

March 2020

Murphy v. NCAA: Why States in Need of Revenue Should Challenge the Constitutionality of 15 U.S.C. § 381

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Recommended Citation

Owen Walsh, *Murphy v. NCAA: Why States in Need of Revenue Should Challenge the Constitutionality of 15 U.S.C. § 381*, 88 U. Cin. L. Rev. 937 (2020)

Available at: <https://scholarship.law.uc.edu/uclr/vol88/iss3/13>

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MURPHY v. NCAA: WHY STATES IN NEED OF REVENUE
SHOULD CHALLENGE THE CONSTITUTIONALITY OF 15 U.S.C.
§ 381

Owen Walsh

I. INTRODUCTION

Taxes—individuals and businesses will inevitably owe them. Although it is certain the businesses will have tax liabilities, questions remain regarding to what extent state governments can tax individual or business. In 1959, Congress partially answered this question and prohibited a state from collecting net income tax from out-of-state businesses whose only income derived from the state was from soliciting orders sent and filled outside the state.¹ In a modern economy, where millions of online orders are placed each day, this restriction on net income taxes can heavily reduce states' tax revenue. While many experts agree that *South Dakota v. Wayfair*² is a revolutionary case when it comes to jurisprudence concerning taxation of out-of-state businesses, states looking to levy net income taxes on out-of-state businesses may have a second bite at the apple thanks to a different source: the sports betting case of *Murphy v. NCAA*.³

Murphy v. NCAA involved New Jersey's attempt to legalize sports gambling. The Supreme Court decided in favor of New Jersey, invalidating a portion of a Congressional act, using the anti-commandeering principle of the United States Constitution. Expanding the anti-commandeering principle,⁴ the Court held that it did not matter whether Congress forced a state to take "affirmative action" or simply prohibited an action, Congress cannot issue direct orders to state legislatures in either event.⁵

This Article seeks to encourage states, especially those in desperate need of tax revenue, to challenge the Interstate Income Act of 1959⁶ (codified as "15 U.S.C. § 381") on the ground that it violates the anti-commandeering principle of the Tenth Amendment. Much like the

1. 15 U.S.C. § 381 (1959).

2. 138 S. Ct. 2080 (2018).

3. 138 S. Ct. 1461 (2018).

4. For further discussion of the Anti-Commandeering Doctrine, see Part II.

5. *Murphy*, 138 S. Ct. at 1478.

6. Act of Sept. 14, 1959, Pub. L. No. 86-272, 72 Stat. 555 (restricting states from imposing a net income tax on income derived within their borders by foreign businesses if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state and are filled by shipment or delivery from a point outside the state).

Professional and Amateur Sports Protection Act (“PASPA”) prohibited New Jersey from repealing existing sports gambling laws, 15 U.S.C. § 381 prohibits states from levying net income taxes on businesses that merely solicit orders within a state but fill and ship said orders from outside the state. On the same grounds that PASPA was held unconstitutional, 15 U.S.C. § 381 could also be held unconstitutional. Part I of this Article discusses the constitutional and congressional limitations on state taxing authority. Part II goes on to discuss the anti-commandeering doctrine. Part III highlights the main argument of this Article: that states in need of tax revenue should challenge the constitutionality of 15 U.S.C. § 381 as it violates the Tenth Amendment.

II. BACKGROUND

As of September 2013, there were 90,106 governmental units in the United States, excluding the Federal Government.⁷ Not all of these governmental units have the power to tax, but a number of them can. A question remains: under what circumstances may these governmental units tax individuals and businesses? The first section of this Part inquires into the jurisdictional question of state and local tax by analyzing constitutional limitations on state taxing authority, the Due Process Clause and Commerce Clause, and also looks at the congressional limitations on tax jurisdiction by analyzing 15 U.S.C. § 381.

The second half of this Part delves into the anti-commandeering doctrine and the impact that it may have on 15 U.S.C. § 381. Until *Murphy* in 2018, there were two principal cases that analyzed the anti-commandeering doctrine: *New York v. United States*⁸ and *Printz v. United States*.⁹ *Murphy* expanded on the rulings in *New York* and *Printz* by analyzing whether a congressional statute regulates private actors or the state. It is under the anti-commandeering doctrine enunciated in these three cases that a state could challenge the constitutionality of 15 U.S.C. § 381.

A. State Taxing Authority

In order for a state to be able to tax an individual or entity, there first must be jurisdiction to tax the individual or entity. At a minimum, in order to have the jurisdiction to tax an individual or entity, the state must meet the constitutional limitations within the Fourteenth Amendment’s Due

7. WALTER HELLERSTEIN, ET AL., STATE AND LOCAL TAXATION, CASES AND MATERIALS 23 (10th ed. 2014).

8. 505 U.S. 144, 150 (1992).

9. 521 U.S. 898, 902 (1997).

Process Clause and the Commerce Clause. In addition to constitutional limitations on tax jurisdiction, Congress also has the power to impose limitations on states' jurisdiction to tax. Part A of section I examines these constitutional limitations, highlighting the major cases under the Due Process Clause and Commerce Clause. Part B then looks at the federal limitations on states' jurisdiction to tax by analyzing 15 U.S.C. § 381, case law interpreting 15 U.S.C. § 381, and a Multistate Tax Commission memorandum clarifying the case law interpreting 15 U.S.C. § 381.

1. Constitutional Limits on State Taxing Authority

The threshold question every time a state or local government imposes a tax on an individual or entity is whether the state or local government imposing the tax has the jurisdiction to do so?¹⁰ This inquiry includes an analysis of two constitutional provisions: the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I, Section 8 Clause 3.¹¹

a. Due Process Clause

When applied to any area of the law, the Due Process Clause's primary consideration is fairness.¹² The landmark case *International Shoe v. Washington* questioned whether an individual had "sufficient minimum contacts" with a state in which jurisdiction "will not offend traditional notions of fair play and substantial justice."¹³ Similarly, the Due Process Clause as interpreted in tax needs "some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax."¹⁴

Traditionally, for a state to tax an individual or entity, that individual or entity needed to have "physical presence" within the state.¹⁵ The traditional rule of "physical presence," however, was eliminated from the Due Process Clause analysis in *Quill Corp. v. North Dakota*.¹⁶ There, Quill Corporation ("Quill"), a Delaware corporation, maintained offices and warehouses in Illinois, California, and Georgia.¹⁷ It did not have any employees or property in North Dakota and only solicited business

10. *Id.*

11. U.S. CONST. art. I, § 8, cl. 3.

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

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

14. *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 345 (1954).

15. *Quill*, 504 U.S. at 298.

16. *Id.*

17. *Id.* at 302.

through catalogs, flyers, advertisements, and phone calls.¹⁸ With annual sales of approximately \$1,000,000 generated within the state, North Dakota attempted to impose its use tax on Quill's property within the state.¹⁹

The Due Process Clause and Commerce Clause both require an inquiry into "substantial nexus."²⁰ For the first time, however, the Court in *Quill* bifurcated these analyses. Despite holding that Quill did not have sufficient nexus under the Commerce Clause, the Court did overrule a former case in deciding that the Due Process Clause does not require physical presence: "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,' and that the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State.'"²¹

The Court noted that physical presence within a state clearly establishes jurisdiction to tax under the Due Process Clause, but abandoned the more formalistic test that requires physical presence.²² The Court instead favored a more flexible inquiry looking at whether a defendant's contacts within the State make it reasonable for them to be subject to suit there: "[a]pplying these principles, we have held that if a ... corporation 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."²³ The Court used this reasoning and justified the imposition of the collection duty on a mail-order that was delivered in the state, whether the selling business was physical present in the state or not.²⁴ The Court concluded that "... there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State."²⁵

b. Commerce Clause

The second constitutional provision limiting a state's taxing authority is the Commerce Clause. The Commerce Clause states that: "Congress

18. *Id.*

19. *Id.* at 303.

20. *Id.*

21. *Id.* at 306.

22. *Id.*

23. *Id.* at 307.

24. *Id.* at 308.

25. *Id.*

shall have the power to regulate Commerce with foreign Nations, and among the several states, and with the Indian tribes.”²⁶ In 1824, Chief Justice John Marshall expanded this definition and read the Commerce Clause as having a negative implication as well.²⁷ The Dormant Commerce Clause (also referred to as the Negative Commerce Clause) is the principle that state legislation may not discriminate against interstate commerce.²⁸ The Negative Commerce Clause “became central to our whole constitutional scheme: the doctrine that the commerce clause by its own force and without national legislation, puts it into the power of the Court to place limits upon state authority.”²⁹

To analyze whether a state tax discriminates against interstate commerce, the Court created a four-part test in *Complete Auto v. Brady*.³⁰ The *Complete Auto* test states that in order for a state tax to be constitutional under the Commerce Clause: (1) the tax must be applied to an activity with substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against foreign commerce; and (4) the tax must be fairly related to services provided by the taxing state. This Article principally focuses on the first prong of the *Complete Auto* test.³¹

Notably, the Due Process Clause and the Commerce Clause both contain a substantial nexus inquiry. *Quill* was the first time the Court bifurcated the “substantial nexus” analyses under the Due Process Clause and the Commerce Clause: “[d]espite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and policies.”³² The Court highlighted that Due Process concerns fairness of governmental activity³³ while the Commerce Clause nexus requirement concerns the effects of state regulation on the national economy.³⁴ The Commerce Clause “prohibits discrimination against interstate commerce and bars state regulations that unduly burden interstate commerce.”³⁵

Despite holding that physical presence was not required under the Due Process Clause, the Court in *Quill* reaffirmed that the substantial nexus

26. U.S. CONST. art. I, § 8, cl. 3.

27. *Gibbons v. Ogden*, 22 US 1 (1824).

28. Norman R. Williams, *Why Congress May Not “Overrule” the Dormant Commerce Clause*, 53 UCLA Law Review 153 (2005).

29. FELIX FRANKFURTER, *THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE* 18-19 (Quadrangle Paperback ed. 1964).

30. 430 U.S. 274 (1977).

31. *Id.*

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

33. *Id.*

34. *Id.*

35. *Id.*

requirement of the Commerce Clause requires physical presence.³⁶ The Court concluded that a bright line physical presence standard “firmly establishes the boundaries of legitimate state authority.”³⁷ Therefore, despite soliciting business in North Dakota and having annual sales of \$1,000,000 in the state, the Court held that Quill did not have a requisite nexus with North Dakota as it did not have a physical presence in the state.³⁸ This bright line physical presence standard, however, has been subsequently chipped away since the decision in *Quill* in both income tax and sales tax cases.³⁹

i. Income Tax

In *MBNA America Bank*, the plaintiff-bank was an out-of-state corporation with its principal place of business and commercial domicile in Delaware.⁴⁰ The bank had no real or tangible personal property and no employees located in West Virginia.⁴¹ The bank promoted its business in West Virginia via mail and telephone solicitation.⁴² West Virginia’s Supreme Court of Appeals, after consideration of the U.S. Supreme Court’s analysis in *Quill*, concluded that the physical-presence requirement for showing a substantial Commerce Clause nexus applies only to use and sales taxes and not to business franchise and corporation net income taxes.⁴³

Rather than applying the physical presence standard, the West Virginia court used a significant economic presence test and believed that was a better indicator of whether substantial nexus exists for Commerce Clause purposes.⁴⁴ The court adopted this test for three principal reasons. First, the substantial economic presence standard “incorporates due process ‘purposeful direction’ towards a state while examining the degree to which a company has exploited a local market.”⁴⁵ Second, “[a] substantial economic presence analysis involves an examination of both the quality and quantity of the company’s economic presence.” Lastly, under a substantial economic presence analysis “[p]urposeful direction towards a state is analyzed as it is for Due Process Clause purposes, and the

36. *Id.* at 318.

37. *Id.* at 315.

38. *Id.* at 314-17.

39. See Tax Comm’r v. MBNA Am. Bank, N.A., 640 S.E.2d 226 (W. Va. 2006); see also Geoffrey, Inc. v. S.C. Tax Comm’n., 437 S.E.2d 13 (S.C. 1993); South Dakota v. Wayfair, 138 S. Ct. 2080 (2018).

40. 640 S.E.2d 226, 226 (W. Va. 2006).

41. *MBNA Am. Bank, N.A.*, 640 S.E.2d at 227.

42. *Id.*

43. *Id.* at 232.

44. *Id.* at 234.

45. *Id.* (internal citations omitted).

Commerce Clause analysis requires the additional examination of the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state.”⁴⁶

Utilizing this new standard, the court concluded that the bank had a substantial nexus with West Virginia such that the bank would be subject to the tax.⁴⁷ The court highlighted that the bank continuously and systematically engaged in direct mail and telephone solicitation and promotion in West Virginia.⁴⁸ Moreover, the court noted that the bank had \$8,419,431.00 in gross receipts attributable to West Virginia customers in 1998 and had \$10,163,788.00 in 1999—large sales figures that should be taxed by the state containing the market for the sales.⁴⁹

In a similar case, South Carolina’s Supreme Court held that licensing intangibles in South Carolina and deriving income from said licenses creates a substantial nexus for Toys-R-Us.⁵⁰ In *Geoffrey, Inc. v. South Carolina Tax Commission*, Geoffrey was a wholly-owned, second-tier subsidiary of Toys-R-Us incorporated in Delaware with its principal offices in Delaware.⁵¹ Geoffrey had no employees or offices in South Carolina and owned no tangible property there.⁵² Geoffrey owned several trademarks that it subsequently sold to Toys-R-Us.⁵³ In return, Geoffrey received a one percent royalty on the licensed materials.⁵⁴ Toys-R-Us began doing business in South Carolina in 1985 and had since then made royalty payments to Geoffrey based on South Carolina sales which South Carolina required Geoffrey to pay income tax on.⁵⁵

The Supreme Court of South Carolina held that “[i]t is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus.”⁵⁶ Moreover, a “taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business.”⁵⁷ Therefore, Geoffrey was subject to the state’s income tax.

46. *Id.*

47. *Id.* at 234.

48. *Id.* at 233.

49. *Id.* at 234.

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

51. *Id.* at 15.

52. *Id.*

53. *Id.* at 17.

54. *Id.*

55. *Id.*

56. *Id.* at 23.

57. *Id.*

ii. Sales Tax

The courts in *MBNA* and *Geoffrey* highlighted the distinction between sales taxes and income taxes, allowing them to conclude that the *Quill* physical presence standard did not apply to income taxation. The Supreme Court in *South Dakota v. Wayfair*,⁵⁸ however, confronted the 26-year-old *Quill* doctrine and changed the physical presence standard for sales and use taxes. In *Wayfair*, South Dakota faced a serious economic problem as it lost between \$48,000,000 and \$58,000,000 per year due to its inability to collect sales tax from non-South Dakota businesses.⁵⁹ To remedy the issue, the state enacted a statute whose purpose was “to provide for the collection of sales taxes from certain remote sellers.”⁶⁰ The statute applied only to sellers that, on an annual basis, deliver more than \$100,000 of goods or services into the State or engage in 200 or more separate transactions for the delivery of goods or services into the state.⁶¹ Upon enactment of the statute, South Dakota sought an injunction requiring Wayfair, Inc, (and other companies running similar business models) to register for licenses to collect and remit sales tax.⁶²

The lower courts both held that the statute was unconstitutional under the *Quill* rule.⁶³ The Supreme Court of South Dakota, despite upholding *Quill*, urged the Supreme Court to grant certiorari to analyze South Dakota’s arguments.⁶⁴ In a landmark decision, the Supreme Court granted certiorari and overturned *Quill*. Listing three main reasons, the Supreme Court claimed that “*Quill* is flawed on its own terms.”⁶⁵

First, the Court stated that the physical presence test is not necessary for “substantial nexus” under the Commerce Clause.⁶⁶ The Court set aside the principle from *Quill* that the burden on businesses in trying to comply with state taxes where they are not principally located will cause an undue burden on interstate commerce.⁶⁷ The Court in *Wayfair* overruled this interpretation, and stated that “administrative costs of compliance, especially in the modern economy with its Internet technology, are largely unrelated to whether a company happens to have a physical presence in a state.”⁶⁸

58. 138 S. Ct. 2080, 2099 (2018).

59. *Id.* at 2088.

60. *Id.*

61. *Id.* at 2089.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.* at 2092.

66. *Id.* at 2092-2093.

67. *Id.* at 2093.

68. *Id.*

Second, the Court pointed out that *Quill* created, rather than solved, market distortions.⁶⁹ Remote sellers have, in effect, been able to avoid the regulatory burden of tax collection and could offer lower prices to consumers than those business that had to pay those taxes: “[i]n effect, *Quill* had come to serve as a judicially created tax shelter for business that decided to limit their physical presence and still sold their goods and services to a state’s consumers.”⁷⁰

Lastly, the Court stated that *Quill* does not match with modern precedents of the Commerce Clause.⁷¹ *Quill* took an extremely formalistic view of the Commerce Clause when it held that physical presence is a mandatory component of substantial nexus.⁷² In the Court’s view, this did not make sense and imposed arbitrary burdens on in-state sellers to the benefit of out-of-state sellers.⁷³ In the end, the *Wayfair* Court held that a taxpayer’s physical presence in a state was not necessary to meet the substantial nexus requirement of the Commerce Clause.⁷⁴

2. Congressional Limits to State Taxing Authority

In addition to the constitutional limits imposed on state taxing authority, Congress also has the power to impose limits on states’ jurisdiction to tax. 15 U.S.C. § 381, which was Congress’ response to *Northwestern States Portland Cement Co. v. Minnesota*, is a prime example.⁷⁵ In that case, an Iowa company had salespeople operating in an office in Minnesota. The salespeople solicited sales in Minnesota.⁷⁶ As a whole, the company had extremely few sales in Minnesota.⁷⁷ The Supreme Court, however, upheld the Iowa company being subject to Minnesota’s net income tax.⁷⁸ Unhappy with a result where out-of-state companies were subject to state income taxes solely by having sales representatives in the state, Congress enacted 15 U.S.C. § 381. This statute denies states the power to impose taxes on net income derived within the state if the “only business activities carried on within the State are the solicitation of orders for sales of tangible personal property, where the orders are sent outside the state for approval or rejection and are filled

69. *Id.* at 2092.

70. *Id.* at 2094.

71. *Id.* at 2092.

72. *Id.* at 2094.

73. *Id.*

74. *Id.* at 2099.

75. 358 U.S. 450.

76. *Id.* at 453.

77. *Id.* at 453-54.

78. *Id.* at 469.

by shipment or delivery from a point outside the state.”⁷⁹

The provision states:

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).⁸⁰

The principle case interpreting 15 U.S.C. § 381 is *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*⁸¹ In that case, Wrigley, an Illinois corporation, was subject to a franchise tax assessed on a percentage of its income in Wisconsin.⁸² Wrigley objected to this assessment by saying that its activities in Wisconsin were limited to “solicitation of orders” within the meaning of 15 U.S.C. § 381.⁸³ The outcome of this case turned on the specific facts. Wrigley had a regional manager who resided in Wisconsin but did not have a company office there.⁸⁴ Instead, the manager held meetings in his basement or a hotel.⁸⁵ In addition to the manager, Wrigley had sales representatives that were supplied with company cars, a stock of gum, and display racks to engage in a number of activities, including replacing old, stale gum and soliciting additional orders.⁸⁶ Wrigley did not own or lease property in Wisconsin and all sales were sent to Chicago for filling.⁸⁷

Despite having minimal contacts with Wisconsin, the Supreme Court held that Wrigley’s business activities were beyond those activities protected by 15 U.S.C. § 381, and Wrigley was subject to Wisconsin’s net income tax.⁸⁸ In coming to this conclusion, the Court noted that

79. 15 U.S.C. § 381.

80. *Id.*

81. 505 U.S. 214.

82. *Id.* at 219.

83. *Id.*

84. *Id.* at 217.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.* at 233

solicitation of orders covers more than what is strictly essential to making requests for purchases.⁸⁹ The solicitation of orders, however, does not extend to those activities that the company would have reason to engage in, but designates those responsibilities to the sales force anyway.⁹⁰

To further define this standard, the Court gave examples of activities that would be protected under 15 U.S.C. § 381 which included: providing a car to salespeople, giving stock of free samples of the goods to potential customers/retailers, regional manager recruitment, and training and evaluation of employees.⁹¹ As examples of non-protected goods, the Court stated that repair or service to the company's products, replacing damaged goods, storage of goods, and replacement of goods would all not be protected under 15 U.S.C. § 381.⁹² Non-protected activities would subject the business to state income tax.

The Court concluded in *Wrigley* that Wrigley's business activities were beyond the scope of 15 U.S.C. § 381 because the sales representatives replaced its retail customers' un-sold stale gum, supplied gum through agency stock checks, and stored the gum in Wisconsin.⁹³ For those reasons, Wrigley was outside the bounds of 15 U.S.C. § 381 and was, therefore, subject to Wisconsin's net income tax.⁹⁴

In the aftermath of *Wrigley*, the Multistate Tax Commission ("MTC")⁹⁵ set forth a statement of information concerning business practices under 15 U.S.C. § 381.⁹⁶ Within this statement of information, the MTC set forth a list of protected and unprotected activities under 15 U.S.C. § 381.⁹⁷ According to the MTC, protected activities include: soliciting orders for sales by any type of advertising; passing orders, inquiries and complaints on to the home office; and providing automobiles to sales personnel for

89. *Id.* at 228

90. *Id.* at 228-29. The Court, for example, cites sales representatives repairing or servicing the company's products. Replacing goods is not strictly essential for "solicitation of orders" whereas providing a car would be.

91. *Id.*

92. *Id.* at 234-35.

93. *Id.*

94. *Id.* at 235.

95. The Multistate Tax Commission is an intergovernmental state tax agency created in 1967 as an effort by states to protect their tax authority and to help promote fair, uniform, and consistent tax policy. As of 2019, all 50 states participate in the Multistate Tax Commission in some form. The guidance set forth by the Commission does not have the force of law, but aids states in developing uniform tax laws. Member states may opt not to follow the Commission's recommendations. *About Us*, MULTISTATE TAX COMM'N, <http://www.mtc.gov/The-Commission/About-Us> [https://perma.cc/F6FC-2SD9].

96. *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272*, MULTISTATE TAX COMM'N (2001), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/StatementofInfoPublicLaw86-272.pdf [https://perma.cc/F25W-PFEXE].

97. *Id.*

their use in conducting protected activities.⁹⁸ By providing this list of protected and unprotected activities, the MTC provided signatory states with clarity in determining whether business practices fell within the protections of 15 U.S.C. § 381 or not, and consequently whether they could tax the business.⁹⁹

B. Anti-Commandeering Doctrine

The anti-commandeering rule has been interpreted to mean that the federal government cannot require a state or state official to adopt or enforce federal law.¹⁰⁰ More specifically, the anti-commandeering doctrine prohibits Congress from imposing affirmative, coercive duties upon states.¹⁰¹ This doctrine acts as another constraint on congressional power, similar to the Bill of Rights.¹⁰² Unlike the Bill of Rights, however, the anti-commandeering principle lacks any textual basis in the Constitution.¹⁰³ The Supreme Court created the doctrine out of the Tenth Amendment and related federalism principles in *New York v. United States*,¹⁰⁴ *Printz v. United States*,¹⁰⁵ and, most recently, *Murphy v. NCAA*.¹⁰⁶

1. *New York v. United States*

In *New York v. United States*,¹⁰⁷ the Supreme Court held that the Low-Level Radioactive Waste Policy Amendments Act of 1985 (“Waste Act”) was constitutional in part, and unconstitutional in part.¹⁰⁸ In an effort to combat a radioactive waste disposal problem, Congress passed the Waste Act which obligated states to provide disposal sites for privately created waste generated within their borders and included incentives and a take-title provision to increase compliance with federal standards and to

98. *Id.*

99. *Id.*

100. Steven D. Schwinn, It’s time to abandon anti-commandeering (but don’t count on this Supreme Court to do it), SCOTUSBLOG (August 17th, 2017, 10:44 AM), <https://www.scotusblog.com/2017/08/symposium-time-abandon-anti-commandeering-dont-count-supreme-court/> [<https://perma.cc/68ZB-CAGN>].

101. Matthew D. Adler, *State Sovereignty and the Anti-Commandeering Cases*, 574 ANNALS OF THE AM. ACAD. OF POL. AND SOC. SCI. 158, 158] (2001), <https://journals.sagepub.com/doi/pdf/10.1177/000271620157400112> [<https://perma.cc/3RD4-YM2J>].

102. *Id.*

103. Schwinn, *supra* note 100.

104. 505 U.S. 144 (1992).

105. 521 U.S. 898 (1997).

106. 138 S. Ct. 1461 (2018).

107. *New York*, 505 U.S. at 150.

108. *Id.* at 188.

mitigate the radioactive waste issue.¹⁰⁹

Congress provided two-fold incentives—monetary and access—which the Supreme Court held constitutional.¹¹⁰ The monetary incentives allowed states with disposal sites to impose a surcharge on radioactive waste received from other States.¹¹¹ Additionally, the Waste Act rewarded states with disposal sites by authorizing them to gradually increase the cost of access to their waste sites and to deny access to states that failed to meet federal guidelines.¹¹² These incentives were held constitutionally permissible due to Congress' power under the Commerce, Taxing, and Spending Clauses of the Constitution.¹¹³

The Supreme Court, however, invalidated the take-title provision under the Waste Act as an unconstitutional exercise of congressional power.¹¹⁴ The take-title provision specified that a state that failed to provide for the disposal of all internally generated waste by a particular date must take title to, and possession of, the waste and become liable for all damages suffered as a result of the state's failure to promptly take possession.¹¹⁵ In holding the take-title provision unconstitutional, the Court noted that “Congress may not simply ‘commandeer the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.’”¹¹⁶ Here, the take-title provision offers state governments a choice of either accepting ownership of waste or regulating according to Congress's instructions.¹¹⁷ Because an instruction to state governments to take title to waste would be beyond the authority of Congress, and because a direct order to regulate would also be beyond the authority of Congress, the Supreme Court held that Congress lacks the power to offer the States a choice between the two.¹¹⁸

2. *Printz v. United States*

Similar to *New York*, in *Printz v. United States*, the Court held that the federal government may not compel states to enact or administer a federal regulatory program.¹¹⁹ In *Printz*, the Brady Handgun Violence Prevention

109. *Id.* at 150.

110. *Id.* at 152-53.

111. *Id.*

112. *Id.* at 153.

113. *Id.* at 188.

114. *Id.*

115. *Id.* at 153-54.

116. *Id.* at 161 (citing *Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc.*, 452 U.S. 264, 288 (1981)).

117. *Id.* at 175.

118. *Id.* at 176.

119. 521 U.S. at 902.

Act required the Attorney General to establish a national system for instantly checking prospective handgun purchasers' backgrounds and commanded the "chief law enforcement officer" ("CLEO") of each local jurisdiction to conduct such checks and perform related tasks on an interim basis until the national system became operative.¹²⁰

The Court concluded that the Tenth Amendment categorically forbids the Federal Government from commanding state officials directly.¹²¹ The Government, in support of the constitutionality of the Brady Handgun Act amendments, attempted to distinguish *New York* by arguing that the background check provision does not require state legislative or executive officials to make policy, ministerial federal tasks do not diminish the state or federal officials' accountability, and the Brady Handgun Act addresses provisions to CLEOs and not the state itself.¹²² The Court dismissed these arguments by stating that the whole object of the Brady Handgun Act was to direct the functioning of the state executive, which would compromise the framework of dual sovereignty, and thus violated the anti-commandeering principle under the Tenth Amendment.¹²³

3. *Murphy v. NCAA*

In 2018, the Supreme Court had another opportunity to review its anti-commandeering jurisprudence. This time, however, the applicable statute did not command the states to take any affirmative action, it merely forbade a state from taking action.¹²⁴ In *Murphy v. NCAA*, New Jersey challenged a provision under the Professional and Amateur Sports Protection Act ("PASPA") that makes it "unlawful" for a state to "sponsor, operate, advertise, promote, license, or authorize by law or compact ... a lottery, sweepstakes, or other betting, gambling, or wagering scheme based ... on" competitive sporting events.¹²⁵ In 2014, despite PASPA, the New Jersey legislature repealed provisions of an old state law prohibiting sports gambling.¹²⁶ The NCAA, among others, brought suit in the District Court and won on the grounds that the law violated PASPA by authorizing sports gambling.¹²⁷ The Third Circuit

120. *Id.* at 902-04.

121. *Id.* at 934.

122. *Id.* at 929-32.

123. *Id.* at 935.

124. 28 U.S.C. § 3702 (1992).

125. *Murphy v. NCAA*, 138 S. Ct. 1461, 1470 (2018).

126. *Id.* at 1471.

127. *Id.* at 1466.

affirmed the District Court.¹²⁸

The Supreme Court granted certiorari and reversed the District Court and Third Circuit.¹²⁹ The Supreme Court held that the PASPA provision at issue, the prohibition of state authorization of sports gambling, violated the anti-commandeering principle.¹³⁰ The Court highlighted that the anti-commandeering principle is simply the expression of a fundamental structural decision in the Constitution to withhold from Congress the power to issue orders directly to the states.¹³¹ The Court noted the principle enunciated by Justice O'Connor in *New York* that “the Constitution confers upon Congress the power to regulate individuals, not states.”¹³²

In *Murphy*, the Court held that a congressional prohibition of state-authorized sports gambling “unequivocally dictates what a state legislature may and may not do.”¹³³ Moreover, “[i]t is as if federal officers were installed in state legislative chambers and were armed with the authority to stop legislators from voting on any offending proposals.”¹³⁴ The NCAA argued that although Congress cannot compel a state to enact legislation, Congress can prohibit a state from enacting new laws. The Court quickly dismissed this argument, stating “[i]t was a matter of happenstance that the laws challenged in *New York* and *Printz* commanded ‘affirmative’ action as opposed to imposing a prohibition. The basic principle—that Congress cannot issue direct orders to state legislatures—applies in either event.”¹³⁵

The lasting effect of the holding in *Murphy* will transcend sports gambling and have a significant impact on various aspects of law, including state taxing authority. In a recent panel hosted by the American Bar Association, tax experts predicted a number of challenges to taxing authority based upon the decision in *Murphy*.¹³⁶ The panelists noted three federal statutes about state taxes that could potentially clash with *Murphy*: 15 U.S.C. § 381, the Internet Tax Freedom Act,¹³⁷ and the Mobile

128. *Id.*

129. *Id.* at 1473.

130. *Id.*

131. *Id.* at 1475.

132. *Id.* at 1477.

133. *Id.* at 1478.

134. *Id.*

135. *Id.*

136. Maria Koklanaris, *Betting Case Looms Large For State Taxation, Specialist Says*, LAW360 TAX AUTH. (Jan 18, 2019), LEXIS, 2019 Law360 18-167.

137. *See Trade Facilitation and Trade Enforcement Act of 2015*, Pub. L. No. 114-125, § 922, 130 Stat. 122 (2016) (codified as 15 U.. The Internet Tax Freedom Act bars all governments from taxing Internet access.

Telecommunications Sourcing Act.¹³⁸

III. DISCUSSION

The anti-commandeering principle has major implications for Congress trying to pass legislation limiting the states' various powers. Although it has not yet been challenged, states could argue that under the anti-commandeering doctrine, especially after the expansion in *Murphy*, 15 U.S.C. § 381 commandeers the states to refrain from taxing businesses in their state if there is only solicitation of orders, even though the business may have substantial nexus in the state under *Wayfair*, *MBNA*, and *Geoffrey*.

This Part advocates for states to challenge the constitutionality of 15 U.S.C. § 381 and proceeds in two parts. First, under the principle stated in *Murphy*, 15 U.S.C. § 381 unconstitutionally prohibits states from imposing a net income tax on out-of-state businesses. Second, a hypothetical illustrates how ruling that 15 U.S.C. § 381 is unconstitutional could help states generate more tax revenue by increasing their tax base.

A. 15 U.S.C. § 381 Violates the Tenth Amendment

The anti-commandeering doctrine generally forbids Congress from commandeering the states' legislative process and coercing states into adopting federal regulatory programs. In *New York* and *Printz*, the Supreme Court held that direct coercion from Congress inducing state governments or officials to take specific action violates the Tenth Amendment. The Supreme Court explained in both cases that the Constitution provides Congress the power to regulate individuals, not states.¹³⁹ Moreover, the Court noted that there has always been an understanding that even where Congress has the authority under the Constitution to pass laws requiring or prohibiting certain acts, it lacks the power directly to compel the States to require or prohibit those acts.¹⁴⁰

Murphy expanded the anti-commandeering doctrine by highlighting the distinction of whether the federal law regulates individuals or the state. If a federal law regulates private actors and not the states, the anti-commandeering doctrine is not implicated and the law would likely be held constitutional.¹⁴¹ If the federal law regulates the states, then the anti-

138. See Mobile Telecommunications Sourcing Act, Pub. L. No. 106-252, § 116, 114 Stat. 626 (2000). The Mobile Telecommunications Sourcing Act sets uniform nationwide sourcing rules for state and local taxation of wireless services.

139. *New York v. United States*, 505 U.S. 144, 166 (1992).

140. *Id.*

141. *Murphy*, 138 S. Ct. at 1489.

commandeering doctrine is implicated and the law is likely unconstitutional under the Tenth Amendment.¹⁴² In *Murphy*, the Court deemed PASPA to be neither a regulation of private actors nor a federal restriction on private actors and, therefore, held the law unconstitutional. The Supreme Court found that PASPA “leaves in place a state law that the state does not want, so the citizens of the state . . . are bound to obey a law that the state does not want but that the federal government compels the state to have.”¹⁴³

15 U.S.C. § 381 is likewise unconstitutional under the anti-commandeering doctrine expounded upon by the Supreme Court in *New York, Printz, and Murphy*. In relevant part, 15 U.S.C. § 381 restricts a state from imposing a net income tax on income derived within that state if the business’ only contacts with the state are through solicitation of order. In other words, 15 U.S.C. § 381 is a federal regulation that regulates the states, not individuals, and is therefore arguable a violation of the Tenth Amendment.

In *Murphy*, the Court held that a congressional prohibition of state authorized sports gambling “unequivocally dictates what a state legislature may and may not do.”¹⁴⁴ Similarly, a congressional prohibition of a state’s taxing authority on a company doing business within a state unequivocally dictates what a state legislature may not do. The fundamental principle of the Tenth Amendment is that Congress cannot issue direct orders to state legislatures, which 15 U.S.C. § 381 does. Congress puts a direct prohibition on the states regarding their taxing authority. Moreover, the regulation does not regulate private actors’ conduct, which is the linchpin of whether the anti-commandeering principle is violated.

One hypothetical challenge proposed at the American Bar Association tax panel involved *Wayfair* by asking: if Congress legislated that states could not impose a sales tax unless retailers had a certain amount of sales within a state, would it violate *Murphy*?¹⁴⁵ Joe Huddleston, former executive director of the Multistate Tax Commission, concluded that it would “[a]bsolutely” violate *Murphy*.¹⁴⁶ As an alternative, an audience member followed by asking if Congress said that retailers were free from tax collection from customers unless they had a certain amount of sales within a state, would it then be constitutional?¹⁴⁷ Huddleston again said

142. *Id.*

143. Oral Argument at 26:18, *Murphy v. NCAA*, 138 S. Ct. 1461, 1470 (2018) (No. 16-476), <https://www.oyez.org/cases/2017/16-476>.

144. *Murphy*, 138 S. Ct. at 1478.

145. Koklanaris, *supra* note 136.

146. *Id.*

147. *Id.*

no, implying that even if the language was aimed at individuals and not states, the substance of the language would still commandeer the states into enforcing a federal regulation, thereby violating of the Constitution.¹⁴⁸

The hypothetical situation put forth by the audience member is the exact issue involved in 15 U.S.C. § 381. Congress steps into the states' taxing authority, via 15 U.S.C. § 381, and prohibits states from taxing. Under 15 U.S.C. § 381, it does not matter that a business could do millions of dollars' worth of sales within a state, so long as those sales are accepted and filled outside of the state, that company is not subject to a state's income tax. In the modern business world, surely this leads to a distorted reality.

In 1959, when 15 U.S.C. § 381 was originally enacted, perhaps merely solicitating orders in a state was unlikely to generate enough revenue to pose a serious threat to a state's tax revenue. However, in the 21st century with the advent of social media and easier access to national sales, 15 U.S.C. § 381 poses a serious threat to state's tax revenue fund. Businesses aware of 15 U.S.C. § 381's far reaching tax exemption are able to avoid states' net income taxes by limiting their direct contacts with a state while still generating sales in the state by filling and shipping advertised sales from outside the state. This avoidance unduly burdens states faced with budget crises that need funding for vital state needs, such as educational funding and infrastructure. For these reasons, states should challenge 15 U.S.C. § 381 on the grounds that it commandeers states into enforcing a federal regulation, thereby violating the Tenth Amendment.

B. Businesses Would No Longer Be Exempt Without 15 U.S.C. § 381

If a state were to challenge 15 U.S.C. § 381 on constitutional grounds and succeed, it would still need to show a business satisfies the constitutional limits on state taxing authority; namely, the Due Process Clause and the Commerce Clause. A hypothetical set of facts is illustrative to show how, without the exemption provided by 15 U.S.C. § 381, businesses would be subject to states' net income tax.

For the purposes of this Article, assume Widgets Co. ("Company") is headquartered in State A. Company manufactures all of its widgets in State A. In addition to doing business in State A, Company also solicits orders through sales representatives in State B. Within State B, the sales representatives advertise and invite orders from customers. The sales representatives are successful and order forms are filled out for \$500,000 worth of widgets annually. These orders are then sent to the home office

148. *Id.*

in State A where they are confirmed, filled, and delivered back into State B from State A through a common carrier such as the U.S. Postal Service. All activities in State B are currently exempted from tax in State B under 15 U.S.C. § 381 despite having generated approximately \$500,000 of net income in annual sales attributable to State B for Company.

Under 15 U.S.C. § 381, State B is unable to tax any of the \$500,000 generated in the state. If, for example, State B has a 10% net income tax, it is losing \$50,000 of tax revenue, assuming there are no applicable deductions or credits. If State B is in a budget crisis, missing out on \$50,000 in revenue is a big deal. To remedy this, State B should challenge the constitutionality of 15 U.S.C. § 381, using to the argument of this Article, in order to levy its net income tax on Company. Assuming *arguendo* that the court accepts the argument and declares 15 U.S.C. § 381 unconstitutional, State B would then need to satisfy the Due Process Clause and Commerce Clause in order to tax Company.

C. Due Process Clause

In *Quill*, the Supreme Court held that a business does not need a physical presence within a state to satisfy nexus under the Due Process Clause. “Applying these principles, we have held that if a . . . corporation 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.”¹⁴⁹ Therefore, if a business allows itself to benefit from the market within a state, the business has sufficient nexus under the Due Process Clause.

In the hypothetical, Company would have sufficient nexus with State B to satisfy the Due Process Clause. The Company solicits orders from citizens of State B, advertises within the state, and has made \$500,000 worth of sales attributable to State B. Each of these facts lends itself to the conclusion that Company has purposefully availed itself to the market in State B and would therefore satisfy the nexus requirements of the Due Process Clause.

D. Commerce Clause

In addition to the Due Process Clause, State B also has to show that taxing the Company does not violate the Commerce Clause. More specifically, State B has to show that the proposed tax does not discriminate against interstate commerce. In analyzing whether a state tax discriminates against interstate commerce, State B must prove the four

149. *Quill Corp. v. N.D.*, 504 U.S. 298, 308 (1992).

elements of the *Complete Auto* test: (1) the proposed tax is applied to an activity with substantial nexus with State B; (2) the proposed tax is fairly apportioned; (3) the proposed tax does not discriminate against out-of-state commerce; and (4) the proposed tax is fairly related to services provided by State B. For the purpose of this Article, elements two through four are assumed, and an analysis is conducted only for element one.

E. Substantial Nexus with the Taxing State

Similar to the Due Process Clause, the Commerce Clause also asks whether a business has sufficient nexus with the taxing state. However, after *Quill*, the standard for sufficient nexus is different between the Due Process Clause and Commerce Clause. Furthermore, there is a distinction in what constitutes sufficient nexus under the Commerce Clause between income tax and sales tax.

For several years, the *Quill* physical presence standard was interpreted as the nexus requirement for both sales and income taxes. However, in *MBNA* and *Geoffrey*, two state courts held that the physical presence standard applied only for sales tax nexus, and not income tax nexus.¹⁵⁰ As discussed *supra*, in *MBNA*, the West Virginia Court believed a significant economic presence test was a better indicator of nexus for the income tax than a physical presence standard.¹⁵¹ Thus, under a substantial economic presence analysis, there is an examination of “the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state.”¹⁵²

The Supreme Court followed the income tax trend in the sales tax case of *Wayfair*. In *Wayfair*, the Supreme Court reversed *Quill*'s longstanding precedent mandating a physical presence within a state before a sales tax could be levied on a business. The Court adopted an economic presence test, upholding South Dakota's statute levying a sales tax on all businesses who have earned \$100,000 in sales or completed more than 200 transactions in the state.

Thus, although the Supreme Court has not decided what constitutes nexus for income tax purposes, the trend in both income tax and sales tax cases supports a conclusion that an economic presence test is the prevailing measure for whether a state has jurisdiction to tax a business.

Under the standard set forth in *MBNA* and *Geoffrey*, it is likely that the Company would have sufficient nexus to State B under the economic presence test. The West Virginia court stated that an income tax nexus requirement inquires into the frequency, quantity, and systematic nature

150. See *Tax Comm'r v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 235 (W. Va. 2006); see also *Geoffrey, Inc. v. S.C. Tax Comm'n.*, 437 S.E.2d 13, 18 (S.C. 1993).

151. *MBNA Am. Bank, N.A.*, 640 S.E.2d at 234.

152. *Id.*

of a taxpayer's economic contacts with a state. With our limited facts, Company likely satisfies this nexus standard because Company has \$500,000 of sales generated from State B. Although Company generated a smaller amount of revenue than the bank in *MBNA*, under the analogous economic presence standard in the sales tax context, \$500,000 in sales would have been sufficient to trigger the South Dakota sales tax. Moreover, Company continually and systemically advertises and solicits orders from within State B. Between the \$500,000 of sales and the systemic solicitation of orders, it is more than likely that the Company would satisfy the income tax economic presence standard under the Commerce Clause.

F. Benefit to State B

In conclusion, if a court were to hold 15 U.S.C. § 381 unconstitutional, State B would be permitted to levy its 10% net income tax on Company's sales, generating an additional \$50,000 of tax revenue for the state every tax year. Although trivial in the grand scheme of tax revenue, an additional \$50,000 per year from similar businesses as the Company could total millions of dollars of extra revenue for State B that could provide funding for public programs.

IV. CONCLUSION

Under the expanded anti-commandeering doctrine enunciated in *Murphy*, states in need of tax revenue should challenge the constitutionality of 15 U.S.C. § 381. Under *Murphy*, congressional statutes that regulate states and not private actors are unconstitutional under the Tenth Amendment. When Congress enforces 15 U.S.C. § 381, it restricts a state from imposing a net income tax on income derived within that state if the business's only contacts with the state are through solicitation. This enforcement regulates the states, not individuals, and therefore violates the Tenth Amendment.

After proving 15 U.S.C. § 381 unconstitutional, a state would have to satisfy the jurisdictional requirements under the Due Process Clause and Commerce Clause to impose its income tax on businesses. Often times, businesses engaged in interstate commerce that are exempted under 15 U.S.C. § 381 would have sufficient contacts with a state to satisfy the requirements of these two constitutional doctrines. A corporation that purposefully avails itself of the benefits of an economic market in a forum state would satisfy the necessary requirements of the Due Process Clause. Moreover, under the Commerce Clause, an inquiry needs to be made into the "frequency, quantity and systematic nature of a taxpayer's economic

contacts with a state.”¹⁵³ Whether a business satisfies this test would depend on the factual scenario, but if a business generated \$500,000 within a state through sales representatives, in-home offices, and advertisements, that business would likely to be deemed to satisfy the requirements under the Commerce Clause too.

States hurting for revenues should strongly consider challenging the constitutionality of 15 U.S.C. § 381. As seen by the Court’s current trend of cases, including *Wayfair* and *Murphy*, the State could likely see a windfall return on its investment after challenging the abused Public Law.

153. *Id.*