cards in Massachusetts, advanced funds and conducted monetary transactions on behalf of Massachusetts residents, and sold services in Massachusetts,<sup>93</sup> *Geoffrey* undisputedly had no physical presence in Massachusetts.<sup>94</sup> It had no employees, no offices, and owned no tangible property, real or personal, in the Commonwealth.<sup>95</sup> All that *Geoffrey* had in connection with Massachusetts was the usage of its intangible properties by two Massachusetts corporations, Toys "R" Us-Mass and Baby Superstore, who already pay taxes on *their* income in Massachusetts.<sup>96</sup> Yet *Geoffrey* concluded that an entity's "economic presence" (specifically, ownership of intangible property which "generates income") constitutes sufficient nexus with the taxing jurisdiction.<sup>97</sup>

C. *Not All States Agree with Geoffrey, and Those that Do Agree with Geoffrey Are Factually Distinguishable*

*Geoffrey's* conclusion is not a prevailing one among the states. At least a handful of other states have rejected Massachusetts' argument that "economic presence" is sufficient to constitute substantial nexus with the taxing state under the Commerce Clause.

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92. *Geoffrey, Inc. v. Comm'r*, 899 N.E.2d 87, 92 (Mass. 2009).

93. *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 78 (Mass. 2009); *see also* 830 Mass. Code Regs. 63.39.1(1)(a), (4)(b) (2009) (describing the circumstances under which a foreign corporation is subject to tax in the Commonwealth and stating that a business that sells services within the Commonwealth is "doing business" within the meaning of the Regulation).

94. *Geoffrey*, 899 N.E.2d at 88-89 ("At issue is whether, consistent with the commerce clause, . . . the Commonwealth can impose a corporate excise tax . . . on a foreign corporation *that does not have a physical presence in Massachusetts.*") (emphasis added).

95. *Id.* at 89.

96. *See id.* at 89-90.

97. *See id.* at 93.

The Michigan appellate court, for example, has held in *Guardian Industries Corp. v. Department of Treasury* that income-generating solicitations of business from a state, standing alone, do not create the requisite nexus with that state for tax purposes under the Commerce Clause.<sup>98</sup> Like the plaintiff-corporation in *Quill*, the plaintiff-corporation in *Guardian* purposefully availed itself of the benefits of an economic market in foreign states by soliciting sales therein.<sup>99</sup> But unlike the plaintiff-corporation in *Quill*, the plaintiff-corporation in *Guardian* did more than sending out mail-order catalogues to the foreign states;<sup>100</sup> “[i]t called on customers, secured orders from them and expanded its markets in the destination states.”<sup>101</sup> Even so, the Michigan appellate court found that the plaintiff-corporation lacked the requisite nexus with the states in which the plaintiff-corporation was soliciting sales and orders.<sup>102</sup> Assuming that the orders secured generated some income for the plaintiff-corporation, *Guardian’s* holding<sup>103</sup> directly contradicts *Geoffrey’s*.

Similarly, an Alabama administrative law court found a foreign corporation that solicited income-generating sales in Alabama, but maintained no physical presence within Alabama, to lack a sufficient nexus with Alabama for franchise tax purposes.<sup>104</sup> In *Cerro Copper Products v. Alabama*, a Delaware corporation whose principal offices are located in Sauget, Illinois, solicited sales in Alabama.<sup>105</sup> It did so by direct mail, telephone,

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98. *Guardian Indus. Corp. v. Dep’t of Treasury*, 499 N.W.2d 349, 357 (Mich. Ct. App. 1993). In *Guardian*, a Michigan corporation argued that because solicitations of businesses from foreign states create a sufficient nexus with those foreign states, that sales solicited from those foreign states are therefore subject to the foreign states’ sales taxes, and that sales solicited from those foreign states are, therefore, *not* subject to Michigan’s sales tax. *Id.* at 352.

99. *See id.* at 352.

100. *See id.* at 357; *cf.* *Quill Corp. v. North Dakota*, 504 U.S. 298, 302 (1992) (whereas the record in *Guardian* was unclear as to whether any of the defendant’s employees were ever present within Michigan, *Quill’s* contact with North Dakota customers was made from out-of-state locations).

101. *Guardian*, 499 N.W.2d at 357; *see also id.* (describing how *Guardian* called on customers, including potential customers, and took orders).

102. *Id.*

103. *Id.* (“A target state that taxed *Guardian’s* solicitation activities would be in violation of the commerce clause if *Guardian’s* employees were never present within the state.”); *Id.* at 356 (stating that it is abundantly clear after *Quill* that a physical presence within the taxing state is necessary to establish a substantial nexus to it).

104. *See Cerro Copper Prods., Inc. v. Alabama Dept. of Rev.*, No. F. 94-444, 1995 WL 800114 (Ala. Dept. Rev., Admin. Law Div. Dec. 11, 1995) (finding a foreign corporation that solicited sales in Alabama, but maintained no physical presence within the state, to not have sufficient nexus for state franchise tax purposes)

105. *Id.* at \*1.

and telecopier.<sup>106</sup> The sales it solicited in Alabama generated more than \$10 million dollars each year.<sup>107</sup> Notwithstanding, the Alabama administrative law court held that the Commerce Clause prohibits Alabama from taxing the Delaware corporation because the Delaware corporation had no physical presence in the state.<sup>108</sup> Indeed, the Delaware corporation "had no employees, owned no property, and maintained no manufacturing facilities in Alabama."<sup>109</sup> Like *Guardian, Cerro Copper Products* directly contradicts *Geoffrey's* holding.<sup>110</sup>

*Rylander v. Bandag Licensing Corp.*, a case in which the plaintiff's only connection with the taxing state was taxpayer's possession of license to do business therein, also rejected the argument that economic presence is sufficient to constitute substantial nexus under the Commerce Clause.<sup>111</sup> In *Rylander*, a Texas court found that the imposition of a franchise tax on an Iowa corporation's royalty income generated by licensing patents on the mere basis that the Iowa corporation possessed a certificate of authority to do business in Texas to be unconstitutional.<sup>112</sup> Even though *Rylander* did not address specifically whether royalty payments from licensing of intangibles were sufficient to satisfy substantial nexus,<sup>113</sup> the message is the same: economic presence in a state does not constitute sufficient nexus therewith under the Commerce Clause.

Finally, *Acme Royalty Co. v. Missouri*, a case factually similar to *Geoffrey*, held that licensing intangible property for use in the taxing state is insufficient to create nexus for income tax purposes.<sup>114</sup> In *Acme Royalty*, the Missouri Supreme Court found that the imposition of income tax on the royalty income<sup>115</sup> of

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106. *Id.*

107. *Id.*

108. *Id.* at \*3 n.2(citing John L. Coalson Jr. & Fred O. Marcus, *Constitutional Limitations on Jurisdiction to Tax and the Impact of Quill and Geoffrey*, State Tax Notes, Aug. 7, 1995, available at 95 STN 153-38).

109. *Id.* at \*1.

110. *Cerro Copper Prods. Inc. v. Alabama Dept. of Rev.*, No. F. 94-444, 1995 WL 80014, at \*5 (Ala. Dept. Rev., Admin. Law Div. Dec. 11, 1995) ("This opinion is a respectful dissent from [*Geoffrey v. South Carolina*, the South Carolina counterpart to *Geoffrey v. Massachusetts*].").

111. *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 300 (Tex. App.—Austin 2000, pet. denied).

112. *Id.* at 298-300.

113. *Cf. Geoffrey, Inc. v. Comm'r*, 899 N.E.2d 87, 93 (Mass. 2009).

114. *Acme Royalty Co. v. Dir. of Revenue*, 96 S.W.3d 72, 75 (Mo. 2002) ("The income the Director attempts to reach is outside the scope of Missouri taxation because the Appellants have no contact, and specifically no sales, within the state.").

115. *Id.* at 74-75. The generated royalty equaled \$34 million. *Id.* at 74.

Acme Royalty, a Missouri corporation, which was generated by licensing trademarks to a Delaware corporation which conducted business and paid taxes in Missouri to be unconstitutional. Like *Geoffrey* had no sales in Massachusetts or elsewhere, Acme Royalty also had no sales in Missouri or elsewhere – as neither corporations sold any products.<sup>116</sup> And, unlike *Geoffrey* which dealt with Massachusetts attempting to tax a foreign (Delaware) corporation, *Acme Royalty* dealt with Missouri attempting to tax a domestic corporation. Based on these similarities and dissimilarities, *Acme Royalty* went even further than the other cases which held that a state cannot tax a foreign corporation whose only connection with it is merely economic.

Even though there are cases that have found “economic presence” to be sufficient to constitute substantial nexus with the taxing state under the Commerce Clause, those cases are factually distinguishable from *Geoffrey*.<sup>117</sup>

Perhaps with the exceptions of *Geoffrey v. South Carolina*,<sup>118</sup> *Geoffrey v. Oklahoma*,<sup>119</sup> and *Bridges v. Geoffrey*,<sup>120</sup> *Geoffrey* can be factually distinguished from the three cases it cited – none of which, of course, have binding power on the Massachusetts court.

*Lanco v. New Jersey*, the first case cited by *Geoffrey* and a case which held that New Jersey could constitutionally subject a foreign corporation which lacked physical presence in New Jersey to its corporation business tax, is also factually distinct from

116. *Id.* at 75.

117. Admittedly, there are also non-case rulings that held that physical presence in the taxing state is not required. For example, Louisiana and Indiana. See La. Dept. of Rev., Rev. Rul. No. 02-001 (May 13, 2002), available at <http://revenue.louisiana.gov/forms/lawspolicies/RR02001.pdf>; see also La. Dept. of Rev., Priv. Ltr. Rul. No. 04-004 (Sept. 13, 2004), available at <http://www.rev.state.la.us/forms/lawspolicies/PLR04-004.pdf>; see In. Dept. of Rev., Ltr. of Findings No. 95-0401, 25 Ind. Reg. 2932, 2934 (June 1, 2002), available at <http://ai.org/legislative/register/xml/old-ir/Vol25/09Jun/14Nonrul.pdf> (ruling that contractual relationship between the intangible-holding subsidiary and the Indiana licensee created the requisite substantial nexus with Indiana); see also In. Dept. of Rev., Ltr. of Findings No. 01-0349, 27 Ind. Reg. 1061, 1062-63 (Dec. 1, 2003), available at <http://www.in.gov/dor/reference/legal/rulings/pdfs/0220010349lof.pdf> (holding that franchise agreements, even though executed out-of-state, were “inextricably related to” the corporation’s activities within Indiana because they allowed the corporation to vigorously exploit its intangible asset within Indiana).

118. *Geoffrey v. South Carolina* is the South Carolina “counterpart” of *Geoffrey*. See *Geoffrey, Inc. v. South Carolina Tax Comm’n*, 437 S.E.2d 13 (S.C. 1993).

119. *Geoffrey v. Oklahoma* is the Oklahoma “counterpart” of *Geoffrey*. See *Geoffrey, Inc. v. Oklahoma Tax Comm’n*, 132 P.3d 632 (Okla. Civ. App. 2005).

120. *Bridges v. Geoffrey* is the Louisiana “counterpart” of *Geoffrey*. See *Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 126 (La. Ct. App. 1st Cir. 2008) (licensing intangible property for use in taxing State and deriving income from such use established substantial nexus for imposition of income-based tax in conformity with commerce clause).

*Geoffrey*.<sup>121</sup> Namely, while the relevant Massachusetts law allowed or required *Geoffrey's* Massachusetts licensees to claim a deduction for the royalties paid to *Geoffrey*,<sup>122</sup> the relevant New Jersey law disallowed the New Jersey licensees to claim deductions for royalty payments made to a related entity for use of intangible property.<sup>123</sup> This distinction is significant because allowing a licensee to deduct royalty payments made to its licensor from income for tax purposes requires a determination that the licensor was independently subject to taxation.<sup>124</sup> And since the plaintiff-licensor in *Lanco* did not bear the burden of the tax as an entity independent from its licensees, the imposition of tax is more justified under an analysis of the totality of circumstances.

*Kmart Properties v. New Mexico Taxation & Revenue Department*,<sup>125</sup> the second case cited by *Geoffrey* and a case which affirmed the imposition of New Mexico's income taxes and gross receipts taxes on the trademarks licensing royalties earned by *Kmart Properties* – a Michigan corporation which had no physical presence in New Mexico, is distinguishable from *Geoffrey* on at least one ground. Specifically, the licensing of *Kmart Properties' trademarks*<sup>126</sup> generated for *Kmart Properties* a royalty income more than six times than that for *Geoffrey*.<sup>127</sup> Thus, under a balancing approach, the imposition of tax is more justified in *Kmart Properties* than that in *Geoffrey*.

*A & F Trademark v. Tolson*,<sup>128</sup> the last case cited by *Geoffrey* and a case which held that mere ownership of intangible

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121. See *Lanco, Inc. v. New Jersey*, 879 A.2d 1234, 1242 (N.J. 2005).

122. See *Geoffrey, Inc. v. Comm'r*, 899 N.E.2d 87, 89 (Mass. 2009).

123. *Lanco, Inc. v. Dir., Div. of Taxation*, 21 T.C. 200, 220 (2003) [hereinafter "*Lanco I*"] (citing N.J.S.A. 54:10A-4.4). Cf. *Lanco I*, 21 T.C. at 212-13 (arguing that a Massachusetts case which affirmed the imposition of tax is justified in part because, even though the licensee was not allowed to deduct its royalty payments to an affiliated licensor, the licensee was disallowed due to a "sham transaction").

124. Cf. *Lanco I*, 21 T.C. at 207-08; *id.* at 211 (citing *Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441 (1944)).

125. *Kmart Props., Inc. v. N.M. Taxation & Revenue Dept.*, 131 P.3d 27, 33 (N.M. Ct. App. 2001) (holding that by allowing the marks to be used in New Mexico to generate income, the subsidiary purposefully availed itself of the benefits of New Mexico's consumer market).

126. *Kmart's trademarks* were worth between \$2,734,100,000 and \$4,101,200,000. *Kmart Props.*, 131 P.3d at 30.

127. Compare *Kmart Props.*, 131 P.3d at 31 ("KPI earned royalty income in excess of \$2,000,000 per year from conducting business within New Mexico."), with *Geoffrey*, 899 N.E.2d at 93 ("Geoffrey's annual royalty income from retail stores in the Commonwealth for the tax year ending February 1, 1997, was \$5,928,567, and it increased to \$7,423,420, by the tax year ending February 3, 2001.").

128. *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. Ct. App. 2004), *cert. denied*, 546 U.S. 821 (2005).

properties within North Carolina constitutes substantial nexus therewith for corporate income tax and franchise tax purposes<sup>129</sup>, is also distinguishable from *Geoffrey*. In particular, *A & F Trademark* focused at least in part on the fraudulent aspects of the case.<sup>130</sup> Unlike *Geoffrey* which did not take any issue with the legitimacy of *Geoffrey's* trademarks transactions with its licensees,<sup>131</sup> *A & F Trademark* discussed some of the deceiving aspects of the licensing transactions.<sup>132</sup> For this reason, *A & F Trademark* is factually distinct from *Geoffrey*.<sup>133</sup>

#### D. Policy Arguments for *Quill's* Physical Presence Test

Even if there are any ambiguities over whether *Bellas Hess* and *Quill's* physical presence doctrine applies to income-based tax, Massachusetts should have resolved *Geoffrey* in *Geoffrey's* favor given the lack of clear policy.<sup>134</sup> As the Supreme Court noted in *Quill*, “the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry,”<sup>135</sup> and to rule against *Geoffrey* after reliance and in the midst of confusions would be unfair.<sup>136</sup>

129. *Id.* at 195.

130. *Id.* at 191 (“It is difficult to determine how tax fraud could occur in the absence of laws or regulations requiring the payment of taxes.”); see *Black's Law Dictionary* 1474 (7th ed. 1999) (defining tax fraud and tax evasion as “the willful attempt to defeat or circumvent the tax law in order to illegally reduce one’s tax liability”).

131. *Geoffrey, Inc. v. Comm’r*, 899 N.E.2d 87, 90 (Mass. 2009).

132. See *A&F Trademark Inc.*, 605 S.E.2d at 189 (discussing how the royalty payments “were made by an accounting journal entry. No checks were written and no physical transfer of funds occurred. Subsequently, the [plaintiff-licensor] entered into agreements loaning any excess operating funds back to the related retail companies in the form of notes receivable bearing a market rate of interest. No attempts were made to collect any outstanding notes, and they were marked ‘Do Not Collect.’”).

133. See *Comptroller of the Treasury v. Syl, Inc.*, 825 A.2d 399 (Md. 2003), *cert. denied*, 540 U.S. 984 (2003) (upholding the imposition of Maryland’s income tax on the trademarks-licensing royalties earned by a Delaware corporation which had no physical presence in Maryland. The Maryland court discussed how SYL urged the practice of separating itself from its licensee, how SYL consisted of only four top executives, did not actually have a Delaware phone listing, an office sign, or business cards, and how SYL failed to list in its financial statements legal expenses associated with the hiring of an outside trademark counsel); cf. *Lanco Inc.*, 21 N.J. Tax at 213 (arguing that the imposition of tax is justified in *SYL* in part because it was due to a sham transaction).

134. See *Geoffrey*, 899 N.E.2d at 94 (citing *Sherwin-Williams Co. v. Comm’r*, 778 N.E.2d 504, 507 (Mass. 2002) (commissioner challenged intercompany royalty payments for lacking economic substance, but did not attempt to tax out-of-state affiliated licensor)).

135. See *id.* at 94 (stating that *Geoffrey* had “reasonable cause to believe that, in the absence of a physical presence in the Commonwealth, it was not subject to Massachusetts corporate excise taxes.”).

136. Cf. *Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992) (Scalia, J., concurring) (“It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax.”); *Id.* at 320 (quoting *Payne v. Tennessee*, 501 U.S. 808, 828 (1991)) (stating that the demands for a bright-line rule for defining nexus are “at

In any case, *Quill's* physical presence standard is the better one because it provides a bright-line rule. A bright-line rule can be readily understood by taxpayers; it is not ambiguous or otherwise subject to interpretation.<sup>137</sup> Currently, "federal corporate income tax policy does not have a uniform effect on all states,"<sup>138</sup> and different states adopt different legal fictions to tax foreign businesses.<sup>139</sup> *Quill's* physical presence test will also help to reduce the likelihood of a single corporation being taxed multiple times by multiple states.<sup>140</sup> Furthermore, *Quill's* physical presence test would help to increase stability and predictability in the state and local tax systems by lowering administrative and compliance costs. Stability and predictability would, in turn, help to foster interstate investment.<sup>141</sup>

It is true that *Quill's* physical presence test may be difficult to apply in the contexts of intangible properties and electronic commerce as they cannot be found to exist in any particular state through physical observation.<sup>142</sup> However, this is no reason to abandon *Quill's* bright-line rule.<sup>143</sup> A logical solution would be

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their acme . . . where reliance interests are involved"); see also *Rodriguez de Quijas v. Shearson/American Exp., Inc.*, 490 U.S. 477, 484 (1989) (Scalia, J., concurring) ("If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [the lower courts] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.").

137. See Brief of Petitioner-Appellant at 31, *Geoffrey, Inc., v. Comm'r*, No. SJC-10106 (Mass. Jan. 8, 2009).

138. MAGUIRE, *supra* note 80, at 2 (showing that the dependence on corporate income taxes varies considerably from South Dakota (3.73%) to New Hampshire (19.88%)).

139. See Brief of Petitioner-Appellant at 32, *Geoffrey, Inc., v. Comm'r*, No. SJC-10106 (Mass. Jan 8, 2009).

140. By, for example, the state of commercial domicile, the state of legal domicile, and all the states in which the business's licensees operate.

141. See Brief of Petitioner-Appellant at 32, *Geoffrey, Inc., v. Comm'r*, No. SJC-10106 (Mass. Jan 8, 2009). Some even argued that uniformity is *imperative* to the survival of corporate income tax. See David Brunori, *The NCCUSL Debacle—Why the Corporate Tax Is in Deep Trouble*, 48 STATE TAX NOTES 899 (June 16, 2008) ("[O]ne must wonder if the corporate income tax has any real chance of survival. Without uniformity, the corporate income tax will become even more irrelevant . . .").

142. *Capital One Bank v. Comm'r*, 899 N.E.2d 76, 86 (Mass. 2009) (citing, *Tax Comm'r of West Virginia v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 234 (W. Va. 2006), *cert. denied sub nom. FIA Card Services, N.A. v. Tax Comm'r of W. Va.*, 551 U.S. 1141 (2007) (commenting that *Bellas Hess* physical presence test "makes little sense in today's world where electronic commerce makes it possible for an entity to have a significant economic presence in a state absent any physical evidence there."); see also *id.* at 84 ("[C]ontemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today."))(quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992)).

143. Cf. *Cerro Copper Prods., Inc. v. Alabama Dept. of Rev.*, No. 94-444, 1995 WL 800114, at \*3 (Ala. Dept. Rev., Admin. Law Div. Dec. 11, 1995) ("As a practical matter, the same benefits of a bright-line, physical presence test cited in *Quill*, at page 1915, for sales and use tax purposes would also apply equally to other types of taxes.").

for the states to agree on a definition for the “location” of intangible properties or electronic commerce. For example, all states can agree that the “location” of intangible properties or electronic commerce is the forum state of the corporations who own them.<sup>144</sup> The fact that corporations could still avoid all state taxations by creating holding companies in Delaware does not justify non-Delaware states’ taxing of Delaware-domiciled holding companies. Any “injustice” done by “the production of ‘nowhere’ income that escapes all state income taxation”<sup>145</sup> to the state and local tax systems cannot be constitutionally restored this way.

#### IV. CONCLUSIONS

Neither *Geoffrey* nor *Capital One*, the main case on which *Geoffrey* relied, had any constitutional authority to rule that the Commerce Clause’s “substantial nexus” can be met by the mere ownership of intangible properties in the taxing state. *Geoffrey*’s conclusion is not widely accepted amongst other states, and those cases that do agree with *Geoffrey* are factually distinguishable.

Even if there are ambiguities over whether *Quill*’s physical presence test applies to income-based tax, *Quill*’s bright-line physical presence test should be applied to all taxes given the non-uniformity in current state and local tax systems. Allowing states to tax foreign corporations which have little connection with the taxing state would be heading down a slippery slope where a corporation can be taxed by any state for virtually any reason – a consequence that would run afoul of the Commerce Clause and its nexus requirements.

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144. See, e.g., *id.* at \*4 (“The general rule is that intangibles are located for tax purposes in the taxpayer’s state of domicile.”).

145. *Geoffrey, Inc. v. South Carolina Tax Comm’n*, 437 S.E.2d 13, 15 (S.C. 1993).