

2002

The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation

Bradley W. Joondeph

Follow this and additional works at: <https://ir.lawnet.fordham.edu/flr>



Part of the [Law Commons](#)

Recommended Citation

Bradley W. Joondeph, *The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation*, 71 Fordham L. Rev. 149 (2002).

Available at: <https://ir.lawnet.fordham.edu/flr/vol71/iss1/3>

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

THE MEANING OF FAIR APPORTIONMENT AND THE PROHIBITION ON EXTRATERRITORIAL STATE TAXATION

Bradley W. Joondeph*

INTRODUCTION

The constitutional requirement that state and local taxes be “fairly apportioned” is a longstanding and well-accepted element of the Supreme Court’s state tax jurisprudence.¹ As early as the late 1800s, the Court indicated that state taxes on interstate commerce must be apportioned to reflect the taxpayer’s activities in the taxing jurisdiction.² And although the Court’s state tax decisions over the past century have hardly followed a consistent or logical path,³ the fair apportionment test has remained a central component of the Court’s doctrinal framework. Today, fair apportionment is a distinct element of the Court’s four-part test, first articulated in *Complete Auto Transit, Inc. v. Brady*⁴ (and now known as the “*Complete Auto* test”), for assessing state taxes under the dormant Commerce Clause. And the Court has found in several cases that state taxes that were not

* Associate Professor, Santa Clara University School of Law. I owe thanks to June Carbone, Peter Faber, Walter Hellerstein, Jeff Kahn, Richard Primus, Srija Srinivasan, Nancy Staudt, John Swain, and Peter Wiedenbeck for their generous and helpful comments on earlier drafts of this article. Thanks also to the students in my state and local tax classes for their many contributions to my thinking on these issues.

1. See Walter Hellerstein, *Is “Internal Consistency” Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation*, 87 Mich. L. Rev. 138, 139 (1988) [hereinafter Hellerstein, *Is Internal Consistency Foolish?*]; Walter Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 Tax Law. 37, 57 (1987) [hereinafter Hellerstein, *State Taxation of Interstate Business*]; James H. Peters, *Sales/Use Taxes: Is Fair Apportionment a Proper Test?*, 6 St. Tax Notes 105, 105 (1994).

2. See, e.g., *Maine v. Grand Trunk Ry. Co.*, 142 U.S. 217, 217-19 (1891); *Pullman’s Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891).

3. The Court has famously described its decisions in the area as comprising a “tangled underbrush” and a “quagmire,” calling them “not always clear . . . consistent or reconcilable.” *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-58 (1959) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344 (1954)); see also Jerome R. Hellerstein & Walter Hellerstein, *State and Local Taxation* 189 (7th ed. 2001).

4. 430 U.S. 274 (1977).

fairly apportioned violated the Due Process Clause of the Fourteenth Amendment.⁵

The fair apportionment requirement serves two distinct functions in constitutional adjudication. First, the fair apportionment of state taxes imposed on interstate commercial activity, at least in theory, eliminates the risk of multiple or duplicative taxation of such commerce simply because it crosses state borders.⁶ If each state only taxes that portion of the relevant value that fairly reflects the taxpayer's activities in that state, the taxpayer should be immune from state taxation on more than 100% of that value (whether it be income, property, consumption, or something else). Second, fair apportionment effectively prevents state governments from projecting their taxing powers beyond their borders.⁷ A fairly apportioned tax is appropriately limited (at least roughly) to those values or activities over which the state has jurisdiction, and therefore prevents extraterritorial taxation.

This article explores the meaning of the fair apportionment requirement in state taxation—the command that states divide values attributable to activities occurring in more than one state—and its implications for the breadth of states' taxing powers.⁸ It makes three

5. See, e.g., *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952); *Johnson Oil Ref. Co. v. Oklahoma ex rel. Mitchell*, 290 U.S. 158 (1933); *Union Tank Line v. Wright*, 249 U.S. 275 (1919); *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194 (1905).

6. Hellerstein, *State Taxation of Interstate Business*, *supra* note 1, at 57. "Multiple taxation" in this context means duplicative tax burdens imposed on taxpayers doing business across state lines that are not imposed on taxpayers doing business exclusively in one state. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 139 n.13. For instance, suppose a New York corporation that did business exclusively within the state of New York was subject to a tax on exactly 100% of its income. If New York imposed a tax on 100% of the income of a multistate corporation, while New Jersey imposed a tax on 30% of the same corporation's income, that corporation would be subject to multiple taxation on 30% of its income. Because the firm is engaged in interstate commerce, it is taxed on 130% of its income, while the purely intrastate business is taxed on only 100% of its income.

7. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 186 ("Wholly apart from its role in preventing multiple taxation, the fair apportionment criterion serves to limit the territorial reach of state power by requiring that the state's tax base corresponds to the taxpayer's in-state presence.").

8. The focus of this article is the constitutional requirement that a state divide the relevant interstate tax base—the *apportionment* aspect of the fair apportionment requirement. It therefore generally does not address the *fairness* of a state's method of apportionment. Clearly, the two issues are closely related, as an unfairly apportioned tax can produce the same problems as an unapportioned tax—namely, multiple taxation and extraterritorial taxation. Evaluating the constitutional standard for the fairness of a method of apportioning interstate values, however, raises a host of issues—the Supreme Court's institutional competence, the role of Congress, and the place of discriminatory purpose analysis, to name a few—that are beyond the scope of what I mean to address here. I have therefore set those questions aside for purposes of this article, although I admit that a fully comprehensive treatment of this subject would address them.

distinct but related points. The first point is that the fair apportionment of state taxes is really a “lower order” constitutional value; that is, rather than being an independent constitutional end, fair apportionment is a means to accomplish two other, more fundamental constitutional objectives. First, by preventing multiple taxation, fair apportionment prevents states from discriminating against interstate commerce. The imposition of multiple tax burdens on interstate commerce that are not also borne by purely intrastate commerce discriminates in practical effect against commercial activity crossing state lines. Second, by limiting a state to taxing its fair share of the relevant tax base, fair apportionment protects interstate commerce from extraterritorial taxation, ensuring that states tax only those activities or values with which they have a sufficient nexus.⁹ Properly understood, then, fair apportionment is no more than a reasonable and effective means to ensuring compliance with two other, “higher order” objectives of the Commerce and Due Process Clauses: protecting interstate commerce from discrimination, and preserving the state’s nexus with the values it seeks to tax.

A second point is that, in examining how the Supreme Court has actually applied the fair apportionment test, it is clear that, although the fair apportionment of state taxes is preferred, it is not always required. In a handful of recent cases, the Court has upheld state taxes as “fairly apportioned” even though the taxes at issue were, in actuality, completely unapportioned.¹⁰ The cases presented circumstances in which the nature of the tax (or the class of taxes of which it was a part) made division of the tax base by the state administratively cumbersome or impractical. Without saying as much, the Court held that, under these conditions, the absence of apportionment is constitutionally permissible so long as the state’s taxing scheme otherwise ensures that interstate commerce is not disadvantaged. Thus, despite the Court’s consistent incantation of fair

9. “Nexus” here refers to the state’s connection with the interstate activity or value being taxed, not with the taxpayer. The Constitution requires a taxing state to have a sufficient nexus with both the taxpayer and the activity or value it seeks to tax. See *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992) (“[I]n the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax.” (citation omitted)); Hellerstein & Hellerstein, *supra* note 3, at 355; Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 Tax L. Rev. 425, 434–35 (1997). Thus, a tax could be fairly apportioned without the state having a sufficient nexus with the taxpayer, and could render the application of the tax impermissible on jurisdictional grounds. The point here is that, regardless of whether the state has nexus with the taxpayer, fair apportionment ensures that the state has a sufficient nexus with the interstate value (or the portion of that value) that it is taxing.

10. See, e.g., *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995) (involving a tax on interstate bus fares); *Goldberg v. Sweet*, 488 U.S. 252 (1989) (considering a tax on telecommunications).

apportionment as a constitutional necessity, in certain circumstances state taxes on interstate commerce need not be apportioned at all.

Third and finally, this understanding of fair apportionment—as representing a constitutional preference rather than an inflexible requirement—reveals something significant about the present state of constitutional law, at least with respect to state and local taxation. Despite the basic understanding of state authority within our federal system as being limited to the regulation of activity occurring within a state's own borders, the Constitution actually permits states to project their taxing powers beyond their jurisdictions. Although the circumstances under which such extraterritorial taxation is permissible are limited, the point is significant. As states grapple with new forms of commerce—many of which map poorly onto traditional conceptions of geographic jurisdiction—we should be cognizant that a degree of extraterritorial taxation is constitutionally permissible, at least when there are practical barriers to dividing the relevant tax base. Indeed, allowing the states to craft practical solutions to the problems of taxing modern commercial activity, even when it means some measure of extraterritorial taxation, furthers the important constitutional objective of ensuring that the states remain vital and independent centers of governmental power.

This article proceeds in three parts. Part I discusses the purposes of the fair apportionment requirement and explains how it is actually a “lower order” constitutional norm. Part II sets out how some of the Court's recent decisions have not actually required the fair apportionment of state taxes, even while nominally imposing the test. These cases reveal that fair apportionment is more of a constitutional preference than a requirement. Finally, Part III explores the implications of this understanding of fair apportionment in state taxation. Significantly, it demonstrates that states are not always limited to taxing only that activity occurring within their borders, the Court's many assertions to the contrary notwithstanding.¹¹ In truth, the supposedly “fundamental” postulate that states cannot tax extraterritorial values¹² is not a rigid prohibition but a flexible principle, one that the Court has pragmatically bent to accommodate the states' need to protect their fiscal authority. This insight could become increasingly important to preserving the practical values of federalism in a world where more and more commercial transactions lack clear territorial locations.

11. See, e.g., *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) (“[A] State may not tax value earned outside its borders.”).

12. See *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 451 (1980) (Stevens, J., dissenting) (“It is fundamental that a State has no power to impose a tax on income earned outside of the State.”).

I. FAIR APPORTIONMENT AS A "LOWER ORDER" CONSTITUTIONAL VALUE

It is blackletter law that a state tax imposed on a multistate business must "be fairly apportioned to reflect the [taxpayer's] business conducted in the State."¹³ Unlike other aspects of constitutional doctrine in this area, the fair apportionment requirement has deep historical roots.¹⁴ Not long after the 1872 *Case of the State Freight Tax*¹⁵—the first case in which the Supreme Court squarely invalidated a state tax on dormant Commerce Clause grounds¹⁶—the Court suggested that the fair apportionment of state taxes was constitutionally necessary. For instance, in the 1891 case of *Maine v. Grand Trunk Railway Co.*,¹⁷ the Court reviewed a gross receipts tax imposed on an interstate railroad.¹⁸ Maine had computed the railroad's gross receipts attributable to the state by multiplying the railroad's total receipts (earned within and without the state) by a fraction, the fraction representing the proportion of the railroad's rail line mileage in Maine to its rail line mileage everywhere.¹⁹ In upholding the tax against constitutional challenge, the Court broadly endorsed Maine's method of determining the gross receipts taxable by the state: "The rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results, both to the State and the corporation taxed."²⁰

Under current doctrine, fair apportionment is an independent prong of the four-part *Complete Auto* test, which the Court has invoked in addressing virtually every dormant Commerce Clause challenge to a state or local state tax since 1977.²¹ *Complete Auto*

13. *Armco Inc. v. Hardesty*, 467 U.S. 638, 644 (1984).

14. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 139 ("The Court has long interpreted the commerce and due process clauses as requiring that taxes be fairly apportioned to the taxpayer's activities in the taxing state.").

15. 82 U.S. (15 Wall.) 232 (1872).

16. See Hellerstein & Hellerstein, *supra* note 3, at 191.

17. 142 U.S. 217 (1891).

18. *Id.* at 217–20.

19. *Id.* at 220.

20. *Id.* at 228.

21. See, e.g., *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 183 (1995); *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 310–11 (1994); *Itel Containers Int'l Corp. v. Huddleston*, 507 U.S. 60, 73 (1993); *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992); *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 372 (1991); *Amerada Hess Corp. v. Dir., Div. of Taxation, N.J. Dep't of Treasury*, 490 U.S. 66, 72–73 (1989); *Goldberg v. Sweet*, 488 U.S. 252, 257–60 (1989); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988); *Am. Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 291 (1987); *Wardair Can., Inc. v. Fla. Dep't of Revenue*, 477 U.S. 1, 8 (1986); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981); *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 443 (1980); *Dep't of Revenue v. Ass'n of Wash. Stevedoring Cos.*, 435 U.S. 734, 745–46 (1978); see also Walter Hellerstein, Michael J. McIntyre & Richard D. Pomp,

concerned a Mississippi tax imposed on the privilege of doing business in the state measured by the taxpayer's gross receipts from Mississippi sales.²² The taxpayer, relying on well-established Supreme Court precedent, challenged the tax's constitutionality solely on the ground that the dormant Commerce Clause prohibited states from formally taxing the privilege of engaging in interstate commerce.²³ The Court in *Complete Auto* overruled the decisions that had established this formalistic rule and upheld Mississippi's tax.²⁴ In doing so, the Court stated that a state tax will satisfy the Commerce Clause when it meets four criteria: "the tax is applied to an activity with a substantial nexus with the taxing state, *is fairly apportioned*, does not discriminate against interstate commerce, and is fairly related to the services provided."²⁵ As subsequent decisions confirm, the Court therefore treats fair apportionment as a discrete aspect of this four-part test for evaluating state taxes under the Commerce Clause.²⁶

Further, fair apportionment is often (though not always) necessary as a matter of due process.²⁷ The Due Process Clause of the Fourteenth Amendment prohibits a state from taxing interstate values or activities "unless there is a minimal connection or nexus between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise."²⁸ A state tax that is not fairly apportioned is apt to reach interstate values with which the state lacks a "minimal connection," and such a tax will often have no "rational relationship" to the taxpayer's activities in the state.²⁹

Commerce Clause Restraints on State Taxation After Jefferson Lines, 51 Tax L. Rev. 47, 49 & n.13 (1995).

22. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 275 (1977).

23. *Id.* at 278.

24. *Id.* at 288–89.

25. *Id.* at 279 (emphasis added).

26. See *supra* note 21 and accompanying text.

27. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 139. The Due Process Clause traditionally has not required the apportionment of an income tax imposed on a business by the state in which the business is commercially domiciled. This is because domicile itself has been considered a sufficient basis for a state to assert jurisdiction over *all* of a taxpayer's income, wherever it is earned. See *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312–13 (1937) ("That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil [sic] itself affords a basis for such taxation."); *Shaffer v. Carter*, 252 U.S. 37, 57 (1920) ("As to residents [the state] may, and does, exert its taxing power over their income from all sources, whether within or without the State . . ."); Hellerstein & Hellerstein, *supra* note 3, at 368–69.

28. *Hunt-Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S. 458, 464 (2000) (internal quotation marks omitted); see also *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165–66 (1983); *Exxon Corp. v. Wis. Dep't of Revenue*, 447 U.S. 207, 219–20 (1980); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436, 437 (1980).

29. For example, suppose an Illinois-based airline uses its airplanes throughout the United States and the world in interstate and international commerce. Although many of the airline's planes spend a portion of their time in Illinois, none spend all of

The logic behind fair apportionment is that each state is only entitled to its “fair share” of the interstate value it seeks to tax.³⁰ That is, no state should have the authority to tax 100% of any value—whether that value be property, income, or something else—that is attributable to commercial activity taking place in more than one state.³¹

Apportionment is most familiar in the sphere of state corporate income taxes. Because tracing income earned by an interstate business to its geographic origin based on some type of separate accounting methodology presents enormous practical problems (and is arguably incoherent in theory), states have long used the method of formulary apportionment to determine the amount of income earned by multistate corporations within their borders.³² Under formulary

their time there, and many planes spend none of their time there. If Illinois attempted to impose an unapportioned property tax on the full assessed value of the airline’s fleet of planes, it would lack a “minimal connection” with the value of the planes attributable to other states (especially those that spend no time in Illinois). Similarly, the tax would not be “rationally related” to the value of the property employed by the airline in Illinois. See *Standard Oil v. Peck*, 342 U.S. 382, 385 (1952) (striking down an unapportioned tax imposed on a full fleet of barges used in multiple states because the tax bore “no relation to the opportunities, benefits, or protection which the taxing state gives [the taxpayer’s] operations”).

It is true that, in *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292 (1944), the Supreme Court upheld an unapportioned property tax on the full value of an airline’s fleet of planes imposed by the airline’s state of commercial domicile. But this decision, handed down during a period in which the Court had briefly returned to doctrinal formalism, was effectively overruled by *Braniff Airways, Inc. v. Neb. State Bd. of Equalization*, 347 U.S. 590 (1954). See Hellerstein & Hellerstein, *supra* note 3, at 256. *Braniff* upheld the right of states other than the state of domicile to impose an apportioned property tax on the value of the airplanes used in the state. 347 U.S. at 597–98.

30. See, e.g., *Okl. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995); *Goldberg v. Sweet*, 488 U.S. 252, 260–61 (1989) (“[T]he central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction.”).

31. See *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434, 447 (1979) (“The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality [of commerce] in full.”); *Johnson Oil Ref. Co. v. Oklahoma ex rel. Mitchell*, 290 U.S. 158, 162 (1933) (“When a fleet of cars is habitually employed in several States—the individual cars constantly running in and out of each State—it cannot be said that any one of the States is entitled to tax the entire number of cars regardless of their use in other States.”).

An exception to this general principle is that the state of a corporation’s commercial domicile has traditionally been permitted to assert jurisdiction over all of the corporation’s income, wherever earned. See Hellerstein & Hellerstein, *supra* note 3, at 368–69. The Supreme Court has suggested, however, that such residence-based jurisdiction must give way to any state asserting source-based jurisdiction over the same income, thus preventing multiple taxation. See *Mobil Oil*, 445 U.S. at 445–46; Walter Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076*, 79 Mich. L. Rev. 113, 135–37 (1980).

32. See Hellerstein & Hellerstein, *supra* note 3, at 469–70; see also *Mobil Oil*, 445 U.S. at 438 (“[S]eparate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.”);

apportionment, all income earned by a taxpayer in the operation of its unitary business is included in the taxpayer's apportionable tax base. That base is then multiplied by a percentage determined by a statutory formula, which formula is designed to reflect the portion of the taxpayer's economic activity occurring in the taxing state. State formulas for the division of corporate income vary, but most are based on a combination of the taxpayer's percentage of property, payroll, and sales located or occurring in the taxing state.³³ Used properly, this method of dividing a multistate corporation's income reasonably approximates the amount of income earned by the taxpayer in the taxing state, and therefore satisfies the requirement of fair apportionment.

Recently the Supreme Court has further fleshed out the fair apportionment requirement, explaining that it comprises two discrete sub-requirements. Specifically, the Court will "determine whether a tax is fairly apportioned by examining whether it is internally and externally consistent."³⁴ The "internal consistency" test asks whether, if the taxing scheme at issue were adopted by all fifty states, interstate commerce would be taxed more heavily than purely intrastate commerce.³⁵ It "simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate."³⁶ The "external consistency" test, in contrast, focuses on the legitimacy of the state's claim to the interstate value it

Butler Bros. v. McCollgan, 315 U.S. 501, 508-09 (1942) (holding that the taxpayer's separate accounting evidence did nothing to "impeach the validity or propriety" of the state's method of formulary apportionment).

33. The Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 356 (1999) ("UDITPA"), the model statute for the division of income of multistate businesses that has been adopted, at least in part, by roughly half of the states imposing corporate income taxes, see Hellerstein & Hellerstein, *supra* note 3, at 571, prescribes a formula that places equal weight on the taxpayer's property, payroll, and sales in the state. UDITPA § 9. Most states have adopted similar formulas, see Walter Hellerstein, *State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond*, 48 Tax L. Rev. 739, 753 (1993), though a majority of states now place greater weight on the sales factor than the property or payroll factors, and a handful of states apportion income based on the sales factor alone. See Hellerstein & Hellerstein, *supra* note 3, at 581-82 (table 2); see also *id.* at 491.

34. *Goldberg*, 488 U.S. at 261; see also *Jefferson Lines*, 514 U.S. at 185 ("For over a decade now, we have assessed any threat of malapportionment by asking whether the tax is 'internally consistent' and, if so, whether it is 'externally consistent' as well.").

35. See *Jefferson Lines*, 514 U.S. at 185 ("Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear."); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983) ("The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed.").

36. *Jefferson Lines*, 514 U.S. at 185.

seeks to tax. It “looks not to the logical consequences of cloning, but to the economic justification for the State’s claim upon the value taxed, to discover whether a State’s tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State.”³⁷

These requirements of internal and external consistency roughly mirror the two distinct constitutional purposes that fair apportionment serves. First, fair apportionment prevents states from imposing duplicative tax burdens on taxpayers simply because they do business across state lines, a problem generally known as “multiple taxation.”³⁸ If every state in which a multistate business operates taxes only a fairly apportioned share of the relevant value, then, at least in theory, there should be no multiple taxation.³⁹ Instead, the sum of the various apportioned shares should be 100% of the taxed value. Of course, if states employ differing schemes for apportioning that value (which they typically do), there will be some overlap and some gaps; some taxpayers will be taxed on a bit more than 100% of the value, while others will be taxed on a bit less than 100%.⁴⁰ But the

37. *Id.*; see also *Goldberg*, 488 U.S. at 262 (“The external consistency test asks whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed.”).

38. As the Supreme Court has noted, the “principle of fair share is the lineal descendant of . . . [the] prohibition on multiple taxation.” *Jefferson Lines*, 514 U.S. at 184; see also *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 n.12 (1997) (“the requirement of apportionment . . . assur[es] that interstate activities are not unjustly burdened by multistate taxation”); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446–47 (1979) (“In order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value.”); *Standard Oil Co. v. Peck*, 342 U.S. 382, 384–85 (1952) (“The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of domicile. . . . Otherwise there would be multiple taxation of interstate operations . . .”).

39. See Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 139–40.

40. See *id.* at 140. The constitutionality of multiple taxation resulting from differing schemes for apportioning income was precisely the issue in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). There, the Court reasoned that because “some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income,” upholding the taxpayer’s claim would have required the Court “to prescribe a uniform definition of” the proper formula for dividing income. *Id.* at 278. Because the Court believed that the best method of apportionment was an issue better resolved by Congress, it declined to hold that such overlap—so long as the state’s method of apportionment was itself fair—violated the Constitution. See *id.* at 280–81; see also Walter Hellerstein, *Commerce Clause Restraints on State Taxation: Purposeful Economic Protectionism and Beyond*, 85 Mich. L. Rev. 758, 763–64 (1987). *Moorman* involved the fairness of a state’s method of apportionment, not the requirement that the relevant tax base be apportioned at all. For the reasons mentioned earlier, questions concerning the fairness of a particular apportionment—and not the command that states apportion the relevant tax base—are outside the scope of this article. See *supra* note 8.

general point is that if a state determines its share of the relevant tax base in a manner that is internally consistent, interstate commerce should not bear any duplicative tax burdens not borne by businesses operating purely within one state.⁴¹

A second purpose of fair apportionment, reflected in the external consistency test, is to restrict each state's taxing authority to its own jurisdiction. Each state (at least other than the state of commercial domicile in the case of income taxes⁴²) should be entitled to tax only that value earned within its borders, or which rightfully reflects the degree of the taxpayer's activity in that state.⁴³ The fair apportionment of the tax base, by limiting the amount attributable to each state, ensures that states only tax those values properly subject to their respective taxing powers. This jurisdictional concern is distinct from the goal of preventing multiple taxation. A state could well impose a tax that is not fairly apportioned without creating a risk of multiple taxation. A simple example illustrates the point.

Suppose that the Acme Corporation, commercially domiciled in Delaware, does business and earns income in California and Oregon. Suppose further that California imposes a tax on all of Acme's income, wherever it is earned, but extends to Acme a credit for any income taxes it pays other states. Such a tax scheme would be internally consistent; the credit provision would ensure that, if every state adopted the same scheme, there would be no multiple taxation.⁴⁴ Still, the tax is *not* fairly apportioned. If Oregon happened not to impose a corporate income tax, California would tax all of Acme's income earned in Oregon, not just that income earned in California. Consequently, California would plainly be projecting its taxing powers beyond its borders, asserting jurisdiction over income attributable to another state.⁴⁵ While precluding multiple taxation, the credit provision—unlike fair apportionment—would do nothing to preclude extraterritorial taxation. Thus, as Professor Hellerstein has noted, “[w]holly apart from its role in preventing multiple taxation, the fair apportionment criterion serves to limit the territorial reach of state power by requiring that the state's tax base corresponds to the taxpayer's in-state presence.”⁴⁶

41. As the Supreme Court has stated, when a state tax is internally consistent, “if every State were to impose an identical tax, no multiple taxation would result.” *Goldberg*, 488 U.S. at 261.

42. See *supra* note 27.

43. See Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 173 (“The critical point is that a tax levied upon interstate activity—whether measured by gross receipts, net income, or other values—must reflect the portion of the enterprise's activity that is being conducted in the taxing state, and the tax measure must be adjusted accordingly.”).

44. See *id.* at 182–83.

45. See *id.* at 185–86; Hellerstein, McIntyre & Pomp, *supra* note 21, at 110.

46. Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 186; see also Peters, *supra* note 1, at 105.

In short, the fair apportionment requirement has two purposes: to prevent multiple taxation, and to prevent extraterritorial taxation. It therefore follows that fair apportionment is not an independent constitutional end but instead a *means* to accomplishing two other, “higher order” constitutional objectives: preventing discrimination against interstate commerce and limiting states to taxing those values with which they have a sufficient connection or nexus.⁴⁷ In fact, fair apportionment is essentially superfluous as a separate criterion for assessing a state tax’s constitutionality. State taxes that are not fairly apportioned should generally be found unconstitutional based either on their discrimination against interstate commerce or on their failure of nexus, regardless of fair apportionment concerns.

First, multiple taxation is a species of discrimination against interstate commerce—a disadvantage in practical effect imposed on business done across state lines that is not faced by purely intrastate business.⁴⁸ A state tax scheme that subjects multistate taxpayers to multiple taxation thus violates the dormant Commerce Clause without reference to whether it is fairly apportioned. It runs afoul of the third prong of the *Complete Auto* test, which demands that state taxes “not discriminate against interstate commerce.”⁴⁹ Indeed, the Supreme Court has invalidated unapportioned state taxes precisely because the effect of such taxes was to discriminate against interstate commerce. At issue in *Nippert v. City of Richmond*,⁵⁰ for example, was a city license tax imposed on all solicitors or selling agents.⁵¹ The measure of the tax was a flat \$50 plus 0.5% of all of a solicitor’s gross receipts exceeding \$1000.⁵² The Court held that, because the levy—at least until the solicitor earned \$1000 in receipts—“lack[ed] any proportion to the number or length of visits or the volume of the business or return,”⁵³ it had “exclusionary” and “discriminatory effects” that disfavored out-of-state operators.⁵⁴ This “discrimination against interstate commerce, in favor of local competing business,” violated the Commerce Clause.⁵⁵ Similarly, in *American Trucking Ass’n v. Scheiner*,⁵⁶ the Court invalidated Pennsylvania’s unapportioned “marker fees” and axle taxes imposed on all motor carriers doing business in the state.⁵⁷ Such flat taxes were “plainly discriminatory”

47. Cf. Hellerstein, McIntyre & Pomp, *supra* note 21, at 109 (describing the fair apportionment requirement as “a means to [the] end” of avoiding multiple taxation).

48. See *supra* note 6.

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

50. 327 U.S. 416 (1946).

51. *Id.* at 418.

52. *Id.*

53. *Id.* at 430–31.

54. *Id.* at 428.

55. *Id.* at 434.

56. 483 U.S. 266 (1987).

57. The “marker fee” was a sum required for an identification marker, issued by the state department of revenue, that needed to be affixed to every motor carrier

because their practical effect was to "impose a cost per mile on [the out-of-state taxpayer] that [was] approximately five times as heavy as the cost per mile borne by local trucks."⁵⁸ Further, the Court explained that the internal inconsistency of the flat taxes impermissibly penalized interstate commerce.⁵⁹ If every state imposed such taxes, interstate motor carriers would be liable for the unapportioned taxes in several states, while purely intrastate carriers would pay the flat amounts only once.⁶⁰

Second, by ensuring that each state limits its tax to its "fair share" of interstate values, fair apportionment acts as a means to fulfilling the independent constitutional requirement of nexus between the taxing state and the activity or value taxed.⁶¹ Again, fair apportionment aside, both the Commerce Clause and the Due Process Clause require a sufficient connection between the state and the interstate value it seeks to tax. The first prong of the *Complete Auto* test demands that state taxes only be applied to "activit[ies] with a substantial nexus with the taxing State."⁶² In addition, the Due Process Clause requires that there be a "minimal connection" between the activity taxed and the taxing state, and that the tax be "rationally related" to the taxpayer's activities in the state.⁶³ A state tax that is not fairly apportioned will generally violate these requirements, the fair apportionment requirement notwithstanding.

Consider *Standard Oil Co. v. Peck*,⁶⁴ which involved an unapportioned property tax on the taxpayer's full fleet of barges that it used up and down the Ohio and Mississippi Rivers. Although Standard Oil had used the barges in several states over the course of the relevant tax year, Ohio imposed its tax on 100% of their assessed value.⁶⁵ The Supreme Court held that the tax violated the Due Process Clause. In failing to apportion the value of the barges based on the proportion of time that they were employed in the state, Ohio's tax bore "no relation to the opportunities, benefits, or protection which the taxing state [gave the taxpayer's] operations."⁶⁶ One could add that Ohio also lacked a "minimal connection" or "substantial

vehicle traveling in the state. *See id.* at 273. The axle tax was an annual levy imposed on commercial trucks traveling in the state measured by their number of axles. *See id.* at 274.

58. *Id.* at 286.

59. *Id.* at 296; see Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 146-47.

60. *Am. Trucking Ass'ns*, 483 U.S. at 284.

61. Again, the relevant nexus here is with the value being taxed, not the taxpayer. *See supra* note 9. Fair apportionment, of course, does nothing to ensure that the taxing state will have a constitutionally sufficient connection with the taxpayer.

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

63. *See supra* notes 24-25 and accompanying text.

64. 342 U.S. 382 (1952).

65. *See id.* at 383.

66. *Id.* at 385.

nexus” with that portion of the fleet’s value that was employed by the taxpayer in other states.

If fair apportionment exists to accomplish the ends of preventing discrimination and sustaining nexus with the value taxed—requirements independently imposed by the Commerce and Due Process Clauses—then fair apportionment must be seen as a sort of “lower order” constitutional value. By “lower order,” I mean that it is essentially unnecessary as a distinct constitutional test; it has no constitutional significance independent of the two objectives it is designed to serve. Instead, fair apportionment is an effective and convenient means to assuring adherence to the “higher order” constitutional norms of preventing discrimination and preserving nexus. To paraphrase the Supreme Court’s opinion in *Grand Trunk Railway*, the fair apportionment of state taxes imposed on interstate commerce is an “eminently reasonable” way of fulfilling these more central constitutional objectives.⁶⁷ It is on these terms that the fair apportionment requirement should be understood.

II. FAIR APPORTIONMENT AS A CONSTITUTIONAL “PREFERENCE”

The notion that the fair apportionment requirement is actually a “lower order” constitutional value—a means to accomplish the goals of nondiscrimination and nexus rather than an end in itself—is reinforced by the Supreme Court’s application of the test in practice. Although the Court has struck down several state taxes on the ground that they were not fairly apportioned,⁶⁸ in some recent cases it has upheld state taxes against fair apportionment challenges where the taxes were, in reality, completely unapportioned. To be sure, the Court purported to hold that the taxes at issue were “fairly apportioned,”⁶⁹ taxing “only the activity taking place within the taxing State.”⁷⁰ And two important conditions were present in these cases: (1) the tax scheme ensured that interstate commerce was not subject to multiple taxation, and (2) it would have been administratively impracticable for the state to apportion the tax (or the class of taxes of which it was a part). Nonetheless, these decisions demonstrate that the fair apportionment “requirement” cannot accurately be termed a constitutional requirement at all. Rather, fair apportionment is better characterized as a constitutional *preference*. It is a preferred—but not always necessary—means to serving other constitutional objectives.

67. *Maine v. Grand Trunk Ry. Co.*, 142 U.S. 217, 228 (1891).

68. *See, e.g., Am. Trucking Ass’ns, Inc. v. Scheiner*, 483 U.S. 266 (1987); *Norfolk & W. Ry. Co. v. Mo. State Tax Comm’n*, 390 U.S. 317 (1968); *Standard Oil*, 342 U.S. 382; *Cent. Greyhound Lines v. Mealey*, 334 U.S. 653 (1948); *Nippert v. City of Richmond*, 327 U.S. 416 (1946); *Hans Rees’ Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931).

69. *E.g., Goldberg v. Sweet*, 488 U.S. 252, 265 (1989).

70. *E.g., Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 196 (1995).

Consider first the Court's holding concerning fair apportionment in *D.H. Holmes Co. v. McNamara*.⁷¹ The State of Louisiana had imposed a use tax on D.H. Holmes, a Louisiana-based department store, for the value of its merchandise catalogs mailed to Louisiana residents.⁷² The subject of the tax was "the use, the consumption, the distribution, and the storage for use or consumption" of tangible personal property in the state, and the Louisiana courts had held that the levy covered the taxpayer's catalogs.⁷³ The state afforded taxpayers a credit against the use tax for any sales tax paid on the same items, but D.H. Holmes had paid no sales tax on the catalogs to any other states.⁷⁴ D.H. Holmes argued before the Supreme Court that applying the tax to its catalogs, which had been mailed directly to Louisiana addresses from the states in which they were printed, violated the Commerce Clause.⁷⁵

Arguably, the issue of fair apportionment was beside the point, as the tax at issue seemed to reach purely intrastate (and no interstate) activities. Specifically, Louisiana had imposed its tax only on the value of those catalogs that had been mailed to Louisiana addresses, catalogs that one could reasonably assume were used exclusively within the state's borders. If the subject of a tax—here, the use of the catalogs—is attributable exclusively to one state, apportionment is simply irrelevant, as only one state can claim the value as its own. Nonetheless, the Court addressed the fair apportionment question, offering the following answer: "The Louisiana taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States."⁷⁶ Such reasoning, however, confuses fair apportionment with the prevention of multiple taxation, issues that are analytically distinct.⁷⁷ As discussed earlier, through the provision of credits for taxes paid to other states, a state tax scheme can prevent multiple taxation even though it is *completely unapportioned*.⁷⁸ The Court's analysis in *D.H. Holmes* conflated these separate questions and, in doing so, implied that an unapportioned state tax could nevertheless be considered "fairly apportioned" if it protected interstate commerce from multiple taxation.

Next consider the Court's decision in *Goldberg v. Sweet*.⁷⁹ At issue was Illinois's Telecommunications Excise Tax, which imposed a five percent tax on the full retail cost of any telecommunication that (1) either originated or terminated in Illinois, and (2) was billed to an

71. 486 U.S. 24 (1988).

72. *Id.* at 26.

73. *Id.* at 27–29 & n.1.

74. *Id.* at 31–32.

75. *Id.* at 28–30.

76. *Id.* at 31.

77. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 184–85.

78. See *supra* text accompanying notes 40–42.

79. 488 U.S. 252 (1989).

Illinois service address.⁸⁰ To avoid multiple taxation, Illinois provided a credit to any taxpayer who could demonstrate that the same telecommunication had been taxed by another state.⁸¹ A group of taxpayers claimed that the tax was unconstitutional on the ground that it was unapportioned; its measure was the full gross charge of the telecommunication, even when the telecommunication crossed state boundaries.⁸² For example, suppose an Illinois resident placed a long-distance call costing \$5.00 to a Missouri resident, and the call was billed to an Illinois service address. Illinois imposed its tax on the full \$5.00 charge of the call, even though a portion of the activity being taxed (arguably half) occurred outside the state. As the Illinois trial court concluded, the “tax by its own terms is not fairly apportioned” because “Illinois is attempting to tax the entire cost of an interstate act which takes place only partially in Illinois.”⁸³

The Supreme Court nonetheless upheld the tax, citing a variety of justifications. First, the Court noted that the “tax at issue [had] many of the characteristics of a sales tax.”⁸⁴ In particular, the tax was “assessed on the individual consumer, collected by the retailer, and accompanie[d] the retail purchase of an interstate telephone call.”⁸⁵ Second, the Court observed that the tax avoided any problem of multiple taxation.⁸⁶ The circumstances under which more than one state would have a sufficient nexus with the same telecommunication to impose a tax were rare, and on the few occasions that this might occur, the credit provision precluded the possibility of actual multiple taxation.⁸⁷ Finally, the Court stated that, unlike cases involving highways or rail lines, this tax involved “the more intangible movement of electronic impulses through computerized networks.”⁸⁸ Consequently, an “apportionment formula based on mileage or some other geographic division of individual telephone calls would produce insurmountable administrative and technological barriers.”⁸⁹ To the Court, Illinois’s tax was “a realistic legislative solution to the technology of the present-day telecommunications industry.”⁹⁰

Regardless of whether these observations were correct, they were essentially non sequiturs. None actually speaks to whether the Illinois tax was fairly apportioned: the tax’s similarity to a sales tax merely

80. *Id.* at 256.

81. *Id.*

82. *Id.* at 260.

83. *Id.* at 258 (quoting the trial court’s opinion, *Goldberg v. Johnson*, No. 85 CH 8081 (Cook County Ct. Oct. 21, 1986)).

84. *Id.* at 262.

85. *Id.*

86. *Id.* at 263–64.

87. *Id.*

88. *Id.* at 264.

89. *Id.* at 264–65.

90. *Id.* at 265.

shows that it resembled a tax that traditionally has been unapportioned; the credit provision's prevention of multiple taxation just shows that one of fair apportionment's principal objectives had otherwise been fulfilled, albeit by other means; and the practical barriers to dividing the tax base only show that apportionment may have been logistically difficult, if not impossible. These are justifications for dispensing with the fair apportionment requirement in this particular context, not reasons that the tax was, in fact, fairly apportioned.⁹¹ Thus, the Court's stated conclusion that "the Tax Act is fairly apportioned" cannot be taken literally. Instead, *Goldberg* must be understood as holding that the Illinois Telecommunications Tax was constitutional despite being completely unapportioned.⁹²

One might argue, as Justice Stevens did in his concurring opinion, that the Illinois tax was effectively apportioned in light of its overall incidence.⁹³ Specifically, if one considers the entire universe of telecommunications originating or terminating in Illinois, although Illinois taxed the full value of interstate calls billed to Illinois service addresses, it taxed none of the value of such calls billed to out-of-state service addresses.⁹⁴ If an Illinois-Missouri call were billed to a Missouri address, for example, Illinois would impose no tax at all. Assuming half of the interstate telecommunications originating or terminating in Illinois were billed to Illinois service addresses, the tax was roughly apportioned, as Illinois taxed half the total value of all interstate calls originating or terminating in the state.⁹⁵

Such rough apportionment of the tax shows that, at least under certain assumptions, Illinois was taxing approximately its fair share of the relevant tax base. But this does not mean that the tax was fairly apportioned. First, the argument is founded on the unrealistic assumption that it will all come out in the wash—that half of the interstate telecommunications originating or terminating in a given state are billed to out-of-state service addresses. This assumption seems wrong with respect to many states; at the very least, there was no empirical evidence to support it.⁹⁶ Second, as to those interstate telecommunications billed to Illinois service addresses, Illinois was plainly taxing more than its fair share. Pointing out that Illinois was

91. See Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 187.

92. *Goldberg*, 488 U.S. at 265. My point here is not that the Court's decision was wrong, but only that the Court upheld a tax on interstate activity despite the tax's clear lack of apportionment.

93. See *id.* at 269–70 (Stevens, J., concurring in part and concurring in the judgment).

94. *Id.* at 269 (Stevens, J., concurring in part and concurring in the judgment).

95. *Id.* at 269–70 (Stevens, J., concurring in part and concurring in the judgment).

96. Justice Stevens simply assumed, without explanation, that Illinois was "taxing half of the relevant universe of interstate calls." *Id.* at 269 (Stevens, J., concurring in part and concurring in the judgment); see also *id.* at 270 n.2 (Stevens, J., concurring in part and concurring in the judgment) (relying on the same assumption).

taxing less than its fair share of *other* telecommunications does not solve this problem. While the rough apportionment of the tax base might provide an additional justification for waiving the fair apportionment requirement under the particular circumstances of the case, it does nothing to demonstrate that Illinois's tax was actually apportioned fairly.

Finally, consider the Court's 1995 decision in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*⁹⁷ In that case, Oklahoma had imposed its general retail sales tax on the purchase of bus transportation (among other things), and the tax's measure was the full retail price of the ticket.⁹⁸ The tax was nominally imposed on the purchaser, but the seller was legally obligated to collect and remit the tax to the state.⁹⁹ Jefferson Lines, a bus company that had since gone bankrupt, had not collected the tax on tickets for interstate travel sold in Oklahoma (although it had collected the tax on tickets for travel solely within Oklahoma).¹⁰⁰ In the taxpayer's bankruptcy proceedings, the state asserted a claim for the unpaid sales taxes, and Jefferson Lines resisted on the ground that the tax was unconstitutional as applied to tickets for interstate travel.¹⁰¹ It argued, like the taxpayers in *Goldberg*, that Oklahoma's tax failed the fair apportionment requirement because it taxed the full retail value of the tickets even though a portion of the services purchased were provided and consumed outside the state.¹⁰²

A hypothetical, alternative method for the bus company to collect its fare (conceived by Professors Hellerstein, McIntyre, and Pomp) shows how the tax reached activity occurring in other states.¹⁰³ Suppose a passenger agreed to purchase a bus ticket for travel from Tulsa, Oklahoma, to Lawrence, Kansas, for \$40. Suppose that, instead of collecting the \$40 in Tulsa, Jefferson Lines first drove the passenger to the Oklahoma-Kansas border and collected \$15 for the Oklahoma portion of the trip. It then completed the trip to Lawrence and collected the remaining \$25. Oklahoma clearly could impose its sales tax on the \$15 fare for the transportation provided in Oklahoma, but the state would be projecting its taxing power beyond its borders if it attempted to tax the \$25 sale for transportation provided and consumed exclusively in Kansas. Yet, by taxing the entire \$40 when the passenger paid the full fare in Tulsa for the same trip, this is precisely what Oklahoma accomplished.

97. 514 U.S. 175 (1995).

98. *Id.* at 177-79.

99. *Id.* at 177-78.

100. *Id.* at 178.

101. *Id.* at 178-79.

102. *Id.* at 178, 191-92; see also Hellerstein, McIntyre & Pomp, *supra* note 21, at 52.

103. See Hellerstein, McIntyre & Pomp, *supra* note 21, at 63; see also Hellerstein & Hellerstein, *supra* note 3, at 835-36.

As in *Goldberg*, the Court found the tax constitutional despite the absence of apportionment. First, the Court reasoned that the Oklahoma tax was properly classified as a “garden-variety sales tax.”¹⁰⁴ And, as the Court explained, it has “perennially sustained” such taxes, “even though levied on goods that have traveled in interstate commerce to the point of sale or that will move across state lines thereafter.”¹⁰⁵ Second, the Court concluded that there was little or no risk of multiple taxation.¹⁰⁶ The Court conceded that passengers could potentially be subjected to a use tax on the portion of the transportation services that they consumed in other states.¹⁰⁷ But the Court noted that “any use tax would have to comply with Commerce Clause requirements,” meaning that “the tax scheme could not apply differently to goods and services purchased out of state from those purchased domestically.”¹⁰⁸ Thus, if the state provided a credit against its use tax for sales taxes paid in that state—which every state imposing a use tax does—it would also have to provide the credit for sales taxes paid to other states.¹⁰⁹ As a result, “the Oklahoma ticket purchaser would be free from multiple taxation.”¹¹⁰

Again, the Court’s conclusions, so far as they go, seem unobjectionable. The Oklahoma tax was essentially a “garden-variety sales tax,” and the risk of multiple taxation was effectively nonexistent. But these are *not* explanations for why the tax was fairly apportioned or how Oklahoma had taxed only its fair share of the interstate value. Rather, these are justifications for upholding Oklahoma’s tax despite its lack of apportionment. As with the tax in *Goldberg*, Oklahoma’s tax plainly was not apportioned to reflect the share of the taxed activity that occurred within the state’s borders. Thus, the Court’s statement that the tax “reach[ed] only the activity taking place within the taxing State” is implausible.¹¹¹ Such reasoning confuses actual fair apportionment with reasons that a tax that is not fairly apportioned may nonetheless be constitutionally tolerable. In short, *Jefferson Lines*, like *Goldberg*, stands for the proposition that a completely unapportioned tax imposed on interstate commercial activity, at least under certain conditions, can still be constitutional.¹¹²

104. *Jefferson Lines*, 514 U.S. at 196.

105. *Id.*

106. *Id.* at 191–95.

107. *See id.* at 193–94.

108. *Id.* at 194.

109. In fact, every state that imposes a use tax provides such a credit, regardless of the state to which the sales taxes were paid. *See* 2 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 18.08[1] (3d ed. 2002).

110. *Jefferson Lines*, 514 U.S. at 194.

111. *Id.* at 196.

112. *See* Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 474; Hellerstein, McIntyre & Pomp, *supra* note 21, at 108–09 (explaining that in *Jefferson Lines*, “the Court recognized that the fair apportionment requirement . . . embraces core constitutional values that are not fully captured by an invariable rule requiring

This is not to say that these cases were wrongly decided. The taxes challenged in both instances, as the Court noted, closely resembled typical retail sales taxes, and such taxes are best understood as levies on the final consumption of goods and services.¹¹³

They generally apply only to final sales and not to sales for resale; they are separately stated; they are imposed on a transaction-by-transaction basis; they are collected by the seller from the purchaser; and the seller may not claim that it is absorbing the tax. In other words, the legislature intended them to be consumption taxes, to be borne by the buyer . . .¹¹⁴

At times, the Supreme Court has missed this point, instead describing retail sales taxes as being imposed “on the transfer of ownership and possession at a particular time and place.”¹¹⁵ This characterization implies that the taxed activity could occur only in one state, thereby obviating the need for apportionment. But to conceptualize a sales tax as being levied on the transaction itself is to let legal form triumph over economic substance. It attaches constitutional significance to the supposed local “incident” of the retail sale rather than the tax’s economic substance, precisely the sort of reasoning that the Court itself has discredited in its modern jurisprudence.¹¹⁶ As the Court stated in *Complete Auto* (and has reiterated several times since¹¹⁷), the constitutionality of a state tax must turn on “not the formal language of the tax statute but rather its practical effect” and “economic realities.”¹¹⁸ The “practical effect” and “economic reality” of a retail sales tax is that it principally taxes the value of consumption by the purchaser.

Indeed, the combined sales and use tax scheme employed by every state imposing a retail sales tax would make little sense if retail sales taxes were not intended as levies on the consumption of the taxed

that an interstate tax base be divided among the states”).

113. See John F. Due & John L. Mikesell, *Sales Taxation: State and Local Structure and Administration* 16 (2d ed. 1994); Walter Hellerstein, *Transaction Taxes and Electronic Commerce: Designing State Taxes That Work in an Interstate Environment*, 50 Nat’l Tax J. 593, 596 (1997); Walter Hellerstein & Charles E. McClure, Jr., *Sales Taxation of Electronic Commerce: What John Due Knew All Along*, 20 St. Tax Notes 41, 41–43 (2001).

114. Hellerstein, McIntyre & Pomp, *supra* note 21, at 78.

115. *Jefferson Lines*, 514 U.S. at 187.

116. See Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 172–73; John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus*, 75 S. Cal. L. Rev. 419, 427 (2002).

117. See, e.g., *Jefferson Lines*, 514 U.S. at 183; *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992); *Trinova Corp. v. Mich. Dep’t of Treasury*, 498 U.S. 358, 372–73 (1991); *Goldberg v. Sweet*, 488 U.S. 252, 259 n.11 (1989); *Am. Trucking Ass’n v. Scheiner*, 483 U.S. 266, 295 (1987); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615–16 (1981); *Mobil Oil Corp. v. Comm’r of Taxes*, 445 U.S. 425, 443 (1980); *Dep’t of Revenue v. Ass’n of Wash. Stevedoring Cos.*, 435 U.S. 734, 750 (1978).

118. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); see also Hellerstein, McIntyre & Pomp, *supra* note 21, at 49.

goods and services. Although the precise language varies from state to state, use taxes are generally imposed on the “storage, use, or other consumption in this state” of most goods (and some services) purchased at retail.¹¹⁹ And every state that imposes a use tax offers a credit for sales taxes that have already been paid on the purchase of the same goods or services.¹²⁰ Providing a credit against the use tax for sales taxes paid on the same item—that is, making the sales tax and the use tax perfect complements—is incomprehensible unless the sales tax, too, is a tax on the “storage, use, or consumption in this state” of the goods or services subject to the tax. The only difference is that the sales tax is collected at the time of sale by the seller (whether it is nominally imposed on the purchaser or the seller), while the use tax is remitted by the taxpayer herself some time after the purchase.

Because retail sales and use taxes are best understood as levies on the consumption of the purchased goods or services, a rigorous application of the fair apportionment test would require a division of the measure (i.e., the purchase price) when goods or services were consumed in more than one state. Such apportionment is theoretically possible.¹²¹ Imagine the purchase of a consumer durable good, such as a computer, at a retail store in California. The sales tax imposed on the purchase will be approximately eight percent,¹²² and the measure will be the item’s full retail price. Thus, if the retail price of the computer were \$2000, the purchaser would pay a tax of \$160 at the moment of sale, and the vendor would remit this amount to the state. At the time of purchase, it is unknown (even by the purchaser) where the good will ultimately be used for its full useful life. Absent evidence to the contrary, it seems reasonable to assume that the item will be used in the state of purchase, thus justifying a tax on its full retail price—the unapportioned value of the purchaser’s potential consumption.

Suppose, however, that the taxpayer moves to Arizona six months after purchasing the computer, and suppose that the value of the computer when she moves is \$1500. To achieve a proper apportionment of the tax, two things would have to occur. First, California would need to refund the tax previously imposed on the value of the computer that, in hindsight, was not consumed in California. Here, California would owe the taxpayer eight percent of \$1500, or \$120, because this is the tax that was imposed at the time of

119. Cal. Rev. & Tax Code § 6201 (West 1998); see also Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 159.

120. See Hellerstein & Hellerstein, *supra* note 109, ¶ 18.08[1].

121. See Hellerstein, McIntyre & Pomp, *supra* note 21, at 78-79.

122. The actual sales tax rate in California depends on the county in which the good is purchased, and ranges from 7.25% in several counties to 8.50% in San Francisco. See Cal. State Bd. of Equalization, California City and County Sales and Use Tax Rates, at <http://www.boe.ca.gov/sutax/pam71.htm> (last visited Aug. 28, 2002).

sale on the mistaken assumption that the computer would be fully consumed in California. Second, the taxpayer would have to pay a use tax to Arizona, with the measure being the remaining value of the computer, i.e., \$1500. If Arizona imposes a statewide use tax of six percent, the taxpayer would be required to remit \$90 to the state.¹²³

Setting theoretical possibilities aside, however, such a system would be an administrative nightmare.¹²⁴ First, taxpayers and state tax administrators would have to assess the value of every good or service subjected to the sales and use tax that was only partially consumed in the state of purchase. This would require large amounts of time, and without a market transaction generating a sales price, the value would often be difficult to discern. Taxpayers would predictably tend to overstate the remaining value of the items in their reports to the state of purchase, placing a large burden on states to verify the validity of rebate claims. Second, the system would rely on taxpayers themselves to report to the second state the value of the goods they have brought there to use and consume. If the present rates of reporting and remittance with respect to self-assessed use taxes are any indication,¹²⁵ compliance would be minimal to nonexistent. Perhaps states could establish protocols by which a request for a rebate from the first state would be reported to the second state, thus alerting that state to the presence and value of the goods. But creating such a system, not to mention effectively enforcing it, would require an enormous investment of resources.

It is these pragmatic considerations that best explain why the Supreme Court has never required the apportionment of retail sales and use taxes.¹²⁶ As the Court conceded in *Jefferson Lines*, it has

consistently approved taxation of sales without any division of the tax base among different States, and ha[s] instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future.¹²⁷

123. For a similar example, see Hellerstein, McIntyre & Pomp, *supra* note 21, at 79.

124. See *id.* (calling such a system “administratively cumbersome”); see also Jesse H. Choper & Tung Yin, *State Taxation and the Dormant Commerce Clause: The Object-Measure Approach*, 1998 Sup. Ct. Rev. 193, 237–38 (discussing the impracticality of apportioning sales taxes).

125. See William F. Fox et al., *Issues in the Design and Implementation of Production and Consumption VATs for the American States*, 23 St. Tax Notes 205, 206 (2002) (describing how “use tax compliance is essentially nonexistent for individuals and is thought to be low for businesses”).

126. See Hellerstein, McIntyre & Pomp, *supra* note 21, at 79–80; Walter Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 Va. L. Rev. 149, 172–73 (1976) [hereinafter Hellerstein, *Standard Pressed Steel and Colonial Pipeline*].

127. *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 186 (1995).

Requiring true apportionment would render retail sales and use taxes virtually impossible to administer, at least given present technology.

Moreover, forcing states to abandon these taxes would substantially undermine states' fiscal authority. In fiscal year 2000, general retail sales and use taxes constituted 32.5% of state tax receipts, second in importance only to personal income taxes (which constituted 37.0% of state tax revenues).¹²⁸ If one adds to this total the state excise taxes that also operate as taxes on consumption (such as taxes on motor vehicle fuels, alcohol, and tobacco products), the figure is 40.1%.¹²⁹ Simply put, states (as they are presently configured) could not survive without these taxes, at least without a long period of transition. Thus, conceptual rigor in the application of the fair apportionment test has given way to real world, pragmatic concerns about the fiscal health of state governments.

Jefferson Lines was arguably the atypical case in which apportioning the sales tax measure was actually feasible. In fact, the Court conceded as much, stating that, unlike the telecommunications tax in *Goldberg*, "no comparable barriers [to apportionment] exist here."¹³⁰ But the Court decided that maintaining consistency in its treatment of sales and use taxes as a group made more sense than creating an exception for those circumstances where apportionment was technically feasible. The Court found "no reason to leave the line of longstanding precedent and lose the simplicity of our general rule sustaining sales taxes measured by full value, simply to carve out an exception for the subcategory" of cases where division of the tax base was possible,¹³¹ and this judgment seems defensible. Because the Court had previously held that sales and use taxes are generally exempt from the rule of apportionment, overarching conceptual coherence had already been sacrificed. Moreover, the marginal gain in theoretical coherence achieved by requiring apportionment in a small subset of sales tax cases is arguably outweighed by the loss of simplicity inherent in the rule that sales and use taxes, as a class, need not be apportioned.

In any event, the larger point remains: *D.H. Holmes*, *Goldberg*, and *Jefferson Lines* are only understandable as approving, under certain conditions, the imposition of completely unapportioned taxes on interstate commerce.¹³² They stand for the principle that if a state tax scheme otherwise protects interstate commerce from multiple

128. Hellerstein & Hellerstein, *supra* note 3, at 6.

129. *Id.*

130. *Jefferson Lines*, 514 U.S. at 195.

131. *Id.* at 196.

132. Cf. Hellerstein, *Standard Pressed Steel and Colonial Pipeline*, *supra* note 126, at 171 (making a similar point with respect to the Supreme Court's decisions addressing gross receipts taxes imposed on business activities, such as manufacturing and wholesaling).

taxation, and the apportionment of the tax in question (or the class of taxes of which it is a part) “would produce insurmountable administrative and technological barriers,”¹³³ the tax will be constitutional despite the absence of apportionment. As the Court noted parenthetically in *Goldberg*, “apportionment does not require [a] State to adopt a tax which would ‘pose genuine administrative burdens.’”¹³⁴

It therefore seems odd to speak of fair apportionment as a constitutional “requirement.” Fair apportionment cannot truly be *required* by the Constitution if taxes imposed on interstate commerce can be constitutional without being fairly apportioned. Instead, fair apportionment—at least as the Court has applied the concept—is better understood as a constitutional *preference*. It is the preferred means for states to prevent multiple taxation and extraterritorial taxation. Thus, where fair apportionment is practically feasible, such as in the imposition of a corporate income tax, states must apportion the value they seek to tax. But when dividing the tax base would impose genuine administrative burdens, such as in the implementation of retail sales and use taxes, apportionment is unnecessary, provided the state takes other steps to protect interstate commerce from discrimination.

III. THE PERMISSIBILITY OF EXTRATERRITORIAL STATE TAXATION

This understanding of fair apportionment—as a constitutional preference rather than a requirement—reveals something significant about the nature of state taxing authority within our system of federalism. When a state imposes an unapportioned tax on interstate commerce, it taxes activity occurring outside its borders, as an unapportioned tax on interstate activity necessarily reaches values attributable to other states. This means that, despite the Supreme Court’s many statements to the contrary—and despite traditional conceptions of the breadth of state sovereignty—extraterritorial state taxation is sometimes permissible. This insight is important, for as commercial activity increasingly occurs in “places” that are not tied to any physical location, states will inevitably encounter difficulties in taxing such activity without projecting their taxing powers beyond their borders. And states are apt to need the authority to tax such activity, both to protect their tax bases from steady erosion and to ensure that different forms of commerce are taxed evenhandedly. In assessing the constitutionality of such taxes, then, we should be cognizant that the “fundamental” principle that the Constitution prohibits extraterritorial state taxation is not steadfast. In truth, the Court’s approach to issues of extraterritoriality in state taxation has

133. *Goldberg v. Sweet*, 488 U.S. 252, 264–65 (1989).

134. *Id.* at 265 (quoting *Am. Trucking Ass’n v. Scheiner*, 483 U.S. 266, 296 (1987)).

been flexible, and this flexibility may be crucial to states' capacity to devise practical ways of ensuring that interstate commerce continues to shoulder its fair share of state tax burdens.¹³⁵

As noted earlier, the Supreme Court has repeatedly held that "a State may not tax value earned outside its borders."¹³⁶ This prohibition on extraterritorial taxation is grounded in both the Commerce Clause and the Due Process Clause, and it extends to all forms of taxation. For instance, in the 1937 decision of *Great Atlantic & Pacific Tea Co. v. Grosjean*,¹³⁷ the Court explained that a "state may not tax real property or tangible personal property lying outside her borders; nor may she lay an excise or privilege tax upon the exercise or enjoyment of a right or privilege in another state derived from the laws of that state and therein exercised and enjoyed."¹³⁸ More recently, the Court stated in *Container Corp. v. Franchise Tax Board*¹³⁹ that "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'"¹⁴⁰ And in the 1991 case of *Trinova Corp. v. Michigan Department of Treasury*,¹⁴¹ Justice Scalia phrased the question presented as whether Michigan's value-added tax on business activity "violates the Due Process Clause

135. Cf. *W. Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938) ("It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden[s] even though it increases the cost of doing business."); *Postal Tel.-Cable Co. v. Richmond*, 249 U.S. 252, 259 (1919) ("Even interstate business must pay its way.").

136. *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982); see also *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983); *Exxon Corp. v. Wis. Dep't of Revenue*, 447 U.S. 207, 221 (1980); *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944); *Butler Bros. v. McCollgan*, 315 U.S. 501, 507 (1942); *Conn. Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938); *Norfolk & W. Ry. Co. v. North Carolina*, 297 U.S. 682, 686 (1936). As Professor Hartman pointed out, the Court "imposed territorial limitations on the power of a state to tax" even before the ratification of the Fourteenth Amendment. Paul J. Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 Vand. L. Rev. 21, 31 n.31 (1959) (citing *Case of State Tax on Foreign-held Bonds*, 82 U.S. (15 Wall.) 300 (1872), *R.R. Co. v. Jackson*, 74 U.S. (7 Wall.) 262 (1868), and *Hays v. The Pac. Mail S.S. Co.*, 58 U.S. (17 How.) 596 (1854)).

137. 301 U.S. 412 (1937).

138. *Id.* at 424; see also *Conn. Gen. Life Ins.*, 303 U.S. at 80-81 ("[A] State which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the State power to tax or regulate the corporation's property and activities elsewhere.").

139. 463 U.S. 159 (1983).

140. *Id.* at 164 (quoting *ASARCO*, 458 U.S. at 315). As one commentator has explained, "[t]he basic proposition can be simply stated: At least as far as nondomiciliary corporations are concerned, a state may only tax income arising from sources within the state. Or, put differently, it cannot give its income tax extraterritorial effect." E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 181 (1970).

141. 498 U.S. 358 (1991).

by taxing extraterritorial values.”¹⁴² As Justice Stevens has summarized the principle, “[i]t is fundamental that a State has no power to impose a tax on income earned outside of the State.”¹⁴³

This prohibition on extraterritorial taxation reflects a basic understanding of the structure of federalism established by the Constitution. While the federal government has the authority to regulate conduct throughout the nation, states generally can regulate only that activity occurring within their borders or which produces harmful local effects.¹⁴⁴ As the Court concisely stated in the 1905 case of *Union Refrigerator Transit Co. v. Kentucky*,¹⁴⁵ “the operation of state laws [is] limited to persons or property within the boundaries of the State.”¹⁴⁶ The Constitution contains several specific provisions that support this constraint on state authority.¹⁴⁷ Probably the best

142. *Id.* at 387.

143. *Mobil Oil Corp. v. Comm’r of Taxes*, 445 U.S. 425, 451 (1980) (Stevens, J., dissenting).

144. See 1 Laurence H. Tribe, *American Constitutional Law* § 6–8, at 1074 (3d ed. 2000) (stating that “the Court has articulated virtually a *per se* rule of invalidity for extraterritorial state regulations—i.e., laws which directly regulate out-of-state commerce, or laws whose operation is triggered by out-of-state events”); Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 Yale L.J. 785, 790 (2001) (“Scores of state laws validly apply to and regulate extrastate commercial conduct that produces harmful local effects.”). There is a lively debate as to the degree to which (if at all) a state can regulate the conduct of its own citizens taking place outside the state’s borders. Compare Mark D. Rosen, *Extraterritoriality and Political Heterogeneity in American Federalism*, 150 U. Pa. L. Rev. 855 (2002), with Seth F. Kreimer, *Lines in the Sand: The Importance of Borders in American Federalism*, 150 U. Pa. L. Rev. 973 (2002). This question, although quite interesting, goes beyond the scope of my discussion here.

145. 199 U.S. 194 (1905).

146. *Id.* at 204; see also *St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 346, 349 (1922) (“[T]he State may regulate the activities of foreign corporations within the State but it cannot regulate or interfere with what they do outside.”); *N.Y. Life Ins. Co. v. Head*, 234 U.S. 149, 161 (1914) (“[I]t would be impossible to permit the statutes of Missouri to operate beyond the jurisdiction of that State and in the State of New York.”); *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881) (“No State can legislate except with reference to its own jurisdiction.”).

147. The Court has frequently cited the dormant Commerce Clause as the source of this extraterritoriality principle. See, e.g., *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 337 (1989) (explaining that the dormant Commerce Clause prohibits a state from “controlling commercial activity occurring wholly outside the boundary of the State”); *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 582 (1986) (holding that state liquor price affirmation statute “regulates out-of-state transactions in violation of the Commerce Clause”); *Baldwin v. G.A.F. Seelig*, 294 U.S. 511, 521 (1935) (stating that the dormant Commerce Clause denies any state the “power to project its legislation into [another state] by regulating the price to be paid in that state”). The Supreme Court has also held that the Due Process and the Full Faith and Credit Clauses restrain states’ authority to regulate extraterritorially. See, e.g., *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 818 (1985) (“[T]he Due Process Clause and the Full Faith and Credit Clause provide[] modest restrictions on the application of forum law.”); *Hartford Accident & Indem. Co. v. Delta & Pine Land Co.*, 292 U.S. 143, 149 (1934) (noting that the Due Process Clause prevents a state from “extend[ing] the effect of its laws beyond its borders so as to destroy or impair the right of citizens of other states to make a contract not operative within its jurisdiction, and lawful where

explanation, however, is that this "extraterritoriality principle" is embedded in our constitutional design: it is inherent in the concept of state sovereignty within our federal republic, "a structural inference from our system as a whole."¹⁴⁸

Regardless of the principle's precise source, it is well established that the Constitution generally prohibits a state government from "project[ing] its legislation into other States"¹⁴⁹ or "regulat[ing] out-of-state transactions."¹⁵⁰ Thus, "a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid."¹⁵¹ For instance, in the recent case of *BMW of North America, Inc. v. Gore*,¹⁵² the Supreme Court invalidated a state jury's punitive damages award partly on the ground that the award was intended to punish conduct by the defendant in other states.¹⁵³ The Court stated that "principles of state sovereignty and comity" dictate that a state cannot punish tortfeasors for lawful activity in other states; nor can a state "impose sanctions on [a defendant] in order to deter conduct that is lawful in other jurisdictions."¹⁵⁴ As the Court explained the idea in *Healy v. Beer Institute, Inc.*,¹⁵⁵ "[t]he limits on a State's power to enact substantive legislation are similar to the limits on the jurisdiction of state courts. In either case, 'any attempt "directly" to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power."¹⁵⁶

Unapportioned taxes on interstate commercial activity, however, contravene this extraterritoriality principle, as they directly regulate activity that takes place in other states. Consider, again, the previous discussions of *Goldberg* and *Jefferson Lines*.¹⁵⁷ In *Goldberg*, the Illinois Telecommunications Excise Tax reached the full value of interstate telecommunications, even though a portion of the activity being taxed took place in other states. By taxing the out-of-state share of an interstate call, Illinois was "assert[ing] extraterritorial

made"). For more comprehensive discussions, see Goldsmith & Sykes, *supra* note 144, at 789-90, and Donald H. Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 Mich. L. Rev. 1865, 1884-85 (1987).

148. Regan, *supra* note 147, at 1895.

149. *Brown-Forman Distillers*, 476 U.S. at 583 (internal quotation marks omitted).

150. *Id.* at 582.

151. *Healy*, 491 U.S. at 336.

152. 517 U.S. 559 (1996).

153. *Id.* at 572-74.

154. *Id.* at 572-73.

155. 491 U.S. 324.

156. *Id.* at 336 n.13 (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982) (plurality opinion) (quoting *Shaffer v. Heitner*, 433 U.S. 186, 197 (1977))).

157. See *supra* text accompanying notes 73-112.

jurisdiction" over activity that occurred in other states.¹⁵⁸ Similarly, Oklahoma's tax on the full retail price of interstate bus travel at issue in *Jefferson Lines* reached the consumption of services provided outside the state's borders. For instance, when Oklahoma taxed the value of the Kansas portion of a Tulsa-to-Lawrence bus ticket, it was "project[ing] its legislation into other States" and "regulat[ing] out-of-state transactions."¹⁵⁹ Indeed, the same is true of all retail sales taxes imposed on goods or services consumed in more than one state. Recall the earlier example of the computer purchased in California but consumed partly in California and partly in Arizona.¹⁶⁰ By imposing a sales tax on the full, unapportioned retail price of the computer at the time of purchase (and not offering a rebate when the purchaser moves to Arizona), California is effectively taxing activity that occurs outside the state, i.e., the value of consumption taking place in Arizona.

Thus, just as the fair apportionment requirement is not truly a requirement, the prohibition on extraterritorial state taxation is not truly a prohibition. To be sure, the general rule, applicable in the run of cases, is that states may not tax extraterritorial values. But the Court's decisions have eschewed a rigid application of this principle, preferring an approach that is flexible and pragmatic. Because states would effectively be incapable of imposing sales taxes (or other taxes that resemble them) if the Constitution rigidly required them to divide the sales and use tax base, the Court has permitted such taxes without fair apportionment. And in doing so, the Court has necessarily allowed states to engage in some measure of extraterritorial taxation. Where apportioning the tax base "would produce insurmountable administrative and technological barriers" or "'pose genuine administrative burdens,'"¹⁶¹ and the state's tax scheme otherwise protects interstate commerce from discrimination, states may project their taxing powers beyond their borders. In the Court's practical calculus, the states' need to preserve a critical means for collecting revenue has trumped a rigorous application of the ban on extraterritorial taxation.

This understanding of the extraterritoriality principle has important implications for the future of state taxation, particularly with respect to the imposition of levies that resemble retail sales taxes. It is hardly news that an increasing share of interstate commercial activity involves the delivery of electronic goods and services, often to "places" lacking any clear geographic location. For instance, a typical

158. *Healy*, 491 U.S. at 336 n.13.

159. *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 582-83 (1986).

160. See *supra* text accompanying notes 122-23.

161. *Goldberg v. Sweet*, 488 U.S. 252, 264-65 (1989) (quoting *Am. Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 296 (1987)).

transaction might involve the delivery of digitized information—text, video, audio, or other content—from a seller's computer to a purchaser's computer via the Internet.¹⁶² The purchaser's computer might well be mobile—a laptop or handheld computer, a personal digital assistant (“PDA”), or a web-enabled phone—lacking any fixed location and used by the purchaser wherever she travels. Moreover, the purchaser, instead of downloading the information to her own device, might have it delivered to an account stored on a third party's computer (for example, a “Yahoo briefcase”), which she could then access via the internet using her mobile device (or any other computer). Further, rather than purchasing the information itself, the consumer might purchase a subscription service that permits her to access a database or other store of proprietary material at any time and from any location.

The practical challenges faced by state governments in applying their sales or use taxes to such transactions are daunting. Most significantly, the solution thus far employed by states (and approved by the Court¹⁶³) for retail sales taxes—permitting the state of purchase to impose an unapportioned tax on the full sales price of the good or service—faces a large problem. Specifically, it may be impossible to determine where these goods or services are actually purchased.¹⁶⁴ The general rule, followed by almost every state, is that sales transactions are taxed by the jurisdiction in which the goods or services are delivered.¹⁶⁵ This is a logical outgrowth of the sales tax being a levy on the value of consumption by the purchaser: the state in which the purchaser is located is permitted to tax the full value of the good based on the assumption that the good will be consumed in that state.¹⁶⁶ When a purchaser downloads a file or accesses a database via the Internet, however, it may be impossible for the seller to discern the physical location of the purchaser, especially when the purchaser uses a mobile device.¹⁶⁷ And if the seller cannot determine the

162. See Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 428–31.

163. See *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 186 (1995) (“We have . . . consistently approved taxation of sales without any division of the tax base among different States . . .”); Hellerstein, *Is “Internal Consistency” Foolish?*, *supra* note 1, at 173–74; see also Peters, *supra* note 1, at 108.

164. See Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 475.

165. See Martin I. Eisenstein, *The Constitutional Limits on Sales Taxation of Cyberspace*, 12 St. Tax Notes 601, 603 (1997); Donald M. Griswold & Michael N. McLoughlin, *Applying the Commerce Clause to Electronic Commerce*, 17 St. Tax Notes 757, 760 (1999); Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 471.

166. See Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 472.

167. See Arthur Angstreich, James R. Fisher & Eric J. Miethke, *Jefferson Lines as the Ticket to Cyberspace? A Proposal for the Taxation of Electronic Commerce Services*, 14 St. Tax Notes 1993, 1995 (1998); Eisenstein, *supra* note 165, at 604; Griswold & McLoughlin, *supra* note 165, at 760; Ada Ko, *A National Sales Tax after Quill? A Proposal for State and Local Taxation of the Sales of Goods and Services on*

purchaser's location, state governments—which rely on sellers to collect and remit the tax—will lack the information as well. Consequently, even if the state of purchase were permitted to tax the full value of the transaction, it would probably lack any means of actually enforcing the tax.

The most practicable solution might be to deem the tax situs of such transactions to be the purchaser's state of residence and allow that state to tax the transaction in full.¹⁶⁸ Here, state of residence could mean (a) the state of the purchaser's billing address, which might be available through the purchaser's credit card information; (b) the location where the purchaser primarily uses her computer, which might be solicited by the seller or registered with the purchaser's internet service provider; or (c) for business-related purchases, a registered business address.¹⁶⁹ No doubt, such a compromise would often allow the "wrong" state to tax the transaction, as the taxed goods or services would frequently be consumed partly or even entirely in other states. But this might be the only administratively feasible solution,¹⁷⁰ and permitting states to apply their sales and use taxes to such transactions could be critical to preserving their fiscal authority in the twenty-first century. Shielding these forms of commerce from state and local taxation might lead to a substantial erosion of the sales and use tax base, and it could force states to treat certain forms of commerce more favorably than others, distorting economic decisions in a manner that violates basic norms of sound tax policy.¹⁷¹

the Internet, 17 St. Tax Notes 53, 55 (1999).

168. If the seller is in State A and the purchaser in State B, the "sale" itself may legally occur in State A. Thus, the tax imposed by State B would technically be a use tax rather than a sales tax. See Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 473; Swain, *supra* note 116, at 427–28. This is merely a semantic difference, however. Assuming State B has jurisdiction over the seller, it can require the seller to collect a use tax on the value of the item sold the same as if it were imposing a sales tax.

169. The Drafting Committee of the National Tax Association Communications and Electronic Commerce Tax Project has proposed a similar solution. See James Eads et al., *National Tax Association Communications and Electronic Commerce Tax Project Report No. 1 of the Drafting Committee*, 13 St. Tax Notes 1255, 1264–65 (1997); see also Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 487–92 (making a similar proposal).

170. It might also be administratively feasible to allow the state in which the seller is located to tax the value of the transaction in full. But such a solution would be inconsistent with the underlying purpose of the sales tax as a levy on personal consumption, as the consumption is much more likely to take place in the state of the consumer's residence than where the seller is located. More practically, this solution might well be susceptible to massive evasion: sellers of electronic content could simply locate their computers that deliver such content in states that decline to tax these transactions. See Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 487 ("If the server's presence is relevant, Oregon (a state with no sales tax) will soon become the server capital of the world . . .").

171. See David Brunori, *State Tax Policy: A Political Perspective* 17–19 (2001).

Most important for present purposes, allowing the purchaser's state of residence (however defined) to tax the full value of these transactions would clearly allow states to project their taxing powers beyond their borders. First, as with the application of any retail sales tax, the state of residence would be taxing extraterritorial values whenever the taxed good or service is consumed in more than one state. Second, the state of residence would often be taxing transactions when *none* of the relevant activity occurred within that state. For example, suppose a resident of State *A* purchases a digitized audio file from a company in State *B*, downloading the file to her computer and consuming it entirely in State *C*. State *A* essentially has no connection to the transaction, as the purchase and consumption of the item occur entirely in other states. Yet if the sale were deemed to occur in the purchaser's state of residence, State *A* would impose a sales tax on the full value of the transaction. It would not just be taxing more than its fair share; it would be taxing the full retail price of the item when it is fairly entitled to *no* share.

If states could never "tax value earned outside [their] borders," as the Supreme Court has often stated,¹⁷² a tax applied in this fashion would plainly be unconstitutional. But *Goldberg* and *Jefferson Lines* demonstrate that the extraterritoriality principle in state taxation is not so rigid. As the Court stated in *Goldberg*, "[i]t should not be overlooked . . . that the external consistency test is essentially a *practical inquiry*."¹⁷³ And if the external consistency test is essentially a practical inquiry, so, too, must be the criteria of fair apportionment and extraterritoriality. Thus, if deeming the situs of these sorts of transactions to be the purchaser's state of residence were the only practicable means available for states to reach these types of transactions with their sales and use taxes, it should not be unconstitutional solely because it results in extraterritorial taxation. As in *Goldberg*, this may be "a realistic legislative solution to the technology of the present-day telecommunications industry."¹⁷⁴

172. See, e.g., *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982).

173. *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989) (emphasis added).

174. *Id.* at 265; see also Arthur R. Rosen & Alysse Grossman, *Coping with Electronic Commerce Today*, 14 St. Tax Notes 463, 468 (1998) ("By virtue of the Court's language in *Goldberg*, it is clear that the Court supports the evolution of the taxing system to accommodate new technology."). Cf. Walter Hellerstein, *Deconstructing the Debate over State Taxation of Interstate Commerce*, 13 Harv. J. L. & Tech. 549, 553 (2000) [hereinafter Hellerstein, *Deconstructing the Debate*] ("[W]hile nexus rules are clearly necessary in the existing environment, and may well be necessary to protect the small business even in a utopian future characterized by greater uniformity among the states in their sales tax regimes, the debate should focus on rules that are appropriate to the twenty-first century, not the nineteenth.").

This is not to say that such a taxing scheme would necessarily be constitutional. It might be that, while some measure of extraterritorial taxation is tolerable, this solution opens the door too far, extending the doctrine's flexibility past its breaking point. It may be that other solutions are practically feasible that would allow states to tax most of these transactions without sanctioning such blatant forms

It is instructive that Congress recently devised a very similar solution for the state and local taxation of mobile telecommunications. Many state and local governments impose excise taxes on telecommunications, levies that essentially operate as retail sales or use taxes on the purchase of telecommunications services.¹⁷⁵ (This was precisely the type of tax at issue in *Goldberg*.) The taxes are typically imposed on the consumer, but the phone service provider is obligated to collect and remit the tax to the state. As the use of mobile phones has grown exponentially in recent years, states have found it increasingly difficult to apply these taxes to wireless telecommunications.¹⁷⁶ First, it can be quite cumbersome and expensive (although technologically feasible) to determine where each call originates and terminates.¹⁷⁷ Second, it is increasingly common for phone service providers to sell “flat rate” plans, under which customers pay a flat amount per month for a certain number of transmission minutes, regardless of where calls originate or terminate.¹⁷⁸ The prevalence of such calling plans makes the process of apportioning customer charges based on the location of individual calls even more complex.

In the Mobile Telecommunications Sourcing Act of 2000,¹⁷⁹ Congress crafted a practical solution to these problems. Under the Act, mobile telecommunications may be taxed by the state and locality “whose territorial limits encompass the customer’s place of primary use, regardless of where the mobile telecommunication services originate, terminate, or pass through.”¹⁸⁰ The Act defines the customer’s “place of primary use” as “the street address representative of where the customer’s use of the mobile telecommunications service primarily occurs,” and this address must

of extraterritorial taxation. Regardless, it should be evident that this sort of taxing system is not unconstitutional simply because it permits states to project their taxing powers beyond their borders. *Goldberg* and *Jefferson Lines* make clear that extraterritorial taxation is not strictly forbidden, specifically when states would otherwise be left without any practicable means of taxing a significant segment of interstate commercial activity.

175. See Robert Cline, *Telecommunications Taxes: 50-State Estimates of Excess State and Local Tax Burden*, 24 St. Tax Notes 931, 940–41 (2002) (table showing revenue raised in 1999 by state and local sales and use taxes imposed on telecommunications); see also S. Rep. No. 106–326, at 1 (2000), available at <http://thomas.loc.gov>; H. R. Rep. No. 106–719, at 7 (2000), available at <http://thomas.loc.gov>; Hellerstein, *State Taxation of Electronic Commerce*, *supra* note 9, at 463.

176. See S. Rep. No. 106–326, at 1–2 (2000), available at <http://thomas.loc.gov>.

177. See *id.*; *Wireless Telecommunications Sourcing and Privacy Act: Hearings on H.R. 3489 Before the Subcomm. on Telecommunications, Trade and Consumer Protection of the House Comm. on Commerce*, 106th Cong. (2000) (testimony of Dan R. Bucks, Executive Director, Multistate Tax Commission), 2000 WL 374445.

178. See S. Rep. No. 106–326, at 2 (2000), available at <http://thomas.loc.gov>.

179. Pub. L. No. 106–252, 114 Stat. 626 (2000), available at <http://thomas.loc.gov>.

180. 4 U.S.C. § 117(b) (2000).

be either "the residential street address or the primary business street address of the customer."¹⁸¹ Conversely, no state or locality other than those that encompass the customer's place of primary use "may impose taxes, charges, or fees on charges for such mobile telecommunications services."¹⁸² This uniform sourcing rule greatly simplifies the task of assessing taxes on these transactions, both for phone service providers and for state and local tax authorities.¹⁸³ It also effectively eliminates the risk that interstate calls will be subject to multiple taxation, and it ensures that wireless telecommunications will not be undertaxed (at least in aggregate) due to practical barriers of administrability in enforcement.¹⁸⁴

The Act plainly authorizes states to impose extraterritorial taxes. Suppose a Washington resident travels to Oregon and places a call to New York City with her wireless phone. The Act authorizes Washington to tax the full retail price of the telecommunication, and it forbids Oregon or New York from taxing any portion of it. But Washington's only connection to the transaction is as the state in which the customer contracts with her phone service provider, an arrangement that allows her subsequently to make the out-of-state call. As discussed earlier (and reinforced by the Court's analysis in *Goldberg*), a telecommunications excise tax is best understood as a tax on the value of the customer's consumption of the service. Here, all of the customer's consumption takes place outside the state—in Oregon and New York. *None* of the consumption takes place in Washington. Yet the Act entitles Washington to impose an unapportioned tax on the full retail value of the call. By doing so, it empowers Washington to project its taxing power beyond its borders, to tax value that is entirely attributable to other states.

Because the Mobile Telecommunications Sourcing Act is an act of Congress, the dormant Commerce Clause is irrelevant in assessing whether state and local taxes imposed pursuant the Act's provisions are unconstitutional.¹⁸⁵ The dormant Commerce Clause is no more

181. 4 U.S.C. § 124(8)-(8)(a) (2000).

182. 4 U.S.C. § 117(b).

183. See Kevin P. Thompson, *Prospects Grow Dim: 106th Congress Will Resolve the Thorniest Issues in Internet Taxation Debate*, PLI Order No. J0-003J, at 145 (March–April 2001), WL 491 PLI/Tax 133.

184. In individual cases, of course, this solution will produce both undertaxation and overtaxation. If the caller's primary place of use is located in a state that does not tax telecommunications, all of her calls will go completely untaxed, even when the state in which a call originates or terminates taxes such telecommunications. Conversely, if the caller's primary place of use is located in a state that taxes such calls, all of her calls will be taxed in full, even when the state of origination or destination imposes no telecommunications tax. Indeed, undertaxation or overtaxation will occur in each instance that the state of the caller's primary place of use taxes such a telecommunication at a rate that differs from the rate imposed by the state of the call's origination or destination.

185. See Hellerstein, *State Taxation of Interstate Commerce*, *supra* note 9, at 503–04.

than a negative inference, and when Congress invokes its commerce power to address the issue in question, there is no longer a negative inference to be drawn.¹⁸⁶ But the extraterritoriality principle is not grounded exclusively in the dormant Commerce Clause. Again, the Court has stated several times that the Due Process Clause prohibits states from “tax[ing] value earned outside [their] borders.”¹⁸⁷ Moreover, the basic principle that “[n]o state can legislate except with reference to its own jurisdiction”¹⁸⁸ is probably best understood as inherent in the structure of Our Federalism.¹⁸⁹ Thus, state taxes imposed on mobile telecommunications that reach transactions occurring in other states may still pose some difficult constitutional questions.¹⁹⁰

The crucial point is that, in answering these questions and others like them, we must be mindful that state taxes are not unconstitutional simply because they reach extraterritorial values. Rather, where a state would face “genuine administrative burdens” in taxing a particular form of commerce without projecting its taxing authority beyond its borders, and the tax scheme at issue protects interstate commerce from discrimination, a state may tax commercial activity occurring in other states. Furthermore, this rule represents a sensible accommodation of the competing constitutional values at stake, the Court’s frequent statements that “a State may not tax value earned

186. See *New York v. United States*, 505 U.S. 144, 171 (1992) (“While the Commerce Clause has long been understood to limit States’ ability to discriminate against interstate commerce, . . . that limit may be lifted . . . by an expression of the ‘unambiguous intent’ of Congress.” (quoting *Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992))); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 425 (1946) (stating that “whenever Congress’ judgment has been uttered affirmatively to contradict the Court’s previously expressed view that specific action taken by the states in Congress’ silence was forbidden by the commerce clause, this body has accommodated its previous judgment to Congress’ expressed approval”).

187. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quoting *ASARCO, Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 315 (1982)); see also *Hunt-Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S. 458, 464 (2000) (stating that the Due Process Clause prohibits taxation of activity “unless there is a ‘minimal connection’ or ‘nexus’ between such activities and the taxing State, and a rational relationship between the [value] attributed to the State and the intrastate values of the enterprise”) (internal quotation marks omitted); *Trinova Corp. v. Mich. Dep’t of Treasury*, 498 U.S. 358, 394 (1991) (Stevens, J., dissenting) (stating that “extraterritorial taxation violates basic principles of due process”).

188. *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881).

189. See *Regan*, *supra* note 147, at 1895; *supra* text accompanying notes 137–41.

190. See Hellerstein, *Deconstructing the Debate*, *supra* note 174, at 564–65; see also *id.* at 565 n.63 (quoting from *Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 Before the Subcomm. on Monopolies and Commercial Law of the House Judiciary Comm.*, 100th Cong. (1989) (letter from Donald H. Regan, Professor, University of Michigan School of Law, regarding the “Constitutionality of H.R. 3521 and Similar Bills Authorizing States to Require Tax Collection by Mail-Order Sellers”)).

outside its borders" notwithstanding.¹⁹¹ As the Court's actual decisions recognize (if only implicitly), it makes little sense to prohibit every incarnation of extraterritorial taxation where doing so would effectively deprive the states of the only practical means to taxing various forms of interstate commercial activity. Whether grounded in the dormant Commerce Clause, the Due Process Clause, or our constitutional structure, the extraterritoriality principle should not operate to prevent the states from "exact[ing] from interstate commerce its fair share of the cost of state government."¹⁹² Instead, the prohibition on extraterritorial taxation must be balanced against the states' need to maintain sound and effective systems for collecting revenue. With such an understanding, we can better accommodate the imperative of protecting interstate commerce from unfair taxation while ensuring that the states continue to function as vital and independent centers of governmental power.

CONCLUSION

Although the Supreme Court for many years has stated that state taxes imposed on interstate commerce must "be fairly apportioned to reflect the [taxpayer's] business conducted in the State,"¹⁹³ the reality of the Court's decisions is a bit more complicated. Properly understood, fair apportionment is a "second order" constitutional value, a means to effectuate the "higher order" objectives of preventing discrimination against interstate commerce and to ensure that states have a sufficient nexus with the values they seek to tax. In fact, as *D.H. Holmes*, *Goldberg*, and *Jefferson Lines* demonstrate, fair apportionment is more of a preference than a constitutional requirement. When a state's tax scheme otherwise protects interstate commerce from discrimination, and it would be administratively burdensome for the state to apportion the tax at issue (or the class of taxes of which it is a part), states may impose completely unapportioned levies on interstate commerce.

The most significant implication of this insight is that, contrary to the "fundamental"¹⁹⁴ principle that a state may not "project its powers beyond its boundaries,"¹⁹⁵ some degree of extraterritorial state taxation is constitutionally permissible. To use the Court's words, the

191. *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982).

192. *Dep't of Revenue v. Ass'n of Wash. Stevedoring Cos.*, 435 U.S. 734, 748 (1978).

193. *Armco Inc. v. Hardesty*, 467 U.S. 638, 644 (1984); see also Hellerstein, *Is "Internal Consistency" Foolish?*, *supra* note 1, at 139 ("The Court has long interpreted the commerce and due process clauses as requiring that taxes be fairly apportioned to the taxpayer's activities in the taxing state.").

194. See *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 451 (1980) (Stevens, J., dissenting) ("It is fundamental that a State has no power to impose a tax on income earned outside of the State.").

195. *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

extraterritoriality principle in state and local taxation calls for “essentially a practical inquiry.”¹⁹⁶ As the landscape of commerce evolves, becoming less and less tethered to traditional conceptions of physical territoriality, this doctrinal flexibility and pragmatism will likely become increasingly important. Understanding that not all extraterritorial taxation is unconstitutional—that states have some leeway to devise “realistic legislative solution[s]”¹⁹⁷ to the emerging challenges posed by interstate commerce—may be critical to the preservation of states’ taxing authority. And protecting such authority, in turn, will help ensure that the states remain the separate and independent sovereigns that the Constitution contemplates, sustaining the values of federalism in practice and not just in legal theory.

196. *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989).

197. *Id.* at 265.

Notes & Observations