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The Effect of the Internet Era and *South Dakota v. Wayfair* on the Unitary Business Rule

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THE EFFECT OF THE INTERNET ERA AND *SOUTH DAKOTA v. WAYFAIR* ON THE UNITARY BUSINESS RULE

Abstract: On June 21, 2018, the Supreme Court in *South Dakota v. Wayfair* eliminated the sales tax physical presence rule for the Dormant Commerce Clause's "substantial nexus" requirement. This decision extends a State's ability to tax interstate commerce. This Comment argues that *Wayfair*'s expansion of state tax jurisdiction should be applicable all forms of state taxation, as opposed to solely sales tax because it interprets the substantial nexus requirement of the Dormant Commerce Clause. Corporate taxation's unitary business rule should utilize the changes to the substantial nexus requirement to restore its original intention and adapt to modern technology.

INTRODUCTION

States impose taxes to fund protections and benefits for the individuals and corporations within their borders.[1] States use several forms of taxes, such as income tax, corporate income tax, sales and use tax, property tax, estate tax, and sin tax.[2] These taxes are often viewed separately under the constitutional restraints of the Due Process Clause and Dormant Commerce Clause, leading to confusion and contradiction.[3] The Supreme Court's 2018 decision in *South Dakota v. Wayfair* expanded the Dormant Commerce Clause's "substantial nexus" jurisdiction for requiring businesses to collect sales tax.[4] The Court reasoned that the prior physical presence rule was overly rigid, and innovations

[1] *See Policy Basics: Where Do Our State Tax Dollars Go?*, CTR. ON BUDGET & PUB. PRIORITIES (July 25, 2018), https://www.cbpp.org/research/state-budget-and-tax/policy-basics-where-do-our-state-tax-dollars-go [https://perma.cc/9XHB-AYA2] (providing examples of how the states spend tax revenue). Taxes are essentially payments we provide to be a part of a governed country. *See* Compania General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J. dissenting) (arguing that taxes fund civilized society).

[2] *See State and Local Taxes*, U.S. DEP'T OF THE TREASURY (Dec. 5, 2010), https://www.treasury.gov/resource-center/faqs/Taxes/Pages/state-local.aspx [https://perma.cc/C2K9-JB49] (listing the types of state and local taxes); Franklin Liu, Note, *Sin Taxes: Have Governments Gone Too Far in Their Efforts to Monetize Morality*, 59 B.C. L. REV. 763, 764 (2018) (describing the sin tax as a method to discourage certain behavior).

[3] *See Why Large Corporations Can Do Business in Your Business Tax Free*, INST. ON TAX'N & ECON. POL'Y (Dec. 2006) (highlighting that all state taxation is subject to the Dormant Commerce Clause limitation). Notwithstanding, sales tax and corporate income tax have different analyses for substantial nexus. *Id.*

[4] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2093 (2018).

in modern technology have distorted traditional notions of jurisdiction.[5] This Comment argues that the changing substantial nexus standard for sales taxes should apply to other areas of state taxation because the Constitution limits states' power to tax equally to all tax forms, and the Internet has changed society such that institutional rules require reevaluation.[6] One rule prime for reevaluation is the unitary business rule, which determines substantial nexus for an out-of-state parent corporation's sale of an interest in an in-state subsidiary.[7] The unitary business rule is outdated and requires modification in light of *Wayfair*.[8] Part I of this Comment details the history of the Due Process Clause and Dormant Commerce Clause restrictions on state taxation, emphasizing sales and corporate taxation.[9] Part II of this Comment discusses the two major themes of the *Wayfair* decision: substantial purposeful availment and modern technology.[10] Part III of this Comment argues for modification of the unitary business rule based on changes in technology and substantial nexus from *Wayfair*.[11]

I. CONSTITUTIONAL RESTRAINTS ON STATE TAXATION

The Constitution grants Congress the power to regulate interstate commerce, implicitly limiting states' power to do so in what is known as the Dormant Commerce Clause.[12] In 1977, in *Complete Auto Transit, Inc. v. Brady*, the Supreme Court formalized the determination of whether statutes violate the Dormant Commerce Clause.[13] A state tax statute is constitutional when it "is applied to an activity with a substantial nexus to the taxing state."[14]

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[5] *See id.* at 2092 (overruling the physical presence rule because it is not required by the Constitution); Nat'l Bellas Hess v. Dep't of Revenue, 386 U.S. 753, 758 (1967) (establishing the physical presence rule).

[6] *See infra* notes 107–134 and accompanying text.

[7] *See* Allied-Signal, Inc. v. Dir., Div. of Taxation ("*Allied-Signal N.J.*"), 504 U.S. 768, 777 (1992) (holding that the unitary business rule appropriately determines the extent of the Due Process Clause and Dormant Commerce Clause restrictions on state taxation).

[8] *See infra* notes 113–125 and accompanying text.

[9] *See infra* notes 12–72 and accompanying text.

[10] *See infra* notes 73–106 and accompanying text.

[11] *See infra* notes 107–136 and accompanying text.

[12] U.S CONST. art I, § 8; *see* Okla. Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 179 (1995) (holding that this negative limitation applies to statutes that cover areas Congress has not specifically legislated). After the American Revolution, most states passed multiple tariffs taxing out of state goods. *See* M.E. Kelley, *Tariff Acts Under the Constitution*, 2 Q. J. ECON. 473, 473 (1888). This restriction on state power protects against the division created by the state tariffs during the Articles of Confederation. Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979); *see* Comptroller of the Treasury v. Wynne, 135 S. Ct. 1787, 1794 (2015) (stating that a central problem of the Articles of Confederation was the burden imposed on interstate commerce by state taxation).

[13] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). This test was a departure from prior cases that analyzed statutes on draftsmanship, rather than substance. *See* Ry. Express Agency v. Virginia, 358 U.S. 434 (1959) (upholding a franchise tax on the receipts from express companies for deliveries inside, outside, or through the state). *But see* Ry. Express Agency v. Virginia, 347 U.S. 359 (1954) (holding that a state cannot tax the privilege of passing through the state while conducting

The Due Process Clause requires that the tax seeks payment for "protection, opportunities[,] and benefits" derived from the state government.[15] In 1944, in *International Harvester Co. v. Wisconsin Department of Taxation*, the Supreme Court held that an in-state corporation's dividend payments to nonresidents can be taxed because the activities producing the dividends received government benefits and protections.[16] In 1991, in *Allied-Signal Inc. v. Commissioner of Finance* ("*Allied-Signal N.Y.*"), the New York Court of Appeals applied *International Harvester* to affirm New York's tax on the sale of an in-state corporation by an out-of-state corporation because of the similarity between capital gains and the dividends received by nonresident shareholders.[17] The sole consideration for constitutionality in these cases was whether the state provided benefits for which it deserved compensation, which always exist when an in-state corporation generates income.[18]

Section A of this Part explores the relationship between substantial nexus and the Due Process Clause.[19] Section B of this Part provides an overview of the sales tax law prior to *Wayfair*.[20] Section C of this Part summarizes the *Way-*

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interstate commerce). Instead, in 1977, the Supreme Court in *Complete Auto Transit, Inc. v Brady* returned to a set of case law that focuses on taxing interstate commerce in a manner proportionate with the taxpayer's in-state activity. *Complete Auto Transit*, 430 U.S. at 279; *see* W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254–55 (1938) (stating that the Commerce Clause did not intend to protect interstate commerce from paying fairly apportioned taxes). *See generally* Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) (holding that a state can impose a tax upon interstate activity in the same manner as it taxes intrastate activity).

[14] *Complete Auto Transit*, 430 U.S. at 279. A substantial nexus relates to the state's taxing jurisdiction, and requires a connection between the state and the activity subject to taxation. *Allied-Signal N.J.*, 504 U.S. at 772 (citing Mobil Oil Corp v. Comm'r of Taxes of Vt., 445 U.S. 425, 436–37 (1980)). The other three requirements of the Dormant Commerce Clause are that the statute is "fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the taxing state." *Id.*

[15] Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940). This requirement is ultimately about fairness, based on "notice or fair warning." Julie Roman Lackner, Note, *The Evolution and Future of Substantial Nexus in State Taxation of Corporate Income*, 48 B.C. L. REV. 1387, 1394 (2007).

[16] Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 442 (1944). The state could tax the ultimate beneficiaries of the government services, regardless of where they resided. *Id.* at 441.

[17] Allied-Signal Inc. v. Comm'r of Fin. ("*Allied-Signal N.Y.*"), 588 N.E.2d 731, 736 (N.Y. 1991). It is important that the Supreme Court, in 1991, in *Allied-Signal Inc. v. Commissioner of Finance,* extended its holding from its decision in 1944 in *International Harvester Co. v. Wisconsin Department of Taxation* to justify taxation under the Dormant Commerce Clause. *Id.* at 737. *International Harvester* was decided before *Complete Auto Transit* formalized the Dormant Commerce Clause, so *International Harvester* was only decided under the Due Process Clause. *See Int'l Harvester*, 322 U.S. at 437 (defining the limitation on state taxation as the Due Process Clause). *See generally Complete Auto Transit*, 430 U.S. 274 (1977) (defining the Dormant Commerce Clause as the important test for determining the constitutionality of state tax statutes).

[18] *Int'l Harvester*, 322 U.S. at 442; *J.C. Penney*, 311 U.S. at 444; *Allied-Signal N.Y.*, 558 N.E.2d at 736–37.

[19] *See infra* notes 23–27 and accompanying text.

[20] *See infra* notes 28–35and accompanying text.

fair decision.[21] Section D of this Part highlights the relevant parts of state corporate taxation for the unitary business rule.[22]

A. Substantial Nexus and the Due Process Clause

The substantial nexus requirement of the *Complete Auto Transit* test implements the Due Process Clause requirement into the Dormant Commerce Clause analysis, even though the Court in *Complete Auto Transit* did not phrase it in this manner.[23] A substantial nexus exists when a taxpayer "avails itself" to the taxing state, thus benefitting from the "substantial privilege" of conducting its business within a particular state.[24] The use of the word "avails" alludes to the Due Process Clause's purposeful availment requirement for personal jurisdiction from the Supreme Court's 1958 decision in *Hanson v. Denckla*.[25] In 2009, in *Polar Tankers, Inc. v. City of Valdez*, the Supreme Court used a "substantial privilege" standard, instead of the bare "privilege" standard it used in *Hanson v. Denckla*, signifying that the Dormant Commerce Clause standard is higher than the Due Process Clause requirement.[26] Only substantial purposeful availment satisfies the substantial nexus requirement because receiving a substantial privilege from the taxing state requires more connection to it.[27]

B. Sales Tax and the Physical Presence Requirement

Beginning in the 1920s, sales tax grew in popularity in the United States and around the world.[28] As of 2014, sales tax was codified in forty-five states and the District of Columbia.[29] The application of sales tax requirements on a

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[21] *See infra* notes 36–49 and accompanying text.

[22] *See infra* notes 50–72 and accompanying text.

[23] *See* Michael Chisum, *State Taxation of Interstate Corporate Income from Intangible Property: Due Process and Commerce Clause Limitations*, 13 TEXAS TECH L. REV. 1, 3 (1982) (illustrating the constitutional restraints against state taxing power); *Wayfair*, 138 S. Ct. at 2093 (stating that the substantial nexus requirement is similar to the Due Process Clause restriction). *But see Complete Auto Transit*, 430 U.S. at 279 (creating the Dormant Commerce Clause analysis without mentioning the Due Process Clause limitation).

[24] Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009).

[25] *See* Hanson v. Denckla, 357 U.S 235, 253 (1958) (holding that a defendant must "*purposefully avail* itself of the *privilege* of conducting activities within the forum state" in order to be sued in that state) (emphasis added).

[26] *Compare Polar Tankers*, 557 U.S. at 11 (citing *Mobil Oil*, 445 U.S. at 437) (stating that the interaction with the state derives a substantial benefit), *with Hanson*, 357 U.S. at 253 (requiring that the interaction with the state derives a benefit).

[27] *See supra* note 25 and accompanying text.

[28] *See* Robert Murray & Carl Shoup, *The Sales Tax in the American States*, 8 BULL. BUS. HIST. SOC'Y 74–75 (1934) (explaining that by 1934, sales tax statutes existed in fourteen states, Europe, South America, Australia, and Canada).

[29] *See* Jared Walczak & Scott Drenkard, *State and Local Sales Tax Rates, Midyear 2018*, TAX FOUND. (July 16, 2018), https://taxfoundation.org/state-local-sales-tax-rates-midyear-2018/ [https://

corporation imposes the duty of collecting the tax from the buyer and remitting the funds to the state.[30] Sales tax litigation often centers on the duty of collection because collecting sales tax increases sales prices and creates an administrative burden for the vendor.[31]

In 1967, in *National Bellas Hess v. Department of Revenue*, the Supreme Court held that National Bellas Hess ("Hess"), a mail order company, did not have the minimum connection with Illinois required to force it to collect and remit sales taxes.[32] Hess's only connection to Illinois was through the U.S. mail and common carriers.[33] The Court held that a state cannot require sales tax collection if the connection between the retailer and the state exists solely through the U.S. mail and common carriers because of the administrative burden it would place on mail-order companies.[34] Twenty-five years later, in 1992 in *Quill Corp. v. North Dakota*, the Supreme Court formalized the *Bellas Hess* rule by defining *Complete Auto Transit*'s substantial nexus factor as a requirement for physical presence in the taxing state before a state may require sales tax collection.[35]

C. The South Dakota v. Wayfair *Decision*

Quill has received much criticism[36] and forced states to respond by adopting new interpretations of physical presence.[37] In 2016, the South Dakota Sen-

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perma.cc/4ZH3-URRV] (stating that sales tax are not enforced Alaska, Delaware, Montana, New Hampshire, and Oregon).

[30] *See Guide to Sales and Use Taxes*, MASS. DEP'T OF REVENUE, https://www.mass.gov/guides/sales-and-use-tax [https://perma.cc/VA2M-3ML7] (stating that the buyer's tax is added to the sales price, and then the vendor sends the tax to the state).

[31] *See, e.g.*, *Wayfair*, 138 S. Ct. 2080 (deciding whether internet vendors are required to collect and pay sales taxes); Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (determining whether a mail order company is required to collect sales taxes); Nat'l Bellas Hess v. Dep't of Revenue, 386 U.S. 753 (1967) (considering whether a mail order company must collect sales tax).

[32] *Bellas Hess*, 386 U.S. at 758. The Supreme Court decided *Scripto, Inc. v. Carson* in 1960 and, until the Court's decision in 1967 in *National Bellas Hess v. Department of Revenue*, it was the furthest reaching case, holding that ten independent salesmen in Florida constituted a minimum connection, and that their employment as independent contractors did not affect the constitutionality of the tax. Scripto, Inc. v. Carson, 362 U.S. 207, 211 (1960).

[33] *Bellas Hess*, 386 U.S. at 754.

[34] *See id.* at 759–60 (detailing negative consequences of allowing Illinois to tax Hess).

[35] *See Quill*, 504 U.S. at 311, 314–15 (adding the *Bellas Hess* rule to the *Complete Auto Transit* test). The Court recognized the advantage this rule gives out-of-state vendors and asserted that Congress is better suited to resolve this dispute. *Id.* at 315, 318. Because tax areas are viewed separately, cases in other areas of taxation have not adopted the *Quill* rule beyond sales and use taxes. *See* Phillip Zinn, *The Requirements of "Substantial Nexus" and "Fairly Related" Under the Commerce Clause*, ST. & LOC. TAX LAW. 59, 59 (2007) (describing the lack of court guidance on how the physical presence rule applies to other areas of tax).

[36] *See* Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124, 1135 (2015) (Kennedy J. concurring) (arguing that *Quill* should be reconsidered in light of modern e-commerce trends and consumer sophistication). Justice Kennedy wrote separately in 2015 in *Direct Marketing Ass'n v. Brohl* to note that the

ate passed Senate Bill No. 106 (the "Act"), declaring an emergency from the state's inability to collect sales tax from Internet sales.[38] Challenging *Quill*, the Act required out-of-state sellers with annual in-state sales of over $100,000, or at least 200 individual transactions, to collect sales tax as if the seller had a physical presence in South Dakota.[39] As provided under Sections 2 and 3 of the Act, South Dakota sought declaratory judgment to assess the validity of the Act and enjoined its terms until a reviewing court could determine its constitutionality.[40] The respondents, Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc., were Internet vendors without a physical presence in South Dakota, and easily met the Act's minimum sales revenue requirement.[41]

Court, in 1992 in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), should have taken the opportunity to reassess its decision in 1967 in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967), in light of the technological advancements. *Brohl*, 135 S. Ct. at 1135 (Kennedy J. concurring).

[37] *See, e.g.*, Vendors Making Internet Sales, 830 MASS. CODE REGS. 64H.1.7(1)(b)2.a (2017) (asserting that "cookies" on in-state mobile devices and computers constituted a physical presence in the state). To counteract the physical presence rule from *Quill*, the Massachusetts Department of Revenue, in 2017, adopted the Vendors Making Internet Sales regulation, concluding that data collected through "cookies" in computer and mobile applications within Massachusetts constitute a physical presence. *Id.*

[38] S. 106 § 8, 2016 Leg. Assemb., 91st Sess. (S.D. 2016). Passing South Dakota Senate Bill 106 was undoubtedly provoked by Justice Kennedy's concurrence in the Supreme Court's decision in 2015 in *Direct Marketing Ass'n v. Brohl*. State v. Wayfair Inc., 901 N.W.2d 754, 761 (S.D. 2017) (stating that South Dakota "accepted Justice Kennedy's invitation"). South Dakota estimated the "Sales Tax Loophole" prevented the collection of between $48 million and $58 million per year. *Wayfair*, 138 S. Ct. at 2084. At the time the case was decided, sales tax accounted for sixty percent of South Dakota's revenue. *Id.* at 2088. The Governmental Accountability Office estimated that the loophole deprived the fifty states of $13 billion in 2017. Greg Stohr, *U.S. Supreme Court to Review Bid to Collect Internet Sales Tax* (Jan 12, 2018), https://www.bloomberg.com/news/articles/2018-01-12/bid-to-collect-internet-sales-tax-gets-u-s-high-court-review [https://perma.cc/2FKN-D9SQ]. The loss of sales tax revenue was depriving South Dakota of resources to fund the state government and other important organizations. S.D. S. 106 § 8. The states, however, are already collecting seventy-five to eighty percent of the sales taxes they would be collecting if remote sellers were forced to collect sales tax. U.S. GOV'T ACCOUNTABILITY OFF., *SALES TAXES: States Could Gain Revenue from Expanded Authority, but Businesses Are Likely to Experience Compliance Costs* (2017), https://www.gao.gov/products/GAO-18-114 [https://perma.cc/B45Q-S6UM].

[39] S.D.S. 106 § 1. This statutory limitation protects against burdening smaller businesses who do not reach either the revenue or transaction requirements, while also protecting against unconstitutionally taxing a corporation that does not have substantial nexus to South Dakota. *See Wayfair*, 138 S. Ct. at 2098–99 (defending against the argument that removing the *Quill* rule will subject small businesses and start-ups to an overwhelming challenge of nationwide sales tax collection). The burden of reporting is not as severe with modern technology than it was during the time of *Bellas Hess* because of advancements the Internet has provided towards tax collection and filing. *See* Joseph Bishop-Henchmen, *What Does the* Wayfair *Decision Really Mean for States, Businesses, and Consumers?*, TAX FOUND (July 9, 2018), https://taxfoundation.org/what-does-the-wayfair-decision-really-mean-for-states-businesses-and-consumers/#5 [https://perma.cc/F6E6-J7NN] (stating that compliance software is available to coordinate multistate sales taxation).

[40] *See* S.D.S. 106 §§ 2–3 (stating the state may bring a declaratory judgment action and such action would enjoin the statute until it survives a motion to dismiss or summary judgment motion).

[41] *See Wayfair*, 138 S. Ct. at 2089 (stating the respondents do not have any employees or real estate in South Dakota, and each had in-state sales beyond $200,000 in South Dakota). Systemax, Inc.

The State sued the defendants in the Circuit Court of the Sixth Judicial Circuit in Hughes County, South Dakota, for noncompliance with the Act.[42] The defendants filed for removal to federal court, claiming the U.S. District Court for the District of South Dakota had original jurisdiction over the State's claims.[43] The South Dakota District Court did not find a federal question under the *Grable* test and well-pleaded complaint rule, and thus remanded the case.[44] Because *Quill* was the law and the Supreme Court must overturn its own cases, the district court directed the state circuit court to find that the Act was unconstitutional.[45]

The final determination of the Act's constitutionality came in June 2018, in *South Dakota v. Wayfair*, when the Supreme Court upheld the Act, overturned *Quill* and *Bellas Hess*, and explicitly returned to the *Polar Tankers* substantial nexus definition.[46] The Court held that *Quill* unnecessarily created the physical presence rule, resulting in improper distinctions between inter- and intrastate commerce.[47] In particular, the Court noted that drastic improvements in technology since *Quill* allowed businesses to be impactful in states without a physical presence.[48] The court found that the Act provided protection to

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was also named as a defendant, but did not challenge South Dakota's authority to impose sales tax collection. South Dakota v. Wayfair, Inc., 229 F. Supp. 3d 1026, 1027 n.1 (D.S.D. 2017).

[42] Complaint at 1, South Dakota v. Wayfair, Inc. (2016) (No. 32CIV16-000092), 2016 WL 11534452.

[43] *Wayfair*, 229 F. Supp. 3d at 1029.

[44] *Id.* at 1033–34. The State promoted the well-pleaded complaint rule from the Supreme Court's decision in 1983 in *Franchise Tax Board v. Construction Laborers Vacation Trust*. 463 U.S. 1 (1983). The well-pleaded complaint rule states that to invoke federal question jurisdiction, the federal question must be in the plaintiff's complaint, not in the defendant's defense, regardless of whether the federal question defense was anticipated. *Id.* at 14. The defendants argued for the test illustrated in the Supreme Court's decision in 2005 in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*. 545 U.S. 308 (2005). The Court in *Grable* held that a federal question must "necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities." *Id.* at 314. The District Court found that, under both tests, removal based on a federal question was improper. *Wayfair*, 229 F. Supp. 3d at 1035.

[45] *Wayfair*, 901 N.W.2d at 760 (citing Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484 (1989)).

[46] *Wayfair*, 138 S. Ct. at 2099–2100 (citing *Polar Tankers*, 557 U.S. at 11).

[47] *Id.* at 2092. Wayfair, Inc. recognized the advantage *Quill* gave it over in-state retailers and used this as a marketing tool by advertising on its website that a benefit their customers received was sales tax avoidance. Brief for Petitioner at 55, South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) (No. 17–494).

[48] *Id.* at 138 S. Ct. at 2094. As of 2018, eighty-nine percent of Americans had Internet access, compared to two percent in 1992, when *Quill* was decided. Brief of Retail Litigation Center, Inc., et al. as Amici Curiae in Support of Petitioner, at 11 n.10, South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) (No. 17-494). In the United States, e-Commerce sales are growing three times faster than traditional retail sales. *See* U.S. DEP'T OF COMMERCE, PUB. NO. CB18-173, QUARTERLY RETAIL E-COMMERCE SALES: 3RD QUARTER 2018 (2018), https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf [https://perma.cc/Q8JX-D6MC] (showing consistent fifteen percent growth for e-commerce sales and five percent growth for retail sales).

small businesses with insufficient connections to the state, so vendors that met the statutory threshold had substantial nexus with South Dakota.[49]

D. Corporate Income Tax

For a state to tax an out-of-state corporation selling an interest in an in-state subsidiary corporation, the transaction must have a connection with the taxing state.[50] The unitary business rule states that such connection exists if the out-of-state corporation forms a "unitary business" with the in-state subsidiary, rather than the in-state corporation being a "discrete business enterprise."[51] If so, income derived from that unity of the businesses is taxable.[52] Determining whether a unitary business exists focuses on the flow of value between the corporations.[53] Functional integration, centralization of management, and economies of scale are the three "hallmark" factors that determine the existence of a unitary business.[54]

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[49] *Wayfair*, 138 S. Ct. at 2098–99.

[50] *See Allied-Signal N.J.*, 504 U.S. at 778 (citing *Quill*, 504 U.S. at 306) (asserting that the Due Process Clause requirement necessitates a connection between the state and the taxpayer, property or transaction).

[51] *See id.* at 772–73 (distinguishing a unitary business and a discrete business enterprise). A discrete business enterprise exists when the income of the subsidiary in-state corporation is the result of an unrelated business activity. Exxon Corp. v. Dep't of Revenue, 447 U.S. 207, 223–24 (1980).

[52] *Exxon*, 447 U.S. at 223–24. When a state taxes the entire unitary business group as one entity it expands the state's taxing jurisdiction. *See* Kimberley Reeder et al., *The Unitary Group's Identity Crisis: Is There Really an "I" in Unitary?*, ST. & LOC. TAX LAW. 83, 83 (2008) (noting that the difference in treatment of the corporate group as an aggregate taxpayer or as separate taxpayers can determine the business group's jurisdictional exposure). The unitary business rule encompasses the benefits that pass within sections of a large corporation that standard accounting does not recognize based solely on in-state activity. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 165 (1983) (detailing the shortcomings of formal geographical or transactional accounting).

[53] *See Container Corp.*, 463 U.S. at 178–79 (discussing the difficulty in determining the exact amount of value a corporation has at specific locations); *see also, e.g.*, State R.R. Tax Cases, 92 U.S. 575, 606–07 (1875) (holding that the railroad system is more valuable than the sum of each state's part assessed individually). A flow of value between two businesses shows the benefit an in-state corporation can receive from an out-of-state corporation. *See Container Corp.*, 463 U.S. at 178 (1983) (examining when parent companies benefit from their subsidiaries). In 1983, in the Supreme Court's decision in *Container Corp.*, the Court held that, when a corporation invests in another business where it can contribute value, the purpose of the investment was likely to make use of the parent corporation's benefits. *Id.* This justifies the tax upon the out-of-state corporation because the interaction the out-of-state corporation has within the taxing state through the in-state corporation gives benefits to the out-of-state corporation. *See J.C. Penney*, 311 U.S. at 444 (describing taxation as a payment for services rendered).

[54] *See Allied-Signal N.J.*, 504 U.S. at 789 (coining the term "hallmark"); Butler Bros. v. McColgan, 315 U.S. 501, 508 (1942) (considering these factors as the main methods by which multistate corporations save costs, compared to smaller, individual corporations). Occasional oversight does not constitute a unitary business. *See* F.W. Woolworth Co. v. Taxation & Revenue Dep't of N.M., 458 U.S. 354, 369 (1982) (holding typical parental oversight is insufficient to create a unitary business). Functional integration is the comingling of business operations that offers the subsidiary operational support that they would not otherwise be able to benefit from. STATE OF MICH. DEP'T OF

In 1992, the Supreme Court, in *Allied-Signal, Inc. v. Director, Division of Taxation* ("*Allied-Signal N.J.*"), rejected New Jersey's argument abandoning the unitary business rule, and allowing a state to apportion all income from out-of-state corporations who have subsidiaries within the state.[55] The Court rejected New Jersey's argument as unconstitutionally taxing beyond state lines.[56] The Court reiterated support for the unitary business rule as one of potentially multiple constitutional methods of apportionment.[57] Moreover, the Court reasoned that the unitary business rule's flexibility allowed it to update with developments in the business industry.[58]

In 2008, in *MeadWestvaco Corp. v. Illinois Department of Revenue*, the Supreme Court analyzed whether a unitary business existed between MeadWestvaco, an Ohio corporation, and LexisNexis ("Lexis"), an Illinois corporation, before MeadWestvaco's sale of Lexis.[59] MeadWestvaco's management of Lexis's affairs involved oversight, approving annual business strategies, and large transactions.[60] MeadWestvaco claimed business expense deductions of $680 million from Lexis between 1988 and 1993.[61] The trial court found that MeadWestvaco and Lexis did not form a unitary business because they did not demonstrate the three hallmark factors.[62] Nevertheless, the trial court held that Illinois could tax MeadWestvaco's profit from the sale because

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TREASURY, REVENUE ADMIN. BULL. 2010-2, at 3 (2010). Centralization of management is grouping the business' strategic planning and operation under one leadership. Matt Barrett, *Centralized and Decentralized Management Explained*, PERSONAL FINANCE LAB, https://content.personalfinancelab.com/finance-knowledge/management/centralized-and-decentralized-management-explained/ [https://perma.cc/JT4Y-QE37] (comparing centralized and decentralized management). This allows for consistency and strategic coordination between the subsidiary and parent corporation. *Id.* Economies of scale refers to the reduction of cost per item from bulk production. *Economies of Scale*, INVESTOPEDIA (Jan 29, 2018), https://www.investopedia.com/terms/e/economiesofscale.asp. Implicitly, there is a grey area of interactivity between the hallmarks of a unitary business and an unrelated, discrete business activity. *See Allied-Signal N.J.*, 504 U.S. at 789 (requiring functional integration, centralization of management, and economies of scale for a unitary business); *Exxon*, 447 U.S. at 223–24 (defining a discrete business enterprise as an unrelated business activity).

[55] *Allied-Signal N.J.*, 504 U.S. at 784. Because this argument was broad and arose for the first time at oral argument, the Court held a second oral argument centering on this question. *See* James A. Mirage, *A Solidification of the Unitary Business Principle:* Allied-Signal, Inc. v. Dir., Div. of Tax'n, 46 TAX LAW 541, 544 (1993) (stating that the theory advanced by New Jersey would require only centralized management for apportionment).

[56] *Allied-Signal N.J.*, 504 U.S. at 784. States have the freedom to create any apportionment formula that values the in-state portion of multistate activity. *Id.*

[57] *See id.* at 787 (mentioning three times that a unitary business is not constitutionally required to apportion income).

[58] *Id.* at 786.

[59] MeadWestvaco Corp. v. Ill. Dep't of Revenue, 553 U.S. 16, 19, 21 (2008).

[60] *See id.* at 22 (describing MeadWestvaco's role in Lexis's various business activities).

[61] *Id.* at 21.

[62] *Id.* at 23.

Lexis served an "operational purpose" in MeadWestvaco's business.[63] The operational function method was derived from specific language in *Allied-Signal N.J.* and *Container Corp.* that appeared to allow apportionment for capital transactions where the intangible asset served an operational function, rather than an investment function.[64] The Appellate Court of Illinois affirmed the trial court's opinion, stating that because MeadWestvaco owned Lexis, had exercised control by approving transactions and cash expenditures, and used deductions for business expenses relating to Lexis, the state had the right to tax the corporation.[65] Because the Appellate Court of Illinois held that Lexis served an operational function, it did not address whether MeadWestvaco and Lexis formed a unitary business.[66] Although the Supreme Court of Illinois denied review, the United States Supreme Court granted certiorari.[67]

The Supreme Court held that the Appellate Court of Illinois erred in considering Lexis's operational function rather than analyzing the functional integration, centralization of management and economies of scale.[68] The language found in *Allied-Signal N.J.* and *Container Corp.* was not intended to create an additional jurisdiction test.[69] As a result, the case was remanded to the Appellate Court of Illinois for consideration of those factors.[70]

The Court did not consider the state's argument that MeadWestvaco's sale of Lexis should be taxable based on Lexis's connection with the state because the argument was not raised during the lower court proceedings.[71] Additionally, the Court did not examine this argument because Ohio and New York were already taxing this income and neither received notice about the potential debate over the constitutionality of their tax codes.[72]

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[63] MeadWestvaco Corp. v. Dep't of Revenue, 861 N.E.2d 1139–41 (Ill. App. Ct. 2007); Mead Corp. v Ill. Dep't of Revenue, No. 00CH7854, 2000 WL 35587638 at *12–13 (Ill. Cir. Ct. Mar. 18, 2003).

[64] *See Allied-Signal N.J.*, 504 U.S. at 787 (identifying an example of operational function as a short-term bank deposit, without a unitary business between the payor and the bank); *Container Corp,* 463 U.S. at 180 n.19 (citing Corn Products Refining Co. v. Comm'r, 350 U.S. 46, 50–53 (1955)).

[65] *See MeadWestvaco*, 861 N.E.2d at 1140 (providing examples of the active role MeadWestvaco played in Lexis's business).

[66] *Id.* at 1139–41.

[67] *See* MeadWestvaco Corp. v. Ill. Dep't of Revenue, 551 U.S. 1189 (2007) (granting certiorari); MeadWestvaco Corp. v. Ill. Dept. of Revenue, 862 N.E.2d 235 (Ill. 2007) (denying the appeal from the Appellate Court).

[68] *MeadWestvaco*, 553 U.S. at 30.

[69] *Id.* at 29. This approach is now limited to the taxpayer's business assets. Fred M. Ackerson & Peter L. Faber, *Supreme Court Curtails Scope of "Operational Function" Test in* MeadWestvaco Corp. v Illinois Department of Revenue, MCDERMOTT NEWSLETTERS (Apr. 16, 2008), https://www.lexology.com/library/detail.aspx?g=f6d274fc-afbb-412d-a12e-6496759aee26 [https://perma.cc/G8VX-FQGC].

[70] *MeadWestvaco*, 553 U.S. at 32.

[71] *See id.* at 30–31 (declining to answer whether Lexis's connections with the state justify taxation).

[72] *Id.* at 31.

II. Analysis of *Wayfair*'s Main Takeaways

In 2018, in *South Dakota v. Wayfair*, the Supreme Court returned to the substantial purposeful availment interpretation of substantial nexus because of the changes to the Internet since the Court's 1992 decision in *Quill Corp. v. North Dakota*.[73] In doing so, the Court aligned the substantial nexus requirement with the Due Process Clause and personal jurisdiction.[74] Personal jurisdiction is changing based on modern technology.[75] Analysis of the recent changes in purposeful availment can advise the proper considerations for substantial nexus.[76] Section A of this Part details purposeful availment.[77] Section B of this Part emphasizes some recent changes in technology that could impact a corporation's ability to acquire personal jurisdiction in another state.[78] Section C of this Part discusses new case law regarding personal jurisdiction and the Internet.[79]

A. Purposeful Availment

Purposeful availment regarding personal jurisdiction occurs if a party takes direct action towards a state, thereby subjecting the party to the benefits and burdens of that state.[80] The use of state resources justifies a court's jurisdiction over the party.[81] Courts have considered intentional actions directed to a state purposeful availment, therefore subjecting the actor to the court's jurisdiction.[82] Unintentional exposure or actions, however, do not grant courts personal jurisdiction over the actor.[83]

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[73] *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) (returning to the definition of substantial nexus in Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009)); *supra* note 47 and accompanying text.

[74] *See supra* notes 23–27 and accompanying text.

[75] *See infra* notes 93–106 and accompanying text.

[76] *See infra* notes 127–136 and accompanying text.

[77] *See infra* notes 80–83 and accompanying text.

[78] *See infra* notes 84–92 and accompanying text.

[79] *See infra* notes 93–106 and accompanying text.

[80] *See* Hanson v. Denckla, 357 U.S 235, 253 (1958) (stating that the defendant must act towards the state, rather than unilateral activity from the other party). Although in 1958, the Supreme Court in *Hanson v. Denckla* most likely could not have predicted the rapid changes in technology, in 1985, in *Burger King Corp. v. Rudzewicz*, the Court held that purposeful availment did not require physical presence because of the growth in mail and wire transactions. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985).

[81] Int'l Shoe Co. v. Washington, 326 U.S. 310, 319 (1945).

[82] *See Rudzewicz*, 471 U.S. at 479–80 (holding that a Michigan franchisee's contract and interactions with the Florida franchisor were sufficiently directed into Florida for specific jurisdiction).

[83] *See* J. McIntyre Mach., Ltd. v. Nicastro, 564 U.S. 873, 883, 887 (2011) (holding that equipment sales through a distributor do not satisfy a minimum connection to New Jersey).

B. Modern Technology and the Internet Era

As the Court emphasized in *Wayfair*, one concern pertaining to the substantial nexus requirement is advancements in modern Internet technology.[84] Physical presence is no longer required for vendors to actively pursue customers and there are certain benefits that online websites have over traditional retailers.[85] Regardless of the direct effect technology has on traditional retail, the indirect effect of increased Internet connectivity raises the importance of an online presence for vendors.[86]

The Internet and information technology have improved various areas of the business industry, including research and strategy development, financial services, and corporate monitoring.[87] Increasing the cost for a consumer to change to another company, improving product development, and replacing employees with technological labor are only some of the methods that utilize information technology to create a competitive advantage.[88] Increased informational flow allows corporations to undertake more strategic development of their business portfolios, resulting in well-informed investments in new markets.[89] Financial technology, known as "FinTech," has simplified the process of transferring money and investing.[90] Information technology also improves corporate oversight by improving risk management.[91] These corporate func-

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[84] *See Wayfair*, 138 S. Ct. at 2095 (repeatedly citing Direct Mktg. Assoc. v. Brohl, 135 S. Ct. 1124, 1134–35 (2015) (Kennedy J. concurring)).

[85] *See id.* (stating that websites have the ability to display more merchandise and connect with consumers than the traditional retail stores). According to a study conducted in 2015, thirty-four percent of Americans preferred to shop online. Aaron Smith & Monica Anderson, *Online Shopping and E-Commerce*, PEW RESEARCH CTR. 1, 22 (2016). Another sign of change from technology is that twenty-four percent of Americans do not use cash. *Id.* at 17.

[86] *See* Cadie Thompson, *21 Technology Tipping Points We Will Reach by 2030*, BUS. INSIDER (Nov. 12, 2015), https://www.businessinsider.com/21-technology-tipping-points-we-will-reach-by-2030-2015-11 [https://perma.cc/P6CT-WWCK] (predicting the future growth of Internet usage around the world).

[87] *See* Matthew Close et al., *Leveraging Search Experts and Technology for Targeted Risk Oversight*, CORPORATE COMPLIANCE INSIGHTS (July 13, 2018), https://www.corporatecompliance insights.com/leveraging-search-experts-and-technology-for-targeted-risk-oversight/ [https://perma.cc/6AN6-7NF6] (describing different technologies and search engines that improve risk management); Bernard Marr, *The Complete Beginners Guide to FinTech That Everyone Can Understand*, FORBES (Feb. 10, 2017) https://www.forbes.com/sites/bernardmarr/2017/02/10/a-complete-beginners-guide-to-fintech-in-2017/#330777cd3340 [https://perma.cc/Y8WL-8C2R] (stating that domestic and international money transfers are easier with modern technology); J. Yannis Bakos & Michael E. Treacy, *Information Technology and Corporate Strategy*: *A Research Perspective,* 10 MIS Q. 107, 108 (June 1986) (stating that Information Technology improves internal, competitive, and business portfolio strategy).

[88] Bakos & Treacy, *supra* note 87, at 111.

[89] *Id.* at 115.

[90] *See* Marr, *supra* note 87 (providing examples of the rapid growth of FinTech).

[91] *See* Close, *supra* note 87 and accompanying text.

tions are ways in which an out-of-state parent corporation can assist and pass value to an in-state subsidiary corporation.[92]

C. The Impact of Modern Technology on Purposeful Availment

By design, personal jurisdiction relates to a party's use of benefits in specific geographical locations.[93] The Internet and modern technology have challenged courts to determine new methods of analyzing personal jurisdiction in the digital age.[94] For example, in 1997, in *Zippo Manufacturing. Co. v. Zippo Dot Com, Inc.*, the U.S. District Court for the Western District of Pennsylvania established the "*Zippo* test" for analyzing Internet-based personal jurisdiction.[95] Zippo Dot Com ("Zippo") was located in California with no physical presence in Pennsylvania.[96] Zippo's only connection to Pennsylvania was through advertising on its website.[97] Considering that traditional personal jurisdiction exists through intentional actions toward a specific state, the *Zippo* test measures the interactivity between the website and the forum state on a sliding scale.[98] The scale ranges from passive informational websites not establishing personal jurisdiction, to interactive vendor websites that seek interaction with users of other states establishing personal jurisdiction.[99] The court

[92] *See* MATTHIAS KRÜHLER ET AL., FIRST, DO NO HARM: HOW TO BE A GOOD CORPORATE PARENT 5–6 (2012) (presenting data on how parent corporations can assist subsidiaries through financing advantages, strategy development, corporate resources and functions, operational engagement, and business synergies).

[93] *See* Alan Trammell & Derek Bambauer, *Personal Jurisdiction and the Interwebs*, 100 CORNELL L. REV. 1129, 1157 (2015) (observing that personal jurisdiction is inherently territorial). Traditionally, personal jurisdiction has revolved around physical presence. *See, e.g.*, Burnham v. Superior Court of Cal., 495 U.S. 604, 619, 628 (1990) (stating that a court has jurisdiction over those summoned in its state); Pennoyer v. Neff, 95 U.S. 714, 723 (1877) (holding that a court may exert power only over persons and property within its limits). Because of its ease of accessibility and design, it is extremely difficult to determine location in the Internet context. Trammell, *supra,* at 1158. Judge Van Graaefieland equates the process of establishing law during the Internet era to boarding a moving bus. Bensusan Rest. Corp. v. King, 126 F.3d 25, 27 (2d Cir. 1997).

[94] *See, e.g.*, MacDermid, Inc. v. Deiter, 702 F.3d 725, 730 (2d Cir. 2012) (establishing personal jurisdiction by use of a computer server in the forum state); Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1124 (W.D. Pa. 1997) (developing a test (the "*Zippo* Test") for determining the personal jurisdiction of websites based on the interactivity of the website).

[95] *Zippo Dot Com*, 952 F. Supp. at 1124.

[96] *Id.* at 1121.

[97] *Id.*

[98] *See id.* at 1124 (distinguishing between "passive" and "active" websites).

[99] *Id.* A website that functions as advertisement is not interactive, and thus does not authorize personal jurisdiction. *See, e.g.*, Mink v. AAAA Dev. LLC, 190 F.3d 333, 337 (5th Cir. 1999) (holding that website not for ordering and containing only vendor contact information was passive). When a website deliberately sells products, personal jurisdiction is warranted. *See, e.g.*, CompuServe, Inc. v. Patterson, 89 F.3d 1257, 1263 (6th Cir. 1996) (allowing personal jurisdiction over a corporation whose website forms contracts for the sale of software products). There are, however, cases that exist within the grey area of the *Zippo* test. *See, e.g.*, Dagesse v. Plant Hotel N.V., 113 F. Supp. 2d 211, 222 (D.N.H. 2000) (examining whether jurisdiction in New Hampshire over out-of-state hotel based solely

held that Zippo purposefully availed itself of Pennsylvania's laws by pursuing business relations with individuals and Internet providers in Pennsylvania through its website.[100] Since *Zippo*, several circuit courts have adopted the *Zippo* test as part or all of their personal jurisdiction analysis in the Internet context.[101] In 2012, in *MacDermid, Inc. v. Deiter*, the Second Circuit Court of Appeals also examined personal jurisdiction relating to the Internet.[102] The Second Circuit held that a state had jurisdiction over a person whose sole interaction with the state was through accessing Internet files located on an in-state computer server.[103] The Second Circuit ruled that Deiter purposefully availed herself of Connecticut's laws because she was aware that the information was located on the Waterbury server and she accessed that server to retrieve confidential files.[104]

These cases highlight that although the courts are applying old rules, they are consistently revisiting them and modernizing ways of establishing personal

on website was proper). The website for Marriott International provided a phone number and online process for hotel reservations. *Id.* at 214. The District Court of New Hampshire held that analysis of Internet personal jurisdiction depends on whether the website forms business transactions or other commercial activities. *Id.* at 223. Because evidence of website transactions was not presented, general personal jurisdiction could not be established. *Id.* Moreover, specific jurisdiction was not present because the plaintiffs did not use the website to book their reservation. *Id.* at 218.

[100] *Zippo Dot Com*, 952 F. Supp. at 1126. Zippo sold news services to about three thousand individuals, and formed a business relationship with seven Internet providers, in Pennsylvania. *Id.*

[101] *See* Trammell, *supra* note 93, at 1150 (providing a table of which circuits have adopted the *Zippo* Test). The Sixth and Eighth Circuits use the *Zippo* Test, the First and D.C. Circuits have implicitly adopted the test, and the Third, Fourth, Fifth, and Ninth Circuits use it as one factor towards determining personal jurisdiction of websites. *Id.* The *Zippo* Test was able to spread from a district court to several jurisdictions because judges find it easy to use, especially given the complexity of the Internet. *Id.* at 1151 (stating that the *Zippo* Test provides judges a simple analysis for increasingly complicated technology).

[102] *See MacDermid*, 702 F.3d at 730 (establishing personal jurisdiction by use of a computer server in the forum state). The case involved MacDermid, Inc., a chemical company headquartered in Waterbury, Connecticut, and Jackie Deiter, a Canadian resident and an employee of a MacDermid subsidiary. *Id.* at 727. MacDermid Inc. stored confidential information on computer servers in Waterbury. *Id.* Employees were informed, as a condition of employment, that their confidential information was stored on the Waterbury server. *Id.* In violation of Connecticut trade secret law, Deiter accessed this server and forwarded confidential files to her personal email account. *Id.*

[103] *See id.* at 727 (showing purposeful availment through the intentional use of the company's server and awareness of the location of the server). On the other hand, in 2012, in *Dairy Farmers of America, Inc. v. Bassett & Walker International, Inc.*, the Eighth Circuit held that routine communication by phone calls and email with the Missouri-based corporation was not sufficient to establish personal jurisdiction with Missouri. 702 F.3d 472, 479 (8th Cir. 2012) (citing Viasystems, Inc. v. EBM-Papst St. Georgen GmbH & Co., KG, 646 F.3d 589, 594 (8th Cir. 2011); Inst. Food Mktg. Assocs., Ltd. v. Golden State Strawberries, Inc., 747 F.2d 448, 456 (8th Cir. 1984)).

[104] *MacDermid*, 702 F.3d at 730.

jurisdiction.[105] *Zippo* and *MacDermid, Inc.,* in their reexamination of the laws of personal jurisdiction, focus on one fundamental requirement: intent.[106]

III. MODIFYING THE UNITARY BUSINESS RULE

International business is growing through use of the Internet, online cash transferring, and other modern technologies.[107] The unitary business rule, although rooted in the 19th century, is supposedly flexible with changes in technology.[108] Unfortunately, the rule is flawed and needs revisiting in light of the Supreme Court's 2018 decision in *South Dakota v. Wayfair*, and the Court's consideration of modern technology and substantial nexus as defined by personal jurisdiction.[109] The unitary business rule has prevented states from receiving their fair percentage of interstate commerce.[110] Section A of this Part argues that the unitary business rule is overly expansive.[111] Section B of this Part promotes a new method of determining corporate tax jurisdiction for the sale of a subsidiary based on the fundamental principles of the Dormant Commerce Clause.[112]

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[105] *See supra* notes 98–104 and accompanying text.

[106] *See, e.g.*, *MacDermid*, 702 F.3d at 730 (allowing personal jurisdiction where the defendant was aware of the location of the server and used it); *Zippo Dot Com*, 952 F. Supp. at 1124 (holding that there is personal jurisdiction over businesses who knowingly use the Internet to enter into contracts and transmit files to foreign jurisdictions); *see also* uBID, Inc. v. GoDaddy Grp., Inc., 623 F.3d 421, 427 (7th Cir. 2010) (concluding advertisements, both physical and online, and an Anti-Cybersquatting claim are sufficient to show the defendant targeted Illinois); ALS Scan, Inc. v. Digital Serv. Consultants, Inc., 293 F.3d 707, 715 (4th Cir. 2002) (holding that uploading files to a website that is accessible in every state does not prove an intent to target every state).

[107] *See* U.N. DEP'T ECON. & SOC. AFFAIRS, *New Globalization Report: Three Mega-Trends Expected to Impact Our Future* (Oct. 19, 2017), https://www.un.org/development/desa/en/news/intergovernmental-coordination/new-globalization-report.html [https://perma.cc/R89X-83CR] (asserting an increased mobility of goods, services, labor, and funding in the modern, interconnected world). *But see* Lydia DePillis, *Foreign Investment in the United States Plunged 32% in 2017*, CNN MONEY (July 11, 2018), https://money.cnn.com/2018/07/11/news/economy/foreign-direct-investment-2017/index.html [https://perma.cc/Z28P-3EAS] (stating international investment has dropped in the past few years). One reason that was suggested is the political confusion surrounding Brexit and other surges in nationalism. *Id.*

[108] *See* Allied-Signal, Inc. v. Dir., Div. of Taxation ("*Allied-Signal N.J.*"), 504 U.S. 768, 786 (1992) (stating that the unitary business rule is flexible to changes in business).

[109] *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) (reverting "substantial nexus" to a foundational definition in light of modern technology); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 335 (1982) (O'Connor J., dissenting) (focusing on ASARCO's control over its subsidiaries as the determinative factor of a unitary business); *infra* notes 113–125 and accompanying text (analyzing a Supreme Court Dormant Commerce Clause decision and changes in modern technology).

[110] *See* D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988) (noting that interstate commerce must pay taxes for the governmental benefits it enjoys); W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938) (noting that the Commerce Clause does not protect interstate commerce from fairly apportioned taxation); *infra* notes 113–118 and accompanying text.

[111] *See infra* notes 113–125 and accompanying text.

[112] *See infra* notes 126–135 and accompanying text,

A. The Unitary Business Rule Does Not Properly Recognize the Flow of Value

The Supreme Court's application of the unitary business rule in 1982 in *ASARCO, Inc. v. Idaho State Tax Commission* exemplifies its flaws.[113] ASARCO held 51.5% of Southern Peru Copper Corp., but did not exercise complete managerial control because of a contract formed with the other shareholders.[114] Thus, the Court found insufficient connection to determine that a unitary business existed.[115] Illinois argued that the unitary business rule included investments that contribute to the taxpayer's business, but the Court held that this would be overly inclusive because every investment can contribute to the taxpayer's business in some way.[116] The dissent argued that Southern Peru provided benefits of profit stability and a steady supply of raw materials to ASARCO, and thus, ASARCO was responsible for compensating the state from which it received benefits.[117] *ASARCO* shows that the current unitary business analysis is overly focused on managerial control, neglecting the importance of benefits derived from other methods.[118]

Modern technology exacerbates the flaws of the unitary business rule because ever-increasing Internet interconnectivity offers more ways to pass value to a subsidiary than functional integration, centralization of management, and economies of scale.[119] According to the Boston Consulting Group, there are at least fifteen ways a parent corporation can add value to their subsidiary corporation under the following categories: (1) financing advancement; (2) strategic development; (3) corporate resources and functions; (4) operational engagement; and (5) business synergy.[120] Financing large purchases or growth for a

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[113] *See ASARCO*, 458 U.S. at 335 (O'Connor J., dissenting) (focusing on ASARCO's control over its subsidiaries as the determinative factor of a unitary business).

[114] *Id.* at 320–21 (majority opinion). ASARCO controlled Southern Peru with three other shareholders. *Id.* at 322. The other three shareholders required ASARCO to sign an agreement that relinquished majority control. *Id.* The agreement assigned six out of thirteen directors to ASARCO and another six to the shareholder group. *Id.* The final member is jointly appointed, and eight votes are required to pass resolutions. *Id.*

[115] *Id.* at 321.

[116] *Id.* at 326 (stating that the rational extent of Idaho's argument would be the inclusion of all investment as contributions towards the taxpayer's business).

[117] *Id.* at 332, 342 (O'Connor J., dissenting).

[118] *See ASARCO*, 458 U.S. at 332–36, 340–43 (arguing that the Court is extending the Constitutional restrictions on state taxation to effect policy). The Court unnecessarily constrains the state's power to choose their tax structure and overlooks the benefits Southern Peru provides to ASARCO upon which the state can tax. *Id.* at 340.

[119] *See* KRÜHLER, *supra* note 92, at 5–6 (illustrating methods a parent corporation can assist a subsidiary without functional integration, centralization of management, and economies of scale).

[120] *Id.* at 5–6, 15. Financing advantages include external funding, internal funding, and tax optimization. *Id.* at 6. Strategy development refers to strategic direction, active mergers and acquisitions, and protection from capital market pressure. *Id.* Corporate resources and functions are the benefits derived from corporate assets, central functions, and people advantages, such as employer branding.

subsidiary corporation is simpler now with advancements in FinTech.[121] Strategic development and the implementation of business synergies are more effective with the use of information technology.[122] Consequently, research and acquisition of subsidiary corporations with similar benefits to a parent corporation, like ASARCO and Southern Peru, is more valuable and profitable when using the Internet.[123] Lastly, corporate oversight and management are more efficient at risk oversight through the Internet.[124] With these methods of assisting subsidiary corporations, out-of-state parent corporations can provide significant value to in-state subsidiaries without facing that state's taxation upon the disposition of that subsidiary.[125]

B. New Apportionment Requirements Based on Old Principles

The unitary business rule is only one constitutional method of determining tax jurisdiction.[126] The Supreme Court should review the unitary business rule in the context of *Wayfair* and the Due Process Clause.[127] Two factors—a flow of value between the multistate corporations and substantial benefits from the state to the out-of-state corporation—determine when a taxpayer has a substantial nexus with the state.[128] A flow of value is the original requirement for tax jurisdiction over out-of-state corporate income.[129] When there is a flow of

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Id. Operational engagement involves budgeting and monitoring, corporate initiatives, and fostering cooperation. *Id.* at 6. Lastly, business synergies are sales synergies, managerial synergies, and operational synergies. *Id.* Each of these fifteen benefits are more accessible without functional integration and centralization of management because of modern technology. *See supra* note 88–91 and accompanying text (demonstrating advancements in business through information technology).

[121] *See* Marr, *supra* note 87 (providing examples of different technological services that allow simpler money transfers for startups, small businesses, and international corporations).

[122] *See* Bakos & Treacy, *supra* note 87, at 114 (diagramming methods that corporations can use to maximize their Information Technology to provide advantages over competitors).

[123] *See id.* at 116 (discussing how a major competitive factor between rival corporations is bargaining with suppliers). ASARCO does not have to negotiate for resources because of its relationship with Southern Peru. *ASARCO*, 458 U.S. at 342 (O'Connor J. dissenting).

[124] Close, *supra* note 87.

[125] *See infra* notes 126–136 and accompanying text (arguing for taxation based on a flow of value and governmental services rendered).

[126] *See Allied-Signal N.J.*, 504 U.S. at 786–87 (repeating multiple times that the unitary business rule is not constitutionally required for taxing jurisdiction).

[127] *See supra* notes 23–27, 38–48 and accompanying text.

[128] *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 178–79 (1983) (stating that the requirement for a unitary business is a flow of value. One potential way of satisfying this requirement is showing the three hallmark factors, however it can be demonstrated by other means); Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 442 (1944) (stating that the state may tax a proportionate amount of income derived from property to sales that receive the protections of the state); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (holding that the state may tax to receive compensation for services rendered).

[129] *Container Corp.*, 463 U.S. at 178–79; *see* State R.R. Tax Cases, 92 U.S. 575, 606–07 (1875) (assessing the value of the railroad parts with respect to the entire railroad, rather than separately).

value from an out-of-state parent corporation to an in-state subsidiary, the parent intended to use protections, resources, and benefits from the foreign state, providing jurisdiction for the state to tax the disposition of the corporate interest or distributions to the out-of-state stockholders.[130] The determination of whether a flow of value exists should be analyzed on a case-by-case basis because changes in technology will likely continue to add additional methods of exchanging value between corporations.[131]

A corporation's receipt of benefits from a state justifies taxation so the state can be compensated for providing them.[132] Nevertheless, a substantial nexus based on the use of state resources cannot be too low a standard because a taxpayer's acceptance of substantial benefits from the state is required.[133] As shown by S. 106, states can use minimum sales and transaction thresholds in sales tax to ensure that insufficient connections from small businesses or large corporations with minimal in-state transactions are not burdened by the state's tax.[134] States can impose similar requirements on other factors, such as payroll, property, and corporate value, for the sale of subsidiaries.[135] In applying these two factors, states can fairly tax out-of-state income.[136]

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[130] *See Int'l Harvester*, 322 U.S. at 421–22 (stating that a state may tax out-of-state income that relates to in-state commerce because it receives an abundance of state benefits); *Int'l Shoe*, 326 U.S. at 319 (holding that when a company conducts activities in a state, it receives benefits from the state); *see also MacDermid*, 702 U.S. at 730 (holding intent to avail oneself of a foreign jurisdiction was present when Deitner was aware of the location she was accessing and proceeded to interact with that location) Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1124 (W.D. Pa. 1997) (designing a test that equates business in a foreign jurisdiction with an intent to avail oneself to the state). When a corporation and a subsidiary exchange value, both are acting with the knowledge of one another's location and the intent to use the resources of each other's state. *See, e.g.*, Burger King Corp. v. Rudzewicz, 471 U.S. 462, 482 (1985) (holding that forming a franchising contract with a foreign corporation that includes a choice-of-law provision avails oneself to that state). Of course, the Supreme Court's decision in 1992 in *Allied-Signal, Inc. v. Director, Division of Taxation* proved that mere ownership is not sufficient for substantial nexus. *See Allied-Signal N.J.*, 504 U.S. at 769 (rejecting New Jersey's argument that the income should be apportioned based solely because of ownership).

[131] *See supra* notes 86–92 and accompanying text. This would close, but not completely eliminate, the gap between the current unitary business threshold and discrete business enterprise. *See supra* note 54 and accompanying text.

[132] *See Int'l Harvester*, 322 U.S. at 442 (stating that the state may tax a proportionate amount of income from property or sales that receive the protections of the state); *J.C. Penney*, 311 U.S. at 444 (holding that the state may tax to receive compensation for services rendered).

[133] *See* Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009) (stating that the substantial nexus requirement necessitates that the taxpayer receive substantial benefits from the state).

[134] *See, e.g.*, S. 106 § 8, 2016 Leg. Assemb., 91st Sess. (S.D. 2016) (requiring either $100,000 in sales or 200 transactions); 830 MASS. CODE REGS. 64H.1.7(3) (2017) (requiring either $500,000 or 100 transactions).

[135] *See, e.g.*, S.D.S. 106 § 1 (creating a threshold of 200 transactions and $200,000 sales); 830 MASS. CODE REGS. 64H.1.7(3) (setting a threshold at 100 transactions or $500,000 sales); Drenkard, *supra* note 14 (arguing that property and payroll factors may accurately consider the benefits a state provides to a corporation).

[136] *See supra* notes 126–135 and accompanying text.

CONCLUSION

Wayfair expanded state tax jurisdiction by overruling the physical presence rule in the Dormant Commerce Clause's substantial nexus requirement. This opens the door to challenging other institutionalized forms of tax jurisdiction. Value passes between corporations more seamlessly than ever. The unitary business rule imposes arbitrary standards and does not properly recognize the benefits certain out-of-state corporations receive from other states. Modifying the unitary business rule to consider the flow of value and the benefits given by the state would allow states to tax income earned from their services, and receive funds for those services.

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