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Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective

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I. INTRODUCTION

The collection of rules that falls under the rubric of "jurisdiction to tax" has aptly been described as "a body of law in search of a theory."[1] Although this Article lays no claim to advancing such a theory, it does seek to provide a broad theoretical perspective on jurisdiction-to-tax issues raised by income and consumption taxation in the new economy. It is designed to suggest ways of thinking about the fundamental questions involved, questions that are often obscured by a preoccupation with the application of specific jurisdiction-to-tax rules to individualized fact patterns in particularized contexts. In short, this Article is designed to establish a framework for exploring the questions to which the balance of the symposium is directed.

II. JURISDICTION TO TAX VERSUS JURISDICTION TO COMPEL COLLECTION OF TAX: OVERVIEW

Analysis of jurisdiction-to-tax issues often fails to distinguish clearly between two discrete aspects of jurisdiction to tax. The first, which I shall call "substantive" jurisdiction to tax, relates to the power of a State[2] to impose tax on the subject matter of the exaction. Substantive jurisdiction to tax includes such questions as whether a State has the power to impose a tax on the income that a nonresident earns from sources within the State or to impose a tax on goods or services purchased outside but consumed within a State. The second, which I shall call "enforcement" jurisdiction, relates to the power of a State to compel collection of the tax over which it has "substantive" tax jurisdiction. Enforcement jurisdiction includes such questions as whether a State has power to enforce the collection of a tax on income earned by a nonresident from sources

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[1] Kulick v. Dep't of Revenue, 624 P.2d 93, 96 (Or. 1981). Although Justice Linde made this observation in *Kulick* in the context of the restraints that the U.S. Constitution imposes on subnational taxing power, the observation is applicable as well to national and international rules governing jurisdiction to tax.

[2] Throughout this Article, general references to the "State" shall include both national and subnational States. Specific references to the American subnational States will be denominated as "subnational" States, except where context renders such a designation unnecessary.

within the State or whether a State has power to enforce the collection of a tax on goods or services purchased by an in-state consumer from a remote vendor.[3]

From the outset, I wish to make it clear that I do not view substantive jurisdiction to tax and enforcement jurisdiction as air-tight categories. To the contrary, the criteria that are employed for determining the existence of substantive tax jurisdiction may be the same as those employed for determining the existence of enforcement jurisdiction. Nevertheless, because the question of whether a State has jurisdiction to impose a tax is often discrete from the question of whether a State has power to compel collection of a tax and because these questions are often addressed to different participants in the economic activity associated with the tax base at issue, the distinction between the two types of jurisdiction can serve a useful function in analysis of the broader, undifferentiated question of "jurisdiction to tax."

A. INCOME TAXES

1. Substantive Jurisdiction to Tax. There are two fundamental, but alternative, predicates for a State's substantive jurisdiction to tax income: residence and source. These principles are widely accepted at the international, national, and subnational levels. They underlie the international tax treaty structure;[4] they are

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[3] The discussion in the text relates to the legal power to enforce the tax, but there are practical issues as well. A State may have the power to enforce a consumption tax against individual consumers—and therefore technically has "enforcement" jurisdiction—but may lack an effective enforcement mechanism if it has no power to require a remote vendor to collect the tax. In that case, the absence of enforcement jurisdiction over the out-of-state vendor will effectively deprive the State of the ability to collect a consumption tax with respect to the goods or services sold by such vendor to local consumers, even if such local consumers have a legal obligation to remit the tax. This, of course, reflects the contemporary state of affairs with respect to remote vendors selling to local consumers under the American retail sales tax (RST). By contrast, under the European Union's (EU) value added tax (VAT), the sale by a remote (unregistered) trader to a private consumer will not create even theoretical enforcement jurisdiction over the individual consumer because he or she is not a "taxable person" required to remit the tax. *See infra* notes 72-77 and accompanying text (elaborating on this and other distinctions between American RST and EU VAT).

[4] *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (Jan. 28, 2003) [hereinafter OECD MODEL].

embodied in national taxing regimes;[5] and they are reflected in constitutional restraints on subnational taxing powers.[6]

a. Residence. A State has substantive jurisdiction to tax income on the basis of residence. This means that a State has power to tax the income of an individual or entity based solely on the fact that the individual or entity is a resident of that State and without regard to the source of that income. There is no single definition of residence for tax purposes. For example, with respect to individuals, a State may define residence by reference to domicile, citizenship, presence in the State for a specified period of time, or presence of an abode in the state.[7] Similarly, with respect to corporations, a State may define residence by reference to the commercial domicile, place of incorporation, location of corporate headquarters, or place of "effective" or "real" management.[8] Despite the existence of various definitions of residence for tax purposes, there is a common thread among them: the special relationship of the individual or entity to the State. It is this special relationship that confers upon the State the power to tax all of a resident's income without regard to the source of such income.

As the U.S. Supreme Court has observed: "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a

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[5] *See* AMERICAN LAW INSTITUTE, FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION 6 (1987).

[6] *See* 1 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 6.03 (3d ed. 1998) [hereinafter HELLERSTEIN & HELLERSTEIN].

It is worth noting that this Article is *not* concerned primarily with "[t]he basic task of international [income] tax rules," namely, "to resolve the competing claims of residence and source nations in order to avoid the double taxation that results when both fully exercise their taxing power." Michael Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1033 (1992). Rather, this Article is concerned primarily with the threshold question of whether, and under what circumstances, jurisdiction to tax (and to enforce collection of the tax) exists at all. Consequently, its principal focus is on the residence and source principles as *alternative* rather than *competing* concepts. Nevertheless, it is sometimes impossible to talk sensibly about residence and source as alternative concepts without recognizing the "competitive" implications of the discussion. Accordingly, I do occasionally address residence and source principles as competing jurisdictional principles, even though it is not the principal focus of this Article.

[7] *See generally* RICHARD DOERNBERG ET AL., ELECTRONIC COMMERCE AND MULTIJURISDICTIONAL TAXATION 73-75 (2001).

[8] *Id.* at 75-76.

basis for such taxation."[9] The underlying justification for this "universally recognized" proposition is that "[e]njoyment of the privileges of residence in the State and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the cost of government."[10] Accordingly, "[a]s to residents [a State] may, and does, exert its taxing power over their income from all sources, whether within or without the State."[11]

The same principles apply regardless of the particular predicate for which a person is deemed a resident, *i.e.*, "by reason of his domicile, residence, place of management or any other criterion of a similar nature."[12] For example, in sustaining the application of the residence principle of taxation on the basis of citizenship in the frequently cited case of *Cook v. Tait*,[13] the U.S. Supreme Court held that the United States had the power to tax the income that a U.S. citizen derived from property located in Mexico, even though the taxpayer was both a permanent resident and domiciliary of Mexico.[14] In so holding, the U.S. Supreme Court affirmed the "principle . . . that the government, by its very nature, benefits the citizen and his property wherever found"; that "the basis of the power to tax" depends on the relationship of the citizen to the United States; and that the government therefore has the power to tax the citizen on his income regardless of his foreign domicile or the foreign source of his income.[15]

In short, substantive jurisdiction to tax income on the basis of residence is conferred by the relationship of the State to the person with the right to the income. Once that relationship is established, the State possesses the power to tax all of the resident's income regardless of the location of the activities that produced it.

b. Source. A State has substantive jurisdiction to tax income on the basis of source. This means that a State has the power to tax the income of an individual or entity based solely on the fact that

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[9] New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 312-13 (1937). The unusual, but acceptable, spelling of domicile is the Court's.

[10] *Id.* at 313.

[11] Shaffer v. Carter, 252 U.S. 37, 57 (1920).

[12] OECD MODEL, *supra* note 4, art. 4(1).

[13] 265 U.S. 47 (1924).

[14] *Id.* at 56.

[15] *Id.*

the income has its source in the State and without regard to the residence of the person with the right to the income. Like the concept of residence for tax purposes, the concept of source for tax purposes has no single definition. Rather, it is a collection of definitions with a common theme, namely, the geographical location of property or activities that produce (or are deemed to produce) the income. For example, the source of income from real property is generally considered to be where the real property is located;[16] the source of income from dividends is often considered to be the State of the corporate payor's residence;[17] the source of income of royalties from the license of intellectual property is commonly considered to be the State where the intellectual property is used;[18] and the source of income from business profits is typically considered to be the location of the activities giving rise to the business profits.[19] This territorial relationship confers upon the State the power to tax the income arising out of that relationship without regard to the residence of the person with the right to the income.

The source principle and its theoretical underpinnings are as "universally recognized"[20] as the residence principle and its theoretical underpinnings. The basic theory underlying source taxation is that a State providing the environment in which income-producing activity occurs—the legal and economic infrastructure, fire and police protection, an educated workforce, etc.—is entitled to tax a portion of the income that its contribution made possible, regardless of the residence of the recipient.[21] As the U.S. Supreme

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[16] *See, e.g.*, OECD MODEL, *supra* note 4, art. 6; I.R.C. § 861(a)(4) (West 2003).

[17] *See, e.g.*, *id.* art. 10(2); I.R.C. § 861(a)(2).

[18] *See, e.g.*, *id.* art. 12 & cmty. to art. 12; I.R.C. § 861(a)(4).

[19] *See, e.g.*, *id.* art. 7; I.R.C. §§ 864, 871(b), 882(a)(1). Several countries with federal systems, including the United States, Canada, and Switzerland, determine the source of business profits among subnational jurisdictions by formulary apportionment. For a discussion of formulary apportionment, see 1 HELLERSTEIN & HELLERSTEIN, *supra* note 6, chs. 8-9; Jack Mintz & Joann M. Weiner, *Exploring Formula Allocation for the European Union* (forthcoming www.umich.edu/~iinet/euc/PDFs/2002%20Papers/MintzWeiner.PDF). *See also Towards an Internal Market Without Tax Obstacles: A strategy for providing companies with a consolidated corporate tax base for the EU-wide activities*, COM(2001)582 final (Oct. 23, 2001) (describing Commission of the European Communities' recommendation that formulary apportionment be used for assigning consolidated corporate tax base among EU member countries).

[20] New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 313 (1937).

[21] *See, e.g.*, Glenn W. Fisher, *Toward a Theory of Personal Income Tax Jurisdiction*, 33

Court declared in response to the contention that a State lacked jurisdiction to tax a nonresident's income:

> That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement.[22]

In short, substantive jurisdiction to tax income on the basis of source is conferred by the relationship of the State to the property or activities that produce the income. Once that relationship is established, the State possesses the power to tax the income attributable to those activities regardless of the residence of the person with the right to the income.

2. Enforcement Jurisdiction. Assuming that a State has substantive jurisdiction to tax income on the basis of either residence or source, the question then arises whether the State has jurisdiction to compel collection of the tax. This inquiry has both theoretical and practical aspects. A State may have the theoretical power to enforce a tax but nevertheless lack an effective enforcement mechanism because the theoretically sound path to tax collection is administratively or economically impractical.

a. Personal Jurisdiction Over Earner. If a State has personal jurisdiction over the individual or entity who earns the income, enforcement of an obligation to pay an income tax ordinarily is unproblematic. Since a taxpayer over whom the State has personal jurisdiction is, by hypothesis, answerable in the State's courts and subject to a default judgment should the taxpayer fail to appear, the State is usually—but not always—in a strong position to enforce the taxpayer's substantive tax obligation. Thus, in most cases, a taxpayer whose substantive tax obligation is attributable to

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TAXES 373, 377 (1955); Graetz & O'Hear, *supra* note 6, at 1033-40.

[22] Shaffer v. Carter, 252 U.S. 37, 57 (1920).

residence in a State, and who is therefore subject to personal jurisdiction on the basis of residence,[23] is likely to have sufficient legal relationships within the State or locally attachable assets as to make the risk of a default judgment a serious disincentive to ignoring a tax obligation. Similarly, a nonresident taxpayer whose substantive tax obligation is attributable to the source principle, and who is subject to personal jurisdiction on the basis of its local contacts,[24] is likely to have sufficient legal relationships within the State or locally attachable assets as to make the risk of a default judgment a serious disincentive to ignoring a tax obligation.

But now let us return briefly to *Cook v. Tait*,[25] in which the U.S. Supreme Court sustained substantive jurisdiction to tax on a residence basis a U.S. citizen who was "permanently resident and domiciled"[26] in Mexico and whose income was derived from "real and personal property located in Mexico."[27] Even if the United States could obtain a default judgment over such a citizen, unless the citizen had assets in the United States, which a citizen like Cook might well not have,[28] enforcement of the claim would be daunting at best. Indeed, under the general principle of territorially limited state sovereignty, "sovereignty prevents a State from pursuing its tax claims in the territory of other States, since this would involve

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[23] "[T]here can be no sovereignty objections to a State requiring its own citizens to appear and defend a suit brought in its courts." Lea Brilmayer, *How Contacts Count: Due Process Limitations on State Court Jurisdiction*, 1980 SUP. CT. REV. 77, 85. Although it is conceivable that a natural or juridical person could be considered a resident for substantive jurisdiction-to-tax purposes but not for personal jurisdiction purposes or vice versa, the possibility seems sufficiently remote as to require no further discussion.

[24] Again, by hypothesis, *i.e.*, the assumption is that whatever in-state activities give rise to substantive jurisdiction to tax on the basis of source (*e.g.*, the existence of a permanent establishment in the State) likewise give rise to personal jurisdiction over the nonresident in the State's courts. I consider below the question of enforcement when there is no personal jurisdiction over a nonresident individual or entity whose income has its source within a State. *See infra* notes 36-40 and accompanying text.

[25] 265 U.S. 47 (1924). *See also supra* notes 13-15 and accompanying text.

[26] *Cook*, 265 U.S. at 54.

[27] *Id.*

[28] There is nothing in the *Cook* opinion or in the opinion below, *Cook v. Tait*, 286 F. 409 (D. Md. 1923), to indicate whether Cook had any assets in the United States, although his income "was derived solely from real and personal property permanently located at all times without the territorial jurisdiction of the United States . . . ." *Cook*, 265 U.S. at 48 (stating argument for plaintiff in error). For whatever reason, Cook nevertheless responded to the demand to file an income tax return, paid the first installment of the amount assessed under protest, and sued in federal district court to recover the amount paid. *Id.* at 53-54.

extraterritorial exercise of its powers."[29] Moreover, despite the fact that the 2003 revision of the OECD Model Tax Convention has an optional provision for mutual assistance in the collection of taxes,[30] and the United States Model Income Tax Convention[31] contains a specific, but limited, clause on tax collection,[32] the prevailing international norm is reflected in the so-called "revenue rule"—"a longstanding common law doctrine that courts of one sovereign will not enforce final tax judgments or unadjudicated tax claims of other sovereigns."[33]

We therefore confront the first instance of the problem that lies at the heart of the conundrum of jurisdiction to tax in the new economy—albeit in a very "old economy" setting—namely, the problem States confront when there is substantive jurisdiction to tax but limited jurisdiction to compel collection of the tax. The obvious theoretical solution to the problem, mutual assistance

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[29] Francisco García Prats, *Mutual Assistance in Collection of Tax Debts* 4, *available at* http://unpan1.un.org/intradoc/groups/public/documents/un/unpan001659.pdf (providing paper presented at the tenth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters, Geneva, Switzerland, September 10-14, 2001).

[30] OECD MODEL, *supra* note 4, art. 27.

[31] UNITED STATES MODEL INCOME TAX CONVENTION OF SEPTEMBER 20, 1996, *available at* http://www.irs.gov/pub/irs-trty/usmodel.pdf [hereinafter U.S. MODEL]. The United Nations Model Tax Convention makes no reference to assistance in recovering other States' tax claims (although it does refer to the exchange of information between States). UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES art. 26 (2001), *available at* http://unpan1.un.org/intradoc/groups/ public/documents/un/unpan002084.pdf [hereinafter UN MODEL].

[32] García Prats, *supra* note 29, at 3. The U.S. Model Income Tax Treaty provides:

> Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the Convention from taxation imposed by that other State does not inure to the benefit of persons not entitled thereto. This paragraph shall not impose upon either of the Contracting States the obligation to carry out administrative measures that would be contrary to its sovereignty, security, or public policy.

U.S. MODEL, *supra* note 31, art. 26(4). In some instances, however, the United States has entered into a more robust and detailed agreement regarding mutual assistance to collect taxes with its close trading partners. For example, Article 26A of the Canada-U.S. treaty, which was incorporated into the treaty in the protocol signed March 17, 1995, contains such an agreement. Revised Protocol Amending the Convention between the United States and Canada with respect to taxes on income and on capital of September 26, 1980, Mar. 17, 1995, U.S.-Can., art. 15, 2030 U.N.T.S. 236, *available at* http://www.intltaxlaw.com/treaties/canada/protocol3.htm#Article%2015.

[33] Attorney Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 109 (2d Cir. 2001).

among States in the collection of tax debts, is one so fraught with practical political and legal concerns[34] that serious consideration of the solution would warrant a separate symposium devoted entirely to that issue. For present purposes, it is appropriate simply to identify the fundamental problem—which is of minor practical significance in the context at issue[35]—and to return to it in more depth when we confront it in the contexts where the problem is of enormous practical significance.

b. Personal Jurisdiction Over Withholding Agent. Assuming that a State has substantive jurisdiction to tax income on the basis of source but lacks (or would have difficulty establishing) personal jurisdiction over the earner of the income,[36] a State may seek to enforce the substantive tax obligation by requiring withholding of the tax at source rather than through collection of tax directly from the earner. Most income tax regimes explicitly provide for withholding at source, at least with respect to categories of income in which direct enforcement of the substantive tax obligation against the earner of the income may be problematic (*e.g.*, income from passive investments).[37]

As a threshold matter, one might raise the question as to whether there are any objections to the use of involuntarily conscripted collection agents to assist the State in its efforts to enforce substantive tax obligations of those over whom it has no personal jurisdic-

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[34] *See supra* notes 29-33 and accompanying text. In the U.S. subnational context, the enforcement of the tax claims of one subnational State in the courts of another subnational State is facilitated by the existence of the Full Faith and Credit Clause, U.S. CONST. art. IV, § 1, which requires a state court to enforce the judgments of the courts of sister States. However, a State is not required to give full faith and credit to a sister state court's judgment unless there was jurisdiction to enter the original judgment. Williams v. North Carolina, 325 U.S. 225, 229 (1945).

[35] Most countries do not employ citizenship as a general predicate for asserting residence-based jurisdiction, DOERNBERG ET AL., *supra* note 7, at 75, and when they do, the citizen may well have legal relationships or assets in the country of citizenship that would be jeopardized by a default judgment for failure to pay a tax obligation.

[36] For reasons suggested above, I am assuming that there is personal jurisdiction over the person whose income is taxable on the basis of residence. *See supra* note 23 and accompanying text.

[37] *See, e.g.*, I.R.C. §§ 871, 881, 882, 1441, 1442 (West 2003) (imposing 30% tax upon U.S. source interest, dividends, rents, annuities, and "other fixed or determinable annual or periodical gains, profits, and income," earned by nonresident alien individuals or foreign corporations, and imposing tax withholding obligation upon "all persons . . . having the control, receipt, custody, disposal, or payment of any of the [specified] items of income").

tion. Isn't the State doing indirectly, one may ask, what it cannot do directly? Although this issue does not appear to have generated much controversy over the years, the U.S. Supreme Court had little difficulty resolving it when confronted with a challenge to a Wisconsin withholding tax on dividends paid to out-of-state shareholders by a corporation doing business in Wisconsin. The Court initially observed that the source principle had no less application to a tax on dividends derived from sources within the State than to any other source-based tax:

> A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers. And the privilege of receiving dividends derived from corporate activities within the state can have no greater immunity than the privilege of receiving any other income from sources located there.
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> . . . The earnings in Wisconsin, their withdrawal from Wisconsin and their distribution in the form of dividends have resulted in the receipt of income by the stockholder-taxpayers and it is Wisconsin's relation to all which permits it to levy the tax.[38]

The Court then disposed of the objection that there was no personal jurisdiction over the shareholders, stating flatly that "[p]ersonal presence within the state of the stockholders-taxpayers is not essential to the constitutional levy of a tax upon so much of the corporation's Wisconsin earnings as is distributed to them."[39] Finally, in addressing the point that is central to the present discussion, the Court declared unequivocally that

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[38] Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 441-42 (1944) (citations omitted).

[39] *Id.* at 441.

> the fact that the stockholder-taxpayers never enter Wisconsin and are not represented in the Wisconsin legislature cannot deprive it of its jurisdiction to tax.... So long as the earnings actually arise there, and their withdrawal from the state and ultimate distribution, in whole or in part, to stockholders are subject to some state control, the conditions of state power to tax are satisfied, *even though some practically effective device be necessary in order to enable the state to collect its tax—here by imposing on the corporation the duty to withhold the tax on so much of the earnings withdrawn from the state as may be distributed in dividends. Imposition of this requirement on the corporation transgresses no constitutional limitations.*[40]

When a State looks to a withholding agent rather than the earner of the income to enforce collection of a substantive tax obligation, the personal jurisdiction inquiry naturally focuses on the person with the withholding obligation rather than on the earner of the income. The criteria for establishing personal jurisdiction over an income tax withholding agent do not appear to be different in substance from the criteria for establishing personal jurisdiction over the earner itself. Accordingly, if a withholding agent is resident in the State (*e.g.*, a resident corporation that pays dividends to a nonresident shareholder) or has substantial local contacts with the State (*e.g.*, a patent licensee that pays royalties to a nonresident patent licensor for use of the patent within the taxing State), then the State ordinarily can enforce the substantive tax obligation, notwithstanding a lack of personal jurisdiction over the earner of the income.

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[40] *Id.* at 443-44 (citations and footnotes omitted) (emphasis added). It is noteworthy that the Court cited for this last proposition cases sustaining sales tax collection obligations imposed on retailers, *id.* (citing Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 364 (1941); Nelson v. Montgomery Ward & Co., 312 U.S. 373 (1941)), discussed *infra* notes 87-91 and accompanying text, because it suggests a theme I will stress throughout—that income and consumption tax enforcement issues have much in common.

B. CONSUMPTION TAXES

Consumption taxes may be broadly defined to embrace any levy on the consumption of goods, services, and intangible property, including general sales and turnover taxes, transaction taxes, value added taxes (VATs), and retail sales taxes (RSTs).[41] For purposes of the ensuing discussion, however, the term "consumption taxes" is used in a somewhat narrower sense to mean taxes that are designed, at least in principle, to reach "final" consumption, even though in practice substantial amounts of "intermediate" consumption may be subject to tax. In other words, the ensuing discussion is directed largely to the VATs now in force in the European Union (EU) and in more than one hundred countries worldwide[42] and to RSTs and similar sales taxes employed in the American states and in a number of countries.[43]

1. Substantive Jurisdiction to Tax.

a. Place of Consumption. A State has substantive jurisdiction to tax consumption where consumption occurs. This virtually axiomatic proposition is reflected in the OECD's statement of the overarching consumption tax principle that "[r]ules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place . . . ."[44] It is likewise reflected in existing consumption tax rules in many States—at least with respect to goods—which are typically taxed at destination,

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[41] *See* DOERNBERG ET AL., *supra* note 7, at 94-95; 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 12.01.

[42] DOERNBERG ET AL., *supra* note 7, at 95-97. Unless otherwise specified, references in the ensuing discussion to VATs will be to the VAT currently levied by the fifteen Member States of the EU (and soon to be levied by a number of additional EU Member States).

[43] *Id.* at 98.

[44] OECD, TAXATION AND ELECTRONIC COMMERCE: IMPLEMENTING THE OTTAWA TAXATION FRAMEWORK CONDITIONS 18 (2001) [hereinafter OTTAWA FRAMEWORK].

where consumption is presumed to occur,[45] and are zero-rated[46] or exempted[47] at origin when destined for export.

Whatever may be the philosophical justification for a consumption tax—whether the benefit principle (based on the view that consumption expenditures may be tied to enjoyment of governmental services),[48] the desire to encourage savings (at least by comparison to an income tax),[49] or simply a convenient way to raise substantial sums of money[50]—the view that there is jurisdiction to tax consumption where consumption takes place is unassailable. As the U.S. Supreme Court declared in sustaining an Iowa "use tax," which it characterized as "a non-discriminatory excise laid on all personal property consumed in Iowa":

> The property is enjoyed by an Iowa resident partly because the opportunity is given by Iowa to enjoy property no matter whence acquired. The exaction is

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[45] "Because VAT is essentially a consumption tax and because it is reasonable to assume that the goods and services are consumed at their place of their destination, the tax is levied in principle at the rate of the Member State of destination." DOERNBERG ET AL., *supra* note 7, at 104.

[46] Under the EU VAT, for example, if a taxable supply is zero-rated, the supplier need not collect VAT on the sale of the supply, and the supply is effectively relieved of VAT altogether at origin, because the supplier can obtain a credit for the payment of any VAT related to its acquisition of the supply. DOERNBERG ET AL., *supra* note 7, at 101-21.

[47] Under the American RST, for example, States generally exempt from tax goods that are exported from the State. *See* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 18.02. For readers unfamiliar with both VATs and RSTs, the nomenclature ("zero-rated," "exempt," etc.) can be confusing, particularly because there are a number of what French teachers are fond of calling *faux amis* (false friends): words that look alike but have different meanings in English and French (*e.g.*, chair (flesh), pain (bread), sensible (sensitive)). Hence, the concepts of "exemption," "taxpayer," or "taxable person" have different meanings (or at least implications) for the two systems. *See, e.g.*, *infra* notes 71-90 and accompanying text. Throughout this discussion, I shall do my best to point out these differences where confusion might otherwise result, but with an eye towards keeping unnecessary clutter out of the Article. *See also* Charles E. McLure, Jr., *EU and US Sales Taxes in the Digital Age: A Comparative Analysis*, 56 BULL. INT'L FISCAL DOC. 135, 137 (2002).

[48] *See* Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 381-82 (1997). In mentioning this justification, I am not suggesting (nor is McLure) that it has been demonstrated that the benefit principle in fact justifies a consumption tax.

[49] *See* RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 305 (5th ed. 1989).

[50] JOHN F. DUE & JOHN L. MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION 15 (2d ed. 1994).

> made against the ultimate consumer—the Iowa resident who is paying taxes to sustain his own state government.[51]

The widely accepted view that there is substantive jurisdiction to tax consumption where consumption occurs does not mean that there is an equally broad consensus as to where consumption takes place (or is deemed to take place) for consumption tax purposes. For an individual, one might define the place of consumption as the place where consumption of goods or services actually occurs; the place where the goods or services to be consumed are received; or the individual's usual place of residence.[52] Similarly, for a business one might define the place of consumption as the actual place of consumption, the place where the goods or services are transferred, or the place where the recipient maintains its business presence.[53] These different approaches to determining the place of consumption may simply reflect the practical recognition that we frequently need to rely on proxies for the actual place of consumption because strict reliance on the actual place of consumption would be administratively impractical. Although these different notions of the place of consumption may have implications for determining which State possesses the substantive jurisdiction to tax particular goods or services, they do not undermine the fundamental principle that jurisdiction to tax consumption exists wherever such consumption takes place or is deemed to take place.

b. Place of Supply/Sale Other than Place of Consumption. While a State plainly has substantive jurisdiction to tax consumption where consumption occurs, and normative consumption tax principles reinforce the exercise of such jurisdiction,[54] substantive jurisdiction to tax consumption also exists in the State in which the

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[51] Gen. Trading Co. v. State Tax Comm'n, 322 U.S. 335, 338 (1944).

[52] *See* OTTAWA FRAMEWORK, *supra* note 44, at 24-27 (analyzing possible alternatives for defining place of consumption with respect to consumption by individuals).

[53] *See id.* (analyzing place of consumption in context of businesses).

[54] As the OECD has observed, "[t]axation at the place of consumption promotes certainty and prevents double taxation or unintentional non-taxation . . . ." *Id.* at 24. It also promotes neutrality by treating all goods or services consumed in the State in the same way, regardless of the location from which they were shipped. William Fox & Matthew Murray, *The Sales Tax and Electronic Commerce: So What's New?*, 50 NAT'L TAX J. 573, 574-75 (1997).

goods or services are supplied or sold, even when they are not consumed there.[55] No one would seriously deny, for example, that a State possesses substantive jurisdiction to tax the supply or sale of goods or services that is made within that State, even though the goods or services will be consumed elsewhere. Thus, if a consumer purchases clothes in State A that she will wear only in State B, or has shoes repaired in State C that she will wear only in State D, there is no question that States A and C have jurisdiction to tax the consumer expenditures for the respective supplies or sales of goods or services.

Just as existing consumption tax rules reflect the substantive jurisdictional principle that consumption is taxable where consumption occurs, so they reflect the alternative substantive jurisdictional principle that consumption expenditures are taxable where the supply or sale of goods or services is made, even when this is not where consumption occurs.[56] Indeed, the place-of-supply rules of

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[55] One might object that this sentence (and, indeed, the ensuing line of analysis) is tautological because the "place of supply" is a malleable concept that can exist anywhere the taxing authority deems it to exist, as illustrated, for example, by the EU's recent change in the place-of-supply rules for certain electronically delivered services. Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily directive 77/338/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, art. 1(b), 2002 O.J. (L 128) 41, 42 [hereinafter Council Directive 2002/38/EC]; Council Regulation 792/2002 of 7 May 2002, amending temporarily Regulation (EEC) no. 218/92 on administrative cooperation in the field of indirect taxation (VAT) as regards additional measures regarding electronic commerce, 2002 O.J. (L 128) 1, 1 [hereinafter Council Regulation 792/2002] (extending Regulation (EEC) No. 218/92 to new services specified in Council Directive 2002/38/EC). Hence, to say that substantive jurisdiction to tax consumption exists at the place of supply is simply to say that substantive jurisdiction to tax exists wherever the taxing authority deems it to exist. While there is more than a kernel of truth in this observation, I think the essential line of analysis in the text is defensible, namely, that (1) a supply of goods (defined in the EU VAT as "the transfer of the right to dispose of tangible property as owner," Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes—Common system of value added tax; uniform basis of assessment, art. 5(1), 1977 O.J. (L 145) 1, 4 [hereinafter EU VAT Sixth Directive]) or a supply of services (defined in the EU VAT as "any transaction which does not constitute a supply of goods," EU VAT Sixth Directive art. 6(1)) frequently occurs, or is deemed to occur, in a location other than where the goods or services are consumed, and (2) there is a generally accepted understanding, reflected in existing place-of-supply rules, that substantive jurisdiction to tax consumption exists at such locations.

[56] It is worth reiterating in the context of consumption taxation the point made earlier in the context of income taxation, namely, that this Article is *not* primarily concerned with "the basic task of international tax rules," which was described as the task of resolving

both the EU VAT and the American RST reflect this principle. Thus the EU VAT applies to "the supply of goods or services effected for a consideration within the territory of a country by a taxable person."[57] The basic rules for the place of supply of such goods are (1) for goods dispatched or transported, "the place where the goods are at the time when dispatch or transport to the person to whom they are supplied begins"; (2) for goods installed or assembled, "the place where the goods are installed or assembled"; and (3) for goods not dispatched or transported, "the place where the goods are when the supply takes place."[58] The basic rule for the place of supply of services is "the place where the supplier has established his business or has a fixed establishment from which a service is supplied . . . ."[59] Similarly, American RSTs typically apply to the transfer within the State of goods and (to a limited extent) services[60] for a consideration.[61] The basic rule for the place of taxation of sales of goods is the place where transfer of title or possession to the goods occurs.[62] Insofar as services are taxable under American RSTs, the general rule is that services are taxed where they are performed.[63] Notwithstanding these "basic rules," there are a

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competing claims of States that have a legitimate, but overlapping, jurisdictional basis for taxation, in order to avoid the double taxation that results when both fully exercise their taxing power. *See supra* note 6. Rather, the principal concern of this Article, in both the context of income and consumption taxation, is the threshold question of whether, and under what circumstances, jurisdiction to tax (and to enforce collection of the tax) exists at all. Consequently, this Article's focus is on jurisdictional principles as *alternative* rather than *competing* concepts.

[57] EU VAT Sixth Directive, *supra* note 55, art. 2(1). The EU VAT also applies to "the importation of goods," which means the entering into the community of goods from outside the EU, as well as to the "intra-Community acquisition of goods," which means the cross-border supply of goods between Member States. *Id.* art. 2(2); Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/338/EEC with a view to the abolition of fiscal frontiers, art. 1(2), 1991 O.J. (L 376) 1, 3 [hereinafter Council Directive 91/680/EEC].

[58] EU VAT Sixth Directive, *supra* note 55, art. 8.

[59] *Id.* art. 9(1). As noted below, however, many services in the EU are taxed under exceptions to the "basic rule," *see infra* note 64 and accompanying text, and it may well be the case that the exceptions swallow the rule.

[60] The American RST does not apply generally to services, although most States tax some services and a few States tax a broad range of services. *See* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 12.05 & ch. 15 (discussing state taxation on selected services).

[61] *See* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶¶ 12.01, 18.02[2].

[62] *Id.* ¶ 18.02[2].

[63] *Id.* ¶ 18.05 & ch. 15.

number of derogations from or modifications of these rules that make the VAT and RST place-of-taxation rules more consistent with a destination-based tax predicated on the principle that consumption should be taxed where consumption occurs.[64]

c. Substantive Jurisdiction to Tax Consumption and the Distinction Between American "Sales" and "Use" Taxes. The alternative predicates for substantive jurisdiction to tax consumption—the place of consumption and the place of supply or sale—underlies one of the more esoteric distinctions in the consumption tax universe, namely, the distinction American RSTs draw between "sales taxes" and "use taxes." Despite the technical nature of this distinction, a proper understanding of it is critical to intelligent analysis of the jurisdictional issues raised by the American RST. I therefore briefly explicate the distinction at this juncture in the hope that we may thereby avoid the misunderstanding and confusion that so often obscures meaningful discussion of jurisdictional issues raised by the American RST.

When the American States first adopted RSTs during the 1930s, the taxes generally applied to the "sale" of tangible personal property at retail,[65] and, as noted above, the basic rule for the place of taxation was where transfer of title or possession of the property occurred. Under the U.S. Supreme Court's interpretation of the Commerce Clause of the American Constitution,[66] however, the

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[64] For example, both the EU VAT and the American RSTs relieve goods that are supplied or sold locally from tax if they are exported, and they impose tax on goods that are supplied or sold outside their territory when they are imported. Most recently, of course, the EU modified the Sixth Directive for certain electronically provided services to bring the place-of-supply rules in line with the principle that consumption should be taxed where consumption takes place. Council Directive 2002/38/EC, *supra* note 55, art. 1(b); Council Regulation 792/2002, *supra* note 55. *See also* EU VAT Sixth Directive, *supra* note 55, art. 9(2)(e) (providing customer-based place-of-supply rules for certain services performed for taxable persons established in EU by suppliers established in different country); *id.* art. 9(3)(b) (providing for application of consumption-based place-of-supply rule in EU when modification of normal rule making place of supply outside EU is necessary to avoid double taxation, nontaxation, or distortion of competition).

[65] The ensuing discussion of the development of American use taxation draws freely from 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 16.01.

[66] The Commerce Clause, by its terms, is no more than an affirmative grant of power to Congress to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3. Nevertheless, the U.S. Supreme Court has long construed the Commerce Clause as imposing implicit restraints on state authority, even when Congress has not acted. Under this so-called "negative" Commerce Clause

American States lack the constitutional power to impose a *sales* tax on goods or services purchased in other States or in interstate commerce because "to impose a tax on such a transaction would be to project its powers beyond its boundaries and to tax an interstate transaction."[67] The constitutional prohibition on the States' taxation of sales consummated outside their borders or in interstate commerce therefore created a troublesome gap in their consumption tax structures. The gap created two concerns. First, States feared the loss of business that local merchants would suffer when prospective customers made out-of-state or interstate purchases to avoid in-state sales tax liability. Second, States feared the loss of revenue they would incur as a result of the diversion of sales tax to nontax States. To deal with this potential loss of business and revenue, States enacted complementary or compensating "*use*" taxes on the use of goods purchased outside the State and brought into the State for use.

Compensating use taxes are functionally equivalent to sales taxes. They are typically levied upon the use, storage, or other consumption in the State of tangible personal property that has not been subjected to a sales tax. The use tax imposes an exaction equal in amount to the sales tax that would have been imposed on the sale of the property in question if the sale had occurred within the State's taxing jurisdiction. The State overcomes the constitutional hurdle of taxing an out-of-state or interstate sale by imposing the tax on a subject within its taxing power—the use, storage, or consumption of property within the State.[68] In principle, then, the in-state purchaser stands to gain nothing by making an out-of-state or interstate purchase free of sales tax because he will ultimately be saddled with an identical use tax when the property is brought into the taxing State. Taken together, the sales and use tax provides a uniform scheme of consumption taxation on goods purchased within the State and goods purchased outside the State for "storage, use,

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doctrine, the Court has consistently struck down taxes that, in the Court's judgment, discriminate against or otherwise burden interstate commerce. *See generally* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ch. 4.

[67] McLeod v. J.E. Dilworth Co., 322 U.S. 327, 328 (1944).

[68] *See* Henneford v. Silas Mason Co., 300 U.S. 577, 577 (1937) (sustaining constitutionality of use tax scheme).

or consumption" within the state. Every one of the forty-five States (and the District of Columbia) that imposes a sales tax also imposes a compensating use tax.[69]

In short, the American RST creates a uniform consumption tax regime by imposing two related levies that rely on two settled principles of substantive consumption tax jurisdiction: (1) a "sales" tax imposed on sales consummated within the State (the place-of-supply-or-sale principle) and (2) a "use" tax imposed on goods (and, occasionally, services) used or consumed within the state (the place-of-consumption principle). The conceptual, constitutional, and statutory underpinning of this regime leaves no room for serious argument that the RST fails to impose a broad-based tax on consumption of goods (and, to a lesser extent, services) in the State wholly consistent with substantive consumption tax principles. As we shall see, the only difficult questions under the RST, like the difficult questions under the VAT, relate to jurisdiction to compel enforcement of a tax that the State plainly has the substantive jurisdiction to impose.

2. Enforcement Jurisdiction. Assuming that a State has substantive jurisdiction to tax consumption based either on where the consumption occurs or where the supply or sale occurs, the question then arises whether the State has jurisdiction to compel collection of the tax. As in the case of income taxation, this inquiry has both theoretical and practical aspects. A State may have the theoretical power to enforce a tax but nevertheless lack an effective enforcement mechanism because the theoretically sound path to tax collection is administratively or economically impractical.

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[69] Insofar as the American States impose taxes on the "sale" of services, the same competitive and revenue concerns arise regarding out-of-state sales of services for use or enjoyment within the State as arise with respect to the sale of goods. Although the theory underlying a "use" tax on goods is equally applicable to services, and although the States clearly possess the same constitutional authority to levy use taxes on services that they have to levy use taxes on goods, they have not exercised such authority over taxable services purchased from out-of-state service providers to the same extent that they have exercised such authority over tangible personal property purchased from out-of-state sellers. *See* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 16.14. Thus, while some States apply their use taxes generally to services they tax under the sales tax, other States do not. Still other States apply their use taxes only selectively to the services they tax under the sales tax. *Id.*

a. Personal Jurisdiction Over Consumer. We observed in the income tax context that personal jurisdiction over the earner ordinarily assures effective enforcement of an income tax obligation,[70] and one might think at first blush that personal jurisdiction over the consumer likewise should assure effective enforcement of a consumption tax obligation. However, the analogy turns out to be less than perfect. In fact, there are at least two reasons why the relationship between substantive tax jurisdiction and enforcement jurisdiction differs in the two contexts.

First, the earner of income is almost invariably the person with the underlying income tax obligation, and personal jurisdiction over the earner generally permits a State to enforce the income tax obligation directly against the earner through the State's legal system.[71] By contrast, the consumer is not "almost invariably" the person with the underlying consumption tax obligation. Under the EU VAT, for example, the person with a consumption tax obligation is the "taxable person." A "taxable person" is someone who "carries out . . . economic activity," including "all activities of producers, traders and persons supplying services . . . ."[72] Such a "taxable person" often is the "intermediate" consumer of taxable supplies,[73] but it generally is not their final consumer, who (in principle) bears the ultimate economic burden of the VAT.[74] Rather, the ultimate consumer who bears the economic burden of the VAT generally is *not* a "taxable person." Consequently, at least with respect to supplies made to nontaxable persons, personal jurisdiction over the

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[70] *See supra* notes 23-24 and accompanying text.

[71] *Id.*

[72] EU VAT Sixth Directive, *supra* note 55, art. 4.

[73] The discussion generally ignores the additional complications arising from the supply of exempt goods and services (*i.e.*, supplies for which no output VAT is chargeable by the supplier and for which no input VAT is recoverable). A trader that makes only exempt supplies (*e.g.*, a financial institution or an insurance company) generally is not considered a "taxable person."

[74] While a "taxable person" is charged tax on his taxable inputs and in turn charges tax on his taxable outputs, it is generally not the person who actually bears the tax because it receives a credit for its input tax against its output tax due and can recover the difference from the taxing authority if the former is greater than the latter. The "taxable person," then, is in substance a business that acts as a tax collector for the State.

consumer typically has little bearing on the VAT enforcement mechanism.[75]

Second, even if the legal obligation for paying the consumption tax rests on the final consumer, as it frequently (but not always) does under American RSTs,[76] personal jurisdiction over the consumer will nevertheless be insufficient as a practical matter to insure effective enforcement of the tax in most instances.[77] Efforts by the American States, for example, to provide for self-assessment of consumption taxes by individual consumers who have the legal obligation to remit such taxes and over whom the States have unquestioned personal jurisdiction have proved largely ineffective.[78] What little revenue they produce "come[s] largely from the uninformed or most scrupulously honest recordkeepers,"[79] leading some to characterize self-assessment of consumption taxes by private consumers as a "tax on honesty."[80] Moreover, it simply is not cost

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[75] Again, I generally ignore the complications that can arise in the cross-border context when a trader who makes exempt supplies purchases taxable supplies.

[76] *See* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶¶ 12.01, 16.01; DUE & MIKESELL, *supra* note 50, at 28-29. This is not to suggest that the legal obligation for paying the consumption tax rests *exclusively* on the final consumer. In fact, it almost never does; the vendor is ordinarily liable (either primarily or secondarily) for tax on any taxable transaction whether or not it collects the tax from the purchaser. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE AND LOCAL TAXATION: CASES AND MATERIALS 800 (7th ed. 2001) [hereinafter HELLERSTEIN & HELLERSTEIN, CASES AND MATERIALS].

[77] Only when individual consumers are required to register the items they purchase (*e.g.*, automobiles) does the State have an effective mechanism for collection of consumption taxes directly from individual, nonbusiness purchasers. DUE & MIKESELL, *supra* note 50, at 262.

[78] *Id.* at 264-65. Some States seek to collect unpaid consumption (use) taxes from individuals who have purchased goods from unregistered remote vendors either by enclosing a use tax return along with the individual income tax return or by inserting a use tax reporting line on the income tax return itself. *Id.* at 264.

[79] *Id.*

[80] The accepted wisdom that voluntary payment of consumption taxes is ineffectual may be subject to reexamination in light of modern technology, the States' greater efforts to educate private consumers, and perhaps, a revised view of human nature:

> Connecticut unveiled a new voluntary tracking program Jan. 6, 2003 that will assist taxpayers in calculating the amount of use tax that they may owe to the state from Internet and mail order purchases.
>
> Designed to assist consumers in keeping track of untaxed purchases they made during the year, the state's new Use Tax Tracker can be downloaded to an individual's own personal computer. The tracker program then utilizes Microsoft Excel to allow users to input qualifying untaxed purchases throughout the year, and it then calculates the appropriate tax due, according to the Department of Revenue Services.
>
> At the end of the year, taxpayers can take the final total from the

efficient for the State to audit individuals for unpaid consumption taxes on innumerable relatively small transactions, and auditing individuals for consumption tax liability is virtually nonexistent.[81]

To be sure, self-assessment mechanisms like "reverse charge"[82] and "direct pay,"[83] under which purchasers of taxable goods and

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> program and plug the information into the use tax line on their income tax return.
>
> Tax Commissioner Gene Gavin noted that the program was developed by DRS employees in response to a taxpayer request.
>
> "I have always said that most taxpayers are law-abiding citizens who want to do the 'right thing' and pay their fair share of taxes to the state," Gavin said in a statement.

Martha Kessler, "State's Tax Authorities Introduce Voluntary Use Tax Tracking Program," DAILY TAX REP. (BNA) H-3 (Jan. 8, 2003), LEXIS, 05 DTR H-3 (2003).

[81] DUE & MIKESELL, *supra* note 50, at 262.

[82] The "reverse charge" is a self-assessment method for applying and accounting for the EU VAT. DOERNBERG ET AL., *supra* note 7, at 118. It generally applies to certain services (*e.g.*, advertising, consulting, data processing), whose place of supply is the customer's establishment, for customers who are taxable persons established within the Community. EU Sixth Directive, *supra* note 55, art. 9(2)(e). Some countries, such as the Netherlands and Finland, use the reverse charge for supplies in addition to those listed in article 9(2)(e) as a "simplification measure" to allow nonresidents to avoid registration. KARL FRIEDEN, CYBERTAXATION 400 (2000). Under the "reverse charge" mechanism, the EU-based business customer, rather than the supplier of the services, becomes responsible for accounting and payment of the tax, as if the business customer had supplied the services to itself. The tax is then available as a credit, assuming the business customer is a "taxable person." Even if the business customer is in principle a nontaxable person because it makes only exempt supplies (*e.g.*, a bank or an insurance company), if the value of the person's imported article 9(2)(e) services exceed VAT registration limits, it is effectively treated as a taxable person and must treat the receipt of these supplies as taxable turnover, even though it receives no credit for the tax. *See, e.g.*, HM Customs and Exercise, Notice 700: The VAT guide, Apr. 2002, ¶ 5.4, at 32-33, *available at* http://www.hmce.gov.uk/forms/graphics/700.pdf.

[83] The Federation of Tax Administrators describes the direct payment process as follows:

> Direct pay is an authority granted by a tax jurisdiction that generally allows the holder of a direct payment permit to purchase otherwise taxable goods and services without payment of tax to the supplier at the time of purchase. (Also in the case of exempt transactions, it allows a holder to purchase without issuing exemption certificates.) Suppliers are to be furnished a written notification of the purchaser's direct pay authority (often a numeric designation). The holder of the direct payment permit is to timely review its purchases and make a determination of taxability and then reports and pays the applicable tax due to the tax jurisdiction. The permit holder's tax determinations and adequacy of payment are subject to audit by the tax jurisdiction.

Federation of Tax Administrators, *Model Direct Payment Permit Regulation and Report Completed*, 64 TAX ADM'RS NEWS 36, 36 (May 2000). According to the cited report, thirty-three of the forty-five states with sales and use taxes provide for the direct payment of tax. *See also* Steering Committee, Task Force on EDI Audit and Legal Issues for Tax Administration, *Model Direct Payment Permit Regulation*, 19 ST. TAX NOTES 435, 438-39 (Aug. 14, 2000).

services remit the taxes due on their purchases directly to the State, have proven feasible and effective for registered businesses.[84] Personal jurisdiction over such businesses—as distinguished from private consumers—is therefore an essential factor in the enforcement of consumption tax obligations imposed on such businesses. But it is worth keeping in mind the salient differences between the business consumer and the private consumer that make the self-assessment mechanism a useful enforcement tool with respect to the former but not the latter: The business consumer, unlike the private consumer, is generally registered with the State taxing authority and is subject to regular audit control. In short, self-assessment of a consumption tax for a business purchaser does not mean a truly "voluntary" assessment as it does, in most instances, for the private purchaser.

b. Personal Jurisdiction Over Supplier / Vendor. Even if there is no personal jurisdiction over the intermediate or final consumer, or, more significantly, such jurisdiction fails to provide the basis for a meaningful consumption tax enforcement mechanism, personal jurisdiction over the supplier or vendor may do so. Indeed, collection of consumption taxes by registered vendors or suppliers from purchasers is the primary mechanism by which consumption taxes are administered and enforced.

The issues raised by the use of suppliers or vendors as collection agents in the consumption tax context may be roughly analogized to those raised by the use of withholding agents in the income tax context, but there are significant differences as well.[85] In discussing the withholding mechanism in the income tax context, I posed the question "whether there are any objections to the use of involuntarily conscripted collection agents to assist the State in its efforts to enforce substantive tax obligations of those over whom it has no personal jurisdiction." No such question arises under the EU VAT because the "taxable person" with the substantive tax obligation is the supplier. Although the supplier thus may be viewed as a

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The appendix to the Task Force report contains a state-by-state list of direct-pay permit requirements. *Id.*

[84] OTTAWA FRAMEWORK, *supra* note 44, at 30.

[85] *See supra* notes 36-40 and accompanying text (discussing jurisdiction over income tax withholding agents).

collection agent in the economic sense because it does not ultimately bear the burden of the VAT, which it passes on to nontaxable persons,[86] the supplier *is* the taxpayer in the legal sense and its tax collection obligations are wholly consonant with its legal status. Hence there is no "collection agent" issue from a legal standpoint.

Under the American RST, however, the "collection agent"/"withholding agent" analogy is more compelling, because the substantive tax obligation is often imposed on the consumer and the vendor simply has a duty to collect the tax.[87] The U.S. Supreme Court, however, has been no more troubled by the imposition of a collection obligation in the consumption tax context than it was by the imposition of withholding obligation in the income tax context. Shortly after the Court sustained the constitutionality of the use tax as a device to levy a consumption tax on goods purchased outside the State,[88] it confronted a vendor's attack on the constitutionality of imposing upon it the obligation that it collect the tax that was due from the consumer. The vendor did "not question the right of the state to collect this tax from the user," but it challenged the State's right to "compel [the vendor] to serve as an agent for collecting the tax"[89] as a burden on interstate commerce and a violation of its rights to due process of law. The Court summarily dismissed these claims, relying on an earlier decision in which it had sustained a similar mechanism for collecting gasoline taxes:

> The statute . . . imposes the tax on motor vehicle fuel used or otherwise disposed of in the state. Instead of collecting the tax from the user through its own officers, the state makes the distributor its agent for that pur-

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[86] *See supra* note 74 (explaining function of "taxable person"). Again, for purposes of this discussion, we ignore the treatment of the supplier of exempt goods and services.

[87] The vendor generally is liable for the tax, however, if it fails to collect it from the consumer. *See supra* note 76 (explaining tax obligation of vendors under American RST).

[88] *See supra* notes 66-69 and accompanying text (discussing constitutional prohibition on States' taxation of out-of-state sales and development of compensating use tax).

[89] Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62, 64 (1939). The Use Tax Act directed retailers maintaining a place of business in the State, and making sales of tangible personal property for storage, use, or other consumption in the State, to collect the tax from the purchaser. There was no issue in these early use tax collection cases of collecting taxes from non-physically present vendors because the use tax collection statutes applied only to vendors who maintained a business in, and were thus physically present in, the State.

> pose. This is a common and entirely lawful arrangement.[90]

In subsequent cases, the Court likewise gave short shrift to complaints by vendors about their conscription as collection agents for the State, observing that "[t]o make the distributor the tax collector for the State is a familiar and sanctioned device."[91]

The foregoing discussion would suggest that there are no serious theoretical objections to enlisting suppliers or vendors as collection agents to enforce a consumption tax in the State where substantive jurisdiction to tax consumption exists. Consequently, there would appear to be no theoretical or practical obstacles to enforcing such an obligation if there is substantive jurisdiction to tax the consumption and there is personal jurisdiction over the supplier or vendor. As in the context of jurisdiction over income tax withholding agents, the criteria for establishing personal jurisdiction over the withholding agent do not appear to be different in substance from the criteria for establishing personal jurisdiction over any other person. Accordingly, if the supplier or vendor is resident within, or has substantial local contacts with, the State in which consumption occurs or in which it makes a supply or sale, the State ordinarily can enforce the substantive consumption tax obligation, notwithstanding a lack of personal jurisdiction over—or a meaningful enforcement mechanism operating directly upon—the consumer.

The foregoing discussion does not address two significant questions, however. First, a fundamental problem arises when there is substantive jurisdiction to tax but uncertain jurisdiction to compel collection of the tax. Indeed, in my view, this is the fundamental problem that lies at the heart of this symposium, a problem to which I alluded above in the discussion of income taxes[92] and to

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[90] *Id.* at 67-68 (quoting Monamotor Oil Co. v. Johnson, 292 U.S. 86, 93 (1934)). In *Monamotor Oil*, the Court characterized the distributors as "mere collectors," noting that "[t]he distributor does not pay the tax; the user does." *Monamotor Oil*, 292 U.S. at 95-96.

[91] Gen. Trading Co. v. State Tax Comm'n, 322 U.S. 335, 338 (1944). *See also* Nelson v. Sears, Roebuck & Co., 312 U.S. 359, 364 (1941); Nelson v. Montgomery Ward & Co., 312 U.S. 373, 375 (1941) (permitting Iowa's imposition of "collection agent" duty on Sears and Montgomery Ward, which were both out-of-state corporations with retail outlets in Iowa, for mail order sales made to Iowa customers).

[92] *See supra* notes 33-35 and accompanying text.

which much of the balance of this Article is devoted. Indeed, in some respects, much of the foregoing discussion does little more than state the obvious, although, I hope, in a way that will advance analysis of the more controversial issues. Second, a related problem arises when there is both substantive jurisdiction to tax and personal jurisdiction to tax a collection agent, but the collection agent's local jurisdictional links are not directly related to the consumption over which the State has unquestioned substantive jurisdiction to tax. This issue will be discussed in more detail below.

c. Border Controls. The discussion thus far has considered two types of enforcement jurisdiction when substantive jurisdiction to tax exists: (1) personal jurisdiction over the person upon whom the ultimate burden of the tax is intended to rest (the earner, in the income tax context, and the consumer, in the consumption tax context); and (2) personal jurisdiction over an intermediary that is in a position to collect the tax from the person described in (1) (a withholding agent, in the income tax context, and a collection agent, in the consumption tax context). In the consumption tax context, however, there is a third form of enforcement jurisdiction that exists, at least with respect to cross-border transactions involving goods, namely, border controls (which may actually be implemented at the post office). It is well recognized that border controls provide an effective mechanism for assuring collection of consumption taxes on cross-border supplies or sales of tangible personal property.[93] Indeed, the application of VAT to the importation of goods into a Member State of the EU[94] is administered principally through border controls, and, prior to 1993, intra-Community cross-border supplies of goods were taxed at the border of the importing Member State.[95]

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[93] OTTAWA FRAMEWORK, *supra* note 44, at 24.

[94] EU VAT Sixth Directive, *supra* note 55, art. 2(2).

[95] DOERNBERG ET AL., *supra* note 7, at 104. In 1993, the original EU VAT system was modified to move the system more in the direction of a single internal market by abolishing existing collection and fiscal controls at the border and replacing them with administrative controls at the enterprise level. Council Directive 91/680/EEC, *supra* note 57, art. 1(2). The current ("transitional") system is based on taxpayer identification, administrative records of the enterprises, and automated exchange of information between tax authorities of Member States. DOERNBERG ET AL., *supra* note 7, at 105. The so-called "definitive system," which would impose a VAT at origin and which assumes a substantial degree of harmonization (if

Despite the general recognition that border controls are an effective method for enforcing collection of consumption taxes on cross-border supplies of goods, they also have their limits, particularly in the new "borderless" economy. Specifically, border controls have never been an effective method for enforcing consumption taxes on cross-border transactions involving supplies other than goods (*e.g.*, services, digital products, and intangibles) for the simple reason that such supplies as a practical matter cannot be stopped at the border.

III. JURISDICTION TO TAX VERSUS JURISDICTION TO COMPEL COLLECTION OF TAX: IMPLICATIONS FOR ANALYSIS

The reader looking for novel conclusions or surprising revelations about jurisdiction to tax is likely to have been disappointed by the foregoing discussion. The fundamental jurisdictional principles discussed above are uncontroversial. The controversial issues involve their application, which I have considered only in passing. Nevertheless, in describing these fundamental principles, I have attempted to place them within an analytical framework that may assist in the analysis of the more controversial questions regarding jurisdiction to tax. Specifically, the foregoing discussion represented an effort to divide the jurisdiction-to-tax question into an inquiry into substantive tax jurisdiction, on the one hand, and enforcement jurisdiction, on the other. In the balance of this Article, I consider some of the contemporary issues regarding jurisdiction to tax through the lens of the analytical framework established above in the hope that it will elucidate some of these issues, even if it provides no definitive suggestions for their resolution.

A. PERMANENT AND OTHER ESTABLISHMENTS

Many of the contemporary controversies dominating discussions of jurisdiction to tax involve the question whether a nonresident

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not an EU-wide VAT) as well as revenue sharing, *id.* at 105-07, has never been (and may never be) introduced. Hence, the "transitional" system continues to apply.

person[96] has a sufficient connection with a State to permit the State to require that person to cooperate with the State's tax administration. The sought-after cooperation may involve a nonresident enterprise's filing of an income tax return relating to the enterprise's own substantive income tax liability with respect to business profits in that State, in which case, under international tax treaties, we ask the question whether the person has a "permanent establishment" in the State.[97] The sought-after cooperation may involve a nonresident supplier's registration for EU VAT and charging VAT on mail-order sales to private consumers in the State, in which case, under the "distance selling rule,"[98] we ask the question whether the supplier has exceeded the applicable distance-selling threshold for the Member State in question. Or the sought-after cooperation may involve the nonresident vendor's registration as a retailer for American subnational sales and use tax and collecting a use tax on sales to customers in the subnational State, in which case, under U.S. constitutional principles, we ask the question whether the vendor has "substantial nexus" with the State.[99]

What is noteworthy about these controversies is that each of them involves a dispute over enforcement jurisdiction rather than substantive jurisdiction to tax.[100] In the case of an enterprise whose profits are not taxable in a State "unless the enterprise carries on business in the . . . State through a permanent establishment situated therein,"[101] the question of substantive jurisdiction to tax

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[96] Individual or jural.

[97] *See, e.g.*, OECD MODEL, *supra* note 4, arts. 5, 7; U.S. MODEL, *supra* note 31, arts. 5, 7.

[98] Under the EU's distance-selling rule, when a mail-order company in one Member State makes sales of goods to nontaxable persons in other Member States, and those sales exceed a specified euro threshold, the vendor is required to register for VAT in the destination State and to charge the destination State's VAT on its sales. EU VAT Sixth Directive (as amended), *supra* note 55, arts. 28a, 28b; DOERNBERG ET AL., *supra* note 7, at 109-11. Articles 28a and 28b were added to EU VAT Sixth Directive in Council Directive 91/680/EEC, *supra* note 57, art. 1(22). They were amended in Council Directive 92/111/EEC, arts. 1(10)-(11), 1992 O.J. (L 384) 47, 50-51. For the consolidated text of EU VAT Sixth Directive, see EU, Consolidated Text of Council Directive 77/388/EEC (Jan. 7, 2003), *at* http://europa.eu.int/eur-lex/en/consleg/pdf/1977/en_1977L0388_do_001.pdf.

[99] Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992); 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 19.02[2][a].

[100] This is not to suggest that the questions are unrelated. As we shall see, they sometimes are closely related.

[101] OECD MODEL, *supra* note 4, art. 7(1); U.S. MODEL, *supra* note 31, art. 7(1).

turns on whether the enterprise has any business profits derived from sources within the State.[102] However, that question is discrete from the question of whether the enterprise has a permanent establishment in the State and therefore can be required to cooperate with the State income tax administration. To be sure, under the OECD and U.S. model income tax treaties, the question of whether an enterprise has business profits that may be taxed within a State depends on whether the enterprise has profits that are attributable to that permanent establishment.[103] In such circumstances, the treaty partners simply have decided not to exercise the power they possess under generally recognized jurisdictional principles to its fullest extent.

This is not always the case, however, as the OECD explicitly recognizes in its Model Income Tax Treaty Commentary. The Commentary first observes that Article 7 of the Model Income Tax Treaty lays down the rule that

> when an enterprise carries on business through a permanent establishment in another State that State may tax the profits of the enterprise but only so much of them as is attributable to the permanent establishment, in other words, that the right to tax does not extend to *profits that the enterprise may derive from that State* otherwise than through the permanent establishment.[104]

But then the commentary goes on to recognize that "[t]his is a matter on which there may be differences of view."[105] Specifically, the Commentary notes:

> Some countries have taken the view that when a foreign enterprise has set up a permanent establishment within their territory it has brought itself within their fiscal

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[102] Because we have assumed that the enterprise is a nonresident of the taxing State, source will be the only basis for substantive jurisdiction to tax.

[103] OECD MODEL, *supra* note 4, art. 7(1); U.S. MODEL INCOME TAX TREATY, *supra* note 31, art. 7(1).

[104] *Id.* cmty. to art. 7, ¶ 5 (emphasis supplied).

[105] *Id.*

> jurisdiction to such a degree that they can properly tax all profits that the enterprise derives from their territory, whether the profits come from the permanent establishment or from other activities in that territory.[106]

Indeed, the United States applies an analogous rule to foreign enterprises that are not residents of States with which the United States has an income tax treaty when they are "engaged in a trade or business within the United States."[107] For such enterprises, the Internal Revenue Code provides that "[a]ll income from . . . from sources within the United States," other than periodical income (such as interest, dividends, and rents), "shall be treated as effectively connected with the conduct of a trade or business in the United States."[108] In short, it is apparent that the permanent establishment rule is a rule of enforcement (*i.e.*, a rule relating to personal jurisdiction over the earner), not a rule of substantive jurisdiction to tax (*i.e.*, whether income has its source in a State), since an enterprise can derive business profits from a State that are attributable "to activities in that territory" other than from the permanent establishment (if any) within the State.

The analysis is even clearer when we turn to the question of a nonresident supplier's obligation to register for and charge VAT to private mail-order consumers under the "distance selling rule" or the nonresident vendor's obligation to register for and charge American subnational sales and use tax to local customers under U.S. constitutional nexus principles. In these circumstances, the substantive jurisdiction to tax consumption in the place where consumption occurs is self-evident. The only question is whether there is personal jurisdiction over the supplier or vendor to allow

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[106] *Id.* The UN Model Income Tax Treaty contains a limited force of attraction rule, permitting the taxation of business profits of an enterprise with a permanent establishment in a State if the profits are attributable to "business activities carried on in that . . . State of the same or similar kind as those effected through that permanent establishment." UN MODEL, *supra* note 31, art. 7(1). *See generally* Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TULANE L. REV. 133, 205-09 (1999) (discussing UN Model Income Tax Treaty's force of attraction rule).

[107] I.R.C. § 864(c)(1)(A) (West 2003).

[108] *Id.* § 864(c)(3).

enforcement of that consumption tax obligation in an effective manner.

At this point, it might be fair to ask, "So What?" What difference does it make whether the jurisdictional controversy relates to substantive jurisdiction to tax, to enforcement jurisdiction to tax, or to both? Without the existence of both types of jurisdiction, the tax obligation is little more than an abstraction, so what is the benefit of distinguishing between the inquiries, especially when (as, for example, in the case of income taxation) the inquiries are so closely intertwined?

There are at least two answers to these questions. First, from a purely descriptive perspective, it makes good sense to clarify the analysis of jurisdiction-to-tax issues to facilitate intelligent discussion of the issues raised. If the analysis of these issues is more transparent, we can avoid discussion of extraneous and misleading issues that sometimes arise when jurisdiction-to-tax issues are treated as a single amorphous question. For example, spokespersons for mail-order vendors frequently defend their "jurisdictional" arguments on the theory that they receive no local benefits as do local retailers. As a spokesman for the Direct Marketing Association (DMA) put it in a debate with a main-street retailer (in defending the DMA's position that there is and should be no "jurisdiction to tax" mail-order vendors): "You receive something in return for collecting taxes on behalf of the state and the municipality. None of these benefits are provided to out-of-state retailers."[109]

But this argument confuses substantive jurisdiction to tax (about which there can be no serious dispute, at least in this context) with enforcement principles. It therefore obscures the real question, which is simply whether it is appropriate under the circumstances to require a vendor to be a collection agent for *someone else's* tax. As the distinguished economist Charles McLure has put it in his

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[109] Doug Sheppard, *Debate: Simplification or Equity First? Target's Hale, DMA's Isaacson Square Off on Internet Taxation*, 18 ST. TAX NOTES 1945, 1948 (June 5, 2000) (quoting George Isaacson, Tax Counsel, Direct Marketing Association).

summary of "Fallacious Arguments for a Permanent Exemption for Electronic Commerce":[110]

> "*Remote vendors do not consume services.*" Some argue that remote vendors should not be required to collect use taxes because they do not consume public services provided by the market states. This view reflects a misunderstanding of the benefit principle of taxation. The sales and use tax is levied primarily to finance services provided to households, not to finance services provided to business firms doing business in the taxing state. Thus it should apply equally to all taxable goods and services consumed in the state, not only to those sold by local merchants. (The invalidity of the argument cited above can be seen by replacing the reference to the sales and use tax with reference to an excise on tobacco products used to finance health care for smokers. No one would seriously suggest that cigarettes sent by mail order from another state should not be taxed, just because they are sold by a vendor that receives few services in the taxing state.)[111]

Wholly apart from the gain in "descriptive" clarity that we achieve by distinguishing between substantive jurisdiction-to-tax issues and jurisdiction to compel collection of the tax—a gain that may be dismissed by those for whom tenure has never been a concern as reflecting an obsessive preoccupation with an "academic desire for tidiness"[112]—distinguishing between substantive and

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[110] Charles E. McLure, Jr., *Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?*, 2000 BYU L. REV. 77, 112.

[111] *Id.* (footnote omitted). In a footnote, McLure provides an "admittedly unrealistic" example further to illustrate his point:

> Suppose that it were possible to sell motor fuel in a state without having a physical presence there. Suppose further that a tax on motor fuels consumed by motorists in the state is used to finance the construction and maintenance of roads and highways in the state. Should fuel sold in the state by a remote vendor be taxed? Of course it should; the tax is intended to charge for the in-state motorist's use of highways.

Id. at n.18.

[112] Comm'r v. Duberstein, 363 U.S. 278, 290 (1960).

enforcement considerations advances the "normative" inquiry into jurisdiction-to-tax questions as well. When we start to ask normative questions about jurisdiction to tax—whether directed to substantive issues,[113] to enforcement issues,[114] or to both—we encounter an overarching question that should inform the more nuanced inquiry into the particular substantive or enforcement question at issue. That question concerns the relationship between substantive jurisdiction and enforcement jurisdiction (both in the legal and practical sense).

Regardless of how a particular question of substantive or enforcement jurisdiction should be resolved, and reasonable people can and do disagree over these questions,[115] in attempting to delineate the proper scope of substantive and enforcement jurisdiction we should take account of the relationship between these two issues. That relationship may be visualized as follows:

Substantive Jurisdiction Enforcement Jurisdiction	No Substantive Jurisdiction Enforcement Jurisdiction
Substantive Jurisdiction No Enforcement Jurisdiction	No Substantive Jurisdiction No Enforcement Jurisdiction

As the foregoing diagram indicates, there are four possible relationships between enforcement and substantive jurisdiction within a taxing State. First, there can be both substantive and enforcement jurisdiction (*e.g.*, when an enterprise with a permanent establishment in a State earns income from sources within the State,[116] or when a supplier or vendor with an establishment in or nexus with a State sells goods or services to a purchaser in the State). Second, there can be substantive jurisdiction but no

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[113] For example, whether the source of income from the sale of personal property should be the residence of the seller, I.R.C. § 865(a) (West 2003), the place where title passes, *id.* §§ 865(b), 861(a)(6), the place where depreciation on the property was taken, *id.* § 865(c), or the place where the intangible is used. *Id.* §§ 865(d), 861(a)(4).

[114] For example, whether the physical presence of a vendor in a State should be a precondition to requiring the vendor to collect consumption taxes on sales to purchasers in the State.

[115] Indeed, most of this symposium focuses on these reasonable disagreements!

[116] Whether the income must be attributable to the permanent establishment is another matter. *See supra* notes 103-08 and accompanying text.

enforcement jurisdiction (*e.g.*, when a nonresident enterprise with no employees, agents, or property in a State earns income from sources within the State, and the income is not subject to an effective withholding mechanism,[117] or when a supplier or vendor with no establishment in, or nexus with, a State sells digital services to a private consumer in the State[118]). Third, there can be enforcement jurisdiction but no substantive jurisdiction (*e.g.*, when a nonresident enterprise with a permanent establishment in a State earns rents unrelated to that permanent establishment from real property in another State, or when a vendor or supplier with an establishment in, or nexus with, a State makes a supply or sale in another State to a consumer in that State). Fourth, there can be neither substantive nor enforcement jurisdiction, a situation that needs no parenthetical elaboration.

In examining what our jurisdiction-to-tax rules should look like, it seems to me that our goal should be to design rules that increase the probability that we end up in the upper left-hand box or the lower right-hand box. If we find ourselves in the other two boxes, we are in an untenable situation from the standpoint of tax administration. In other words, we should try to design our substantive jurisdiction-to-tax rules so that substantive jurisdiction exists in States in which (a) enforcement jurisdiction exists as a legal matter and (b) such enforcement jurisdiction can be implemented as a practical matter. By the same token, we should try to design our enforcement jurisdiction rules so that enforcement jurisdiction exists (both as a legal and practical matter) in the

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[117] For example, there is substantive jurisdiction to tax but no effective withholding mechanism if a foreign corporation without a permanent establishment in the State earns royalties from licensing its right to use the patent within a State to another corporation without a permanent establishment in the State. *See* I.R.C. § 861(a)(4) (treating as income from sources within the United States royalties for the use of patents in the United States); Rev. Rul. 80-362, 1980-2 C.B. 208 (holding that royalties paid for use of patent in U.S. are subject to U.S. tax and withholding obligations).

[118] This, of course, is *the* "new economy" jurisdictional question for consumption taxes. *See, e.g.*, OTTAWA FRAMEWORK, *supra* note 44, at 17-42. I should note at this point, as I make clear below, that this problem does *not* necessarily arise within a federal system or a "group of countries bound by a common legal framework for their consumption tax systems." *Id.* at 45 n.6. *See infra* notes 185-99 and accompanying text. I should also note that the statement in the text implies nothing about what the standards for determining the existence of an establishment or nexus should be.

States in which substantive jurisdiction exists.[119] In short, "reverse engineering" has a role to play in the proper design of a tax regime.[120]

This is not to suggest that we can design our substantive jurisdiction-to-tax rules and our enforcement jurisdiction rules on a clean slate to achieve the desired goal of harmonizing the two sets of rules. To the contrary, as noted in Part II of this Article, there are long-standing and deeply entrenched principles governing substantive and enforcement jurisdiction that restrict our freedom to "design" jurisdictional rules. Nevertheless, if there is anything that is as clear as the existence of settled understandings regarding the broad contours of the rules governing substantive and enforcement jurisdiction in the tax arena, it is the existence of opportunities to align these two sets of rules. These opportunities exist not only because of the existence of alternative bases for the exercise of substantive and enforcement jurisdiction, but also because of the unsettled nature of the precise criteria for determining the existence of such jurisdiction.

As noted above, there are two alternative pillars of substantive jurisdiction to tax income: residence and source. One may define residence by reference to domicile, citizenship, or presence in the

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[119] Needless to say, this inquiry should also take account of the practical constraints on enforcement, but those practical restraints are less amenable to legal "design" and must essentially be viewed as "givens," although we should remain acutely aware of the fact that such "givens" are likely to change as technology changes. *See, e.g.*, OTTAWA FRAMEWORK, *supra* note 44, at 17-47 (discussing "interim," "medium term," and "long term" consumption tax mechanisms depending on available technologies).

[120] I articulated an earlier version of this thesis in the specific context of American subnational taxation of electronic commerce several years ago:

> What we need . . . is a fresh approach that essentially "reverse engineers" the nexus issue. In other words, the first question should be: What kind of taxing regime will allow participants in electronic commerce to pay and collect taxes in an administratively feasible fashion to those states with a legitimate claim to the tax revenues? Once we answer that question, we can build our nexus rules (and, also our tax sourcing or situsing rules) around such a regime.

Walter Hellerstein, *Transaction Taxes and Electronic Commerce: Designing State Taxes That Work in an Interstate Environment*, 50 NAT'L TAX J. 593, 597 (1997). *See also* Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 TAX L. REV. 425, 480-502 (1997) (discussing policy concerns raised by state taxation of e-commerce and suggesting legal rules to address concerns); Walter Hellerstein, *State and Local Taxation of Electronic Commerce: Reflections on the Emerging Issues*, 52 U. MIAMI L. REV. 691, 694-704 (1998) (setting forth suggestions regarding solution to problems associated with state taxation of e-commerce).

State for a specified period of time for individuals, or by reference to place of incorporation, place of corporate headquarters, or place of effective management for corporations.[121] One may define source by reference to physical location of income-producing property or activities, the place where property is licensed to be used, or the residence of the seller of property or of payors of dividends or interest.[122] Similarly, there are two alternative pillars of substantive jurisdiction to tax consumption, the place of consumption and the place of supply or sale. One may define the place of consumption by reference to the place of actual consumption, the place where goods or services are received, or the place of personal residence or business presence.[123] One may define the place of supply or sale other than the place of consumption by reference to the place where goods are at the time they are dispatched or transported, the place where goods are delivered, the place where title to goods passes, or the place where services are performed.[124]

Similar alternative jurisdictional bases (and variations on the precise definitions of those bases) exist for the delineation of enforcement jurisdiction, although the inquiry is often directed to a withholding or collection agent rather than to the earner of income or the consumer of goods and services, as it often would be in an inquiry into substantive jurisdiction to tax income or consumption.[125] These variations would include, in addition to many of the criteria described above, the use of border controls to enforce consumption taxes on imported goods.[126] Moreover, the requisite jurisdictional relationship between the taxing State and a withholding or collection agent may well be different from the requisite jurisdictional relationship between a person with the underlying substantive tax obligation, when a State looks to that person for direct enforcement of the tax obligation. For example, it may well be that a withholding agent need not have a permanent establishment in a State in order for that State to have enforcement jurisdic-

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[121] *See supra* notes 7-8 and accompanying text.
[122] *See supra* notes 16-19 and accompanying text.
[123] *See supra* notes 52-53 and accompanying text.
[124] *See supra* notes 56-64 and accompanying text.
[125] *See supra* notes 23-24, 36-38, 70-91 and accompanying text.
[126] *See supra* notes 93-95 and accompanying text.

tion to require the agent to withhold payments on income that a nonresident derives from sources within the State.

The point of reciting this extended litany of alternative predicates for the assertion of both substantive jurisdiction to tax and enforcement jurisdiction should be apparent. There is enough play in the joints of these concepts for a "designer" of a jurisdictional construct to operate within the confines of existing understandings while fashioning rules that move us closer to the normative ideal of congruence between substantive and enforcement principles and practicalities. Without pretending to undertake a systematic inquiry into the opportunities for designing jurisdictional rules to create a congruence between substantive jurisdiction to tax and enforcement jurisdiction, I would nevertheless like to suggest briefly some of the areas in which such an inquiry might be fruitful, thereby (in the finest of academic traditions) attempting to secure my continued employment by laying the groundwork for my own future research.

1. Income.

a. The Permanent Establishment Concept. Few jurisdiction-to-tax issues have received more attention in recent years than the permanent establishment concept, and it may therefore be appropriate to evaluate that concept in light of the norms suggested by our "little black box." Specifically, how does the permanent establishment concept, which we have characterized as a rule of enforcement jurisdiction,[127] measure up against the criterion of "congruence" between enforcement jurisdiction and substantive jurisdiction to tax?

When the permanent establishment concept was first embraced as a criterion for determining the existence of enforcement jurisdiction over a nonresident enterprise with respect to its business profits from sources within the State, it arguably created a reasonably good "fit" between enforcement jurisdiction and substantive jurisdiction. The permanent establishment concept originated in the work of the Committee of Technical Experts who drafted the League of Nations model income tax treaty in the 1920s.[128] At that

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[127] *See supra* notes 100-08 and accompanying text.

[128] *See* Graetz & O'Hear, *supra* note 6, at 1088-89 ("[C]oncern[ed] with expanding

time, the American business community was becoming increasingly concerned over what it viewed as the aggressive assertion of source-based taxing claims by foreign governments, which were under great pressure to raise revenues after World War I. According to one contemporary observer, foreign governments

> began to try to tax the earnings of the visiting businessman and the profits of the foreign company on goods sold through him. Canada even tried to tax a United States firm on profits from advertising its wares and receiving mail orders from customers in its territory.
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> In the early 1920s, the British Board of Inland Revenue sought to impose liability . . . [on] sales through a local commission agent . . . [e]ven if the nonresident and his British intermediary took pains to conclude the contract abroad. . . . In the face of this concern with expanding jurisdiction over business income, the Committee of Technical Experts adopted the 'permanent establishment' safeguard: only the nation in which the permanent establishment of a business enterprise was located could legitimately levy source-based taxes on the enterprise's income.[129]

While the permanent establishment concept was adopted as a restraining rule of "enforcement jurisdiction" over the broader substantive source-based jurisdiction that some States were asserting over business profits, enforcement jurisdiction nevertheless roughly corresponded to substantive jurisdiction because at that time, as Jeffrey Owens has pointed out, "physical presence was necessary to conduct significant business operations."[130] Hence,

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jurisdiction over business income the Committee of Technical Experts adopted the 'permanent establishment' safeguard."). The OECD's model income tax treaty is a "direct descendant" of the League of Nations model treaty. *Id.* at 1066. The Graetz & O'Hear article, on which the following historical discussion relies, contains a detailed examination of the "legislative history" of the League of Nations model treaty.

[129] *Id.* at 1088 (alterations in original) (quoting Mitchell B. Carroll, *International Tax Law: Benefits for American Investors and Enterprises Abroad*, 2 INT'L LAW 692, 700 (1968)).

[130] Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 535 (1997) (crediting Owens and citing Frances M. Horner & Jeffrey Owens, *Tax and the*

even if the permanent establishment concept was a conscious effort to cabin the exercise of source-based jurisdiction within the confines of a more narrowly defined enforcement rule, the former can fairly be viewed as serving the function of smoothing the edges of the latter, operating at the margins to keep the application of substantive jurisdiction to tax business profits within "reasonable" bounds.[131]

But times have changed over the three-quarters of a century since the permanent establishment concept first became a fixture of international income tax jurisdiction. Indeed, if there is one proposition with which virtually all observers agree, it is that the way in which income is generated in the "new economy" is materially different from the way it was generated during the formative era of international income tax rules.[132] These differences are well known and well documented, and there is no need to belabor them here. Suffice it to say that services and intangibles have become increasingly important (relative to goods) in today's economy and electronic commerce pervades (when it does not dominate) many

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Web: New Technology, Old Problems, 50 BULL. INT'L FISC. DOC. 516, 516-18 (1996)).

[131] To be sure, the adoption of the permanent establishment concept primarily served the broader objective of resolving "the competing claims of residence and source nations in order to avoid the double taxation that results when both fully exercise their taxing power." Graetz & O'Hear, *supra* note 6, at 1033. As noted above, Graetz and O'Hear describe this objective as "[t]he basic task of international [income] tax rules." *Id. See also* Avi-Yonah, *supra* note 130, at 517-23 (discussing Single Tax Principle and traditional goal of avoiding double taxation); Arthur J. Cockfield, *Transforming the Internet into a Taxable Forum: A Case Study in E-Commerce Taxation*, 85 MINN. L. REV. 1171, 1177-80 (2001) (discussing history and rationale of permanent establishment principle). Under the widely shared view that the primary right to tax income belongs to the source country, AMERICAN LAW INSTITUTE, *supra* note 5, at 6, the adoption of the permanent establishment rule essentially provided a threshold of economic activity that an enterprise had to exceed before its business income would be subject to tax by the State of source rather than by the State of residence, which had the right to tax all of the enterprise's income regardless of source. As we noted at the outset of this undertaking, however, this Article, in keeping with the topic of this symposium, is concerned principally with the preliminary question of whether, and under what circumstances, jurisdiction to tax (and to enforce collection of the tax) exists at all and not with the question of the equitable division of income between competing jurisdictions. *See supra* note 6. For this reason, I have generally (and somewhat artificially) limited my focus to the first question, although I recognize that how one resolves the first question has implications for the second question and that resolution of these two questions may be inextricably intertwined.

[132] *See, e.g.*, DOERNBERG ET AL., *supra* note 7, at 1-66; Avi-Yonah, *supra* note 130, at 510-16; Arthur J. Cockfield, *Designing Tax Policy for the Digital Biosphere: How the Internet Is Changing Tax Laws*, 34 CONN. L. REV. 333, 337-50 (2002); McLure, *supra* note 48, at 281-98.

forms of income-producing activity. Consequently, today's economy bears a fading resemblance to the economy of the 1920s in ways that bear directly on both the theoretical and practical underpinnings of income tax jurisdiction. Specifically, the significance of the relationship that traditionally existed between the physical location of activities and the income they produce has diminished. The implications for jurisdictional analysis are apparent. The concept of a permanent establishment, rooted as it is in indicia of physical presence, has become a less accurate gauge of the source of income than it was when the concept was first adopted. Hence the relationship between enforcement jurisdiction and substantive jurisdiction has become more attenuated.

This is hardly a novel observation, although it has not always been framed in terms of a "disconnect" between enforcement and substantive jurisdiction. For example, Jeffrey Owens has observed that "[t]he principle of physical presence comes under pressure where a business is able to exploit a market in a country without establishing a physical presence there"; that "the concept of geographical fixedness may be inapplicable or even irrelevant in the Internet environment"; and that "the operation of the permanent establishment concept could be easily manipulated for tax purposes."[133] Reuven Avi-Yonah similarly observes that in the new economy "[i]nteractivity, speed, and electronic payment mean that commerce on a much grander scale can be conducted without any physical presence in the consumer's jurisdiction."[134] Arthur Cockfield notes that the decreasing significance of the physical manifestations of economic activity will, "erode the ability of capital-importing countries to impose their income taxes on activities that

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[133] Jeffrey Owens, The Tax Man Cometh to Cyberspace 22-21 (Apr. 5, 1997) (paper presented at Harvard International Tax Program Symposium on Multijurisdictional Taxation of Electronic Commerce, on file with author). Owens illustrates the possibilities for manipulation with the following two examples: First, "a multinational business could locate its web site on a server in a tax haven so as to constitute a permanent establishment in that tax haven and use that server to conduct business anywhere in the world." *Id.* at 21. Second, "a business could arrange for a permanent establishment to exist nowhere by regularly moving its web site from a server in one jurisdiction to a server in another." *Id.*

[134] Avi-Yonah, *supra* note 130, at 535.

previously were conducted through the permanent establishment."[135]

We come, then, to the ultimate question: What do we do about the mismatch between enforcement jurisdiction (in the form of the traditional permanent establishment concept) and substantive jurisdiction (in the form of business profits that may plausibly be regarded as having their source in countries in which little or no physical activity occurs[136])? The fundamental answer, it seems to me, is the one I suggested at the outset of this discussion: We do our best to redesign our rules of enforcement jurisdiction or our rules of substantive jurisdiction so that they are more closely aligned. Whether we modify the former or the latter or both depends on a variety of factors including (1) the relative merits of the misaligned rules; (2) the leeway that exists from a legal and political standpoint to modify the rules; and (3) the practical implications of the modifications.

If the cause of the "misalignment" is that the source of income no longer corresponds to physical presence, there are at least two plausible paths to realigning the enforcement rules with the substantive rules. First, one could substitute a different substantive rule that would be more consonant with prevailing enforcement rules. For example, the U.S. Treasury has suggested in its white paper on "Selected Tax Policy Implications of Global Electronic Commerce"[137] that a solution to the difficulties of enforcing a source-based income tax regime when the source of income has lost its connection to precise physical locations is simply to abandon the substantive tax principle of source and replace it with the substan-

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[135] Cockfield, *supra* note 106, at 158.

[136] Needless to say, the source question itself can be a contentious one, and I am not suggesting whether, or the extent to which, any particular income from business profits attributable to economic activity not reflected by physical activity occurring within a State should be characterized as having its source in the State in which the economic activity arguably occurs. All I am suggesting is that the source of such income may "plausibly" be regarded as located in such States under reasonable conceptions of source. *See, e.g.*, Avi-Yonah, *supra* note 130, at 540 ("[T]he Demand jurisdiction is a source of income (it could not have been earned but for the market).").

[137] Office of Tax Policy, U.S. Dep't of Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (Nov. 1996), *available at* http://www.ustreas.gov/offices/tax-policy/library/internet.pdf.

tive tax principle of residence.[138] Alternatively, one could cure the "misalignment" between the substantive rule and the enforcement rule by substituting a different enforcement rule that would be more consonant with the substantive rule. For example, Reuven Avi-Yonah has suggested an enforcement rule based on a threshold of sales into a destination State, backed up by a withholding mechanism in the State of origin "to force taxpayers to file a return in a jurisdiction where they have no physical presence."[139] Finally, if one is of the opinion (contrary to the views described above) that the root cause of the "misalignment" problem is that we have failed to

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[138] The Treasury white paper declares:

> The growth of new communications technologies and electronic commerce will likely require that principles of residence-based taxation assume even greater importance. In the world of cyberspace, it is often difficult, if not impossible, to apply traditional source concepts to link an item of income with a specific geographical location. Therefore, source-based taxation could lose its rationale and be rendered obsolete by electronic commerce. By contrast, almost all taxpayers are resident somewhere . . . United States tax policy has already recognized that as traditional source principles lose their significance, residence-based taxation can step in and take their place. This trend will be accelerated by developments in electronic commerce where principles of residence-based taxation will also play a major role.

Id. ¶ 7.1.5.

[139] Avi-Yonah, *supra* note 130, at 538. He notes that this is similar to the rule for U.S. real estate transactions (citing I.R.C. § 1445). It is also worth noting that the OECD, while bravely amending the existing Commentary on the existing definition of a permanent establishment to deal with the challenges raised by electronic commerce, *see* OECD, *Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on Article 5*, *in* IMPLEMENTING THE OTTAWA FRAMEWORK CONDITIONS 79, 79-85, has recognized the broader question of whether the permanent establishment concept as presently written is suitable for an economic environment in which electronic commerce plays a significant role. The OECD's Committee on Fiscal Affairs has given its Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits in the Context of Electronic Commerce the mandate "to examine how the current treaty rules for the taxation of business profits apply in the context of electronic commerce and examine proposals for alternative rules." *Id.* at 79-80. Moreover, it has explicitly asked for advice on the "*more important issue*," *id.* at 80 (emphasis added)—more important, that is, than the issue of interpreting the existing permanent establishment definition—"of whether any changes should be made to that definition or whether the permanent establishment concept should be abandoned." *Id.* Given the thorny issues that the Commentary on the existing definition raises in light of its conclusion that a computer server (which can be put virtually anywhere) may constitute a permanent establishment, *id.* at 82-83; *see* Cockfield, *supra* note 131, at 1192-1200 (discussing problems with taxing profits from servers), the report of the TAG considering the broader issue should be of considerable interest.

maintain a proper understanding of the source principle by allowing it to come loose from its moorings in identifiable physical activities, then the solution lies in clarifying the substantive scope of the source principle to reestablish its "bedrock" connection to physical activity in identifiable geographic locations.

Needless to say each of these proposed solutions is subject to criticism. Thus the substitution of a residence-based rule of substantive jurisdiction for a source-based rule of substantive jurisdiction is subject to the objections that it contravenes generally accepted international norms of tax policy that the source jurisdiction has the primary right to tax business profits;[140] that residence is a relatively meaningless concept, especially for "virtual" enterprises, and that its adoption could raise as many problems as it resolves; and that adoption of a residence-based rule raises troublesome questions of international tax equity because it favors countries like the United States, which produce so much of the world's intellectual property, over those countries in which such content is employed or consumed.[141] The use of a destination-based sales threshold for enforcement jurisdiction (backed up by a withholding tax in the State of origin to force compliance) would require a degree of international cooperation that may charitably be characterized as implausible. And the "reinvigoration" of the source principle so that it more closely corresponds to physical activities in identifiable locations would run counter to what many regard as contemporary economic reality.

The debate over these questions is intense and important, but I do not wish to prolong that debate here.[142] My more limited immediate purpose is simply to suggest that the foregoing framework provides a useful analytical structure for addressing these issues.

b. American Subnational Corporate Income Taxes. One of the more salient examples of the "disconnect" between substantive jurisdiction-to-tax rules and enforcement jurisdiction can be found in rules that the American States use to "source" business income.

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[140] Avi-Yonah, *supra* note 130, at 520, 525.

[141] McLure, *supra* note 48, at 420.

[142] This is not to suggest that I have no views on these questions. *See supra* note 120.

The States generally employ formulary apportionment for determining the source of income from what the international tax community would call "business profits"[143] and what the States generally call "business income."[144] The States enjoy considerable freedom in designing their apportionment formulas and thereby determining their "substantive" jurisdiction to tax on a formulary basis. Historically, most States employed an equally weighted three-factor formula of property, payroll, and sales for apportioning corporate business income.[145] In 1978, however, the U.S. Supreme Court sustained Iowa's single-factor sales formula for apportioning corporate income.[146] Over the past quarter century, many States have accorded increasing (if not exclusive) weight to the sales factor in their apportionment formulas, so that today almost three-quarters of the States with corporate income taxes place at least half the weight on sales and eight place exclusive weight on sales.[147]

Whatever may be the merits of States' tendency to define their substantive jurisdiction to tax business income by relying more heavily on sales within the State,[148] it has exacerbated a "misalignment" between substantive jurisdiction to tax and enforcement jurisdiction that has existed for some time in the American corporate income tax context. The "misalignment" arises from the fact that federal statutory (and, arguably, constitutional) restraints limit the States' power to impose an income tax on income derived by a

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[143] OECD MODEL, *supra* note 4, art. 7; U.S. MODEL, *supra* note 31, art. 7.

[144] Most States define "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT § 1(a) 7A U.L.A. 147, 147 (2002) [hereinafter UDITPA].

[145] 1 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 8.06.

[146] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272 (1978).

[147] Charles E. McLure, Jr. & Walter Hellerstein, *Does Sales-Only Apportionment of Corporate Income Violate International Trade Rules?*, 25 ST. TAX NOTES 779, 779 (Sept. 9, 2002); Michael Mazerov, *The Single-Sales-Factor Formula: A Boon to Economic Development or a Costly Giveaway?*, 20 ST. TAX NOTES 1775, 1775 (May 21, 2001).

[148] While this is not the appropriate place to pursue these issues, I have expressed my views on the defensibility of the single-factor sales formula elsewhere. *See, e.g.*, 1 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 8.13[2][b]; McLure & Hellerstein, *supra* note 147; Walter Hellerstein, *On the Proposed Single-Factor Formula in Michigan*, 9 ST. TAX NOTES 999 (Oct. 2, 1995).

nonresident person from the interstate sale of tangible personal property to customers in the State if the out-of-state person's in-state activities do not exceed solicitation of orders that are fulfilled by shipment from outside the State.[149] At the same time, however, the States define their substantive jurisdiction as including income attributable to sales of tangible personal property to purchasers within the State.[150] Although some States employ a "throwback" rule under which sales are "thrown back" to the State of the origin of the shipment when the State of destination lacks the power to tax the out-of-state vendor,[151] many States (including, in particular, those with single-factor or heavily weighted sales formulas such as Connecticut, Iowa, and Minnesota) do not employ the "throwback" rule.[152] As a consequence, the States confront a classic situation in which substantive jurisdiction and enforcement jurisdiction are misaligned, i.e., substantive jurisdiction exists where enforcement jurisdiction does not.[153]

On the predicate that underlies the analysis in this Article, namely, that it makes little sense from a normative standpoint to have rules of substantive jurisdiction to tax that are out of alignment with our rules of enforcement jurisdiction, it would seem that there are two possible solutions to the misalignment problem the States confront in their corporate income taxes. First, if rules like

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[149] Act of Sept. 14, 1995, Pub. L. No. 86-272, 73 Stat. 555 (codified as amended at 15 U.S.C. § 381 (2000)) (commonly referred to as Public Law 86-272). There is considerable debate and uncertainty over whether, and the extent to which, federal constitutional restraints limit the States' power to impose income taxes on nonresident corporations with no or limited physical presence in the State, 1 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ch. 6 (1998 & Supp. 2002), a point I simply note without pursuing the issue.

[150] UDITPA, *supra* note 144, § 16(a).

[151] *Id.* § 16(b).

[152] McLure & Hellerstein, *supra* note 147, at 781 n.18.

[153] One could quarrel with the characterization of the problem as one of misalignment between substantive and enforcement jurisdiction on the ground that Public Law 86-272 is a rule of substantive jurisdiction by depriving a State of power to impose a tax on a certain category of income, not merely the power to enforce a tax. I do not find such an argument persuasive. The Court in *Moorman* made it clear that the States enjoy considerable leeway in determining the income they can tax as state-source income on a formulary basis. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978). Public Law 86-272, it seems to me, is analogous to the permanent establishment limitation on taxing income, namely, an "enforcement jurisdiction" limitation that precludes a State from taxing income that concededly has (or may plausibly be deemed to have) its source within a State.

Public Law 86-272[154] and similar restraints that limit States' power to enforce income taxes on out-of-state enterprises with little or no physical presence in the State are to remain the "supreme Law of the Land,"[155] it makes little sense to adhere to rules of substantive jurisdiction that systematically assign income to such States. In short, as a matter of tax policy—although perhaps not economic development policy[156]—if physical presence (or "substantial" physical presence) is to remain the touchstone of enforcement jurisdiction in the state income tax context, then it should likewise be the guiding principle for designing rules of substantive jurisdiction to tax. For substantive jurisdictional rules to be "congruent" with the limits on enforcement jurisdiction, the factors of the formula should be designed to reflect only indicia of income-producing activity in States that have the enforcement jurisdiction to tax such income (*e.g.*, property and payroll). Alternatively, States could adopt "throwback" rules to assure that substantive jurisdiction and enforcement jurisdiction are in alignment.[157]

A second path to alignment of the substantive and enforcement rules in the American state corporate income tax context would involve modification of the enforcement rules. Essentially, the enforcement rules could be brought into line with the rules the States currently employ to "source" income to the States based on destination sales. Accordingly, if the "supreme Law of the Land" were changed to permit States to enforce income taxes on out-of-state enterprises with little or no physical presence in the State but whose income was assigned to the State on the basis of destination sales—and such a change could be effectuated with the stroke of a

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[154] 15 U.S.C. § 381 (2000).

[155] U.S. CONST. art. VI, cl. 2. It is worth keeping in mind that in the context of American subnational taxation, as distinguished from international taxation, there is a supervening authority (Congress) that has the power to create the proper alignment between substantive jurisdiction and enforcement jurisdiction should it choose to exercise that power. *See generally* Walter Hellerstein, *Federal Constitutional Limitations on Congressional Power Regarding State Taxation of Electronic Commerce*, 53 NAT'L TAX J. 1307, 1323-24 (2000).

[156] The movement towards adoption of apportionment formulas weighted heavily or exclusively on sales has been motivated largely by economic development concerns. McLure & Hellerstein, *supra* note 147, at 779; Mazerov, *supra* note 147, at 1775.

[157] I should make it clear that the analysis in the foregoing paragraph is directed exclusively to the "alignment" issue and not the policy concerns that might underlie the adoption of any of the rules necessary to achieve such alignment.

congressional pen[158]—the "disconnect" between substantive jurisdiction to tax and enforcement jurisdiction to tax would disappear.[159]

Once again, it is critical to stress that my intent in suggesting these "solutions" to the mismatch between existing rules governing substantive and enforcement jurisdiction is not to advance any particular solution or to imply that the proposed solutions do not raise important policy concerns of their own. Plainly, the suggested solutions each raise serious tax policy issues that would need to be addressed before any particular solution were adopted (*e.g.*, the merits of the "physical presence" rule as an exclusive determinant of source-of-income, the practical problems of identifying sales—particularly digital sales—under a sales destination test). Nevertheless, to reiterate the mantra underlying this entire enterprise, consideration of the objective of aligning the rules for substantive and enforcement jurisdiction ought to play a role in the analysis of the issues raised under the broad umbrella of "jurisdiction to tax."

2. Consumption. The analysis of jurisdiction-to-tax issues, by focusing separately on substantive jurisdiction and enforcement jurisdiction, serves a function in the context of consumption taxation similar to the function that it serves in the context of income taxation.

a. International VAT Issues. At first blush, one might conclude from the discussion in Part II of this Article that the alignment between substantive jurisdiction and enforcement jurisdiction in the context of international cross-border consumption taxation is relatively close—or at least close enough for government

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[158] *See generally* Hellerstein, *supra* note 155.

[159] The Multistate Tax Commission, inspired by the work of Charles McLure, is currently advancing a proposal along these lines, although it recognizes that its ability fully to implement the proposal is limited by existing federal restraints on state tax power. Multistate Tax Commission, *Factor Presence Nexus Standard*, 25 ST. TAX NOTES 1035 (Sept. 30, 2002); Dan Bucks & Frank Katz, *Explanation of the Multistate Tax Commission's Proposed Factor Presence Nexus Standard*, 25 ST. TAX NOTES 1037, 1037, 1040-41 (Sept. 30, 2002). *See generally* Charles E. McLure, Jr., *The Nuttiness of State and Local Taxes—and the Nuttiness of Responses Thereto*, 25 ST. TAX NOTES 811 (Sept. 16, 2002); Charles E. McLure, Jr., *Implementing State Corporate Income Taxes in the Digital Age*, 53 NAT'L TAX J. 1287 (2000).

work (which is, after all, the subject of this symposium). Substantive jurisdiction to tax exists in the place of consumption and in the place of supply or sale when this is different from the place of consumption.[160] Enforcement jurisdiction exists in the place of supply and, at least with respect to purchases by registered businesses, in the place of consumption.[161] Moreover, consumption taxes on supplies of goods can be enforced at importation through border controls. Accordingly, from the standpoint of the raw power to enforce consumption taxes on cross-border transactions, it appears that ample authority exists to enforce such taxes where substantive jurisdiction to tax exists—if such authority is exercised to its fullest extent.

The problem with this rosy picture, however, is that it fails to take account of the significant policy-based and competitive restraints on the enforcement of consumption taxes to the full extent that enforcement jurisdiction exists. Specifically, from a policy standpoint, consumption *should* be taxed where consumption occurs rather than where the supply occurs, when consumption occurs other than at the place of supply.[162] Moreover, from a competitive standpoint, exercising consumption tax jurisdiction at the place of supply (when it is not the place of consumption) can put suppliers at a competitive disadvantage if they make supplies in States that do not tax consumption. Consequently, when suppliers make supplies of goods or services in one State for consumption in another State, the enforcement jurisdiction that exists to enforce consumption taxes at the place of supply *should not* be exercised. Rather, such enforcement jurisdiction should be exercised only at the place of consumption. It is these policy-based and competitive concerns

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[160] With respect to the objection to the tautological character of the statement that "[s]ubstantive jurisdiction to tax exists . . . in the place of supply or sale when this is different from the place of consumption," see *supra* note 55.

[161] For purposes of the ensuing analysis, I ignore the possibility of enforcing consumption taxes directly against private consumers, even though legal authority for such enforcement may exist. *See supra* notes 44-53, 70-84 and accompanying text (discussing generally enforcement of consumption taxes directly against private consumers).

[162] Since States may (and often do) define the place of supply as the place of consumption, perhaps a more precise way of stating the point in the text would be to say "when consumption occurs other than at the place where the supply of the goods or services in question is deemed to occur." *See supra* note 55 (discussing concept of "place of supply").

that create the principal "misalignment" between substantive jurisdiction to tax and enforcement jurisdiction in the consumption tax arena.

On the assumption that consumption should be taxed only where consumption occurs and that the State where consumption occurs will seek to exercise its enforcement jurisdiction to the limits of its authority, the issues of aligning substantive and enforcement jurisdiction in the cross-border consumption tax context may be illustrated by the following diagram:

B2B Tangible Property	B2B Services, Intangibles
B2C Tangible Property	B2C Services, Intangibles

In fact, there is a relatively good "fit" between substantive jurisdiction to tax and enforcement jurisdiction in three of the four categories of transactions identified above. In every category there is substantive jurisdiction to tax, because the place of taxation is, by hypothesis, the place of consumption. For business-to-business (B2B) transactions involving supplies of tangible personal property, there is ample enforcement jurisdiction through the State's border controls or through the State's authority over its registered traders. Similarly, for business-to-consumer (B2C) transactions involving supplies of tangible personal property, there is ample enforcement jurisdiction through border controls. Even with respect to transactions involving supplies of intangibles or services (especially those transmitted through electronic means where border controls are of little assistance), there is enforcement jurisdiction in the State of consumption in the B2B context.[163] As noted above, the self-assessment or "reverse charge" mechanism is an effective means of enforcing consumption tax obligations in the place of consumption with respect to supplies of services or intangibles to registered traders.

We come, then, to the final category—B2C transactions involving supplies of services or intangibles. This is the one context in which

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[163] This is not to suggest, however, that determining the place of consumption for B2B transactions is without difficulty. *Cf.* OTTAWA FRAMEWORK, *supra* note 44, at 44-45 (providing guidelines on definition of place of consumption).

the match between enforcement jurisdiction and substantive jurisdiction is less than ideal. Inasmuch as there is no enforcement jurisdiction directly over the private consumer,[164] and because border controls are often likely to be ineffectual with respect to the supplies in question,[165] the alignment of enforcement jurisdiction with substantive jurisdiction requires either the establishment of enforcement jurisdiction over the remote supplier or abandoning the principle that consumption should be taxed where it occurs.[166] The latter option seems undesirable for the reasons suggested above. The former, however, raises the fundamental question of how enforcement jurisdiction can be established over nonregistered suppliers.

This is hardly an abstract question as demonstrated by the recent amendments to the EU's Sixth Directive requiring non-EU suppliers to register and collect VAT with respect to certain electronically delivered services supplied to private consumers in the community.[167] Yet it is a question that the foregoing analysis puts into theoretical perspective, even if it does not suggest precisely how the issue should be resolved. First, it identifies the issue for what it is—one of enforcement jurisdiction, not substantive jurisdiction. It therefore helps to focus the debate on the real question at issue: whether the tax can or should be enforced, not on whether the tax

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[164] This is true, as a legal matter, within a consumption tax regime like the EU VAT that is imposed only on "taxable persons," and as a practical matter, within a consumption tax regime like the U.S. RST, where the consumer may have a legal obligation to pay use taxes, but in which enforcement, as a practical matter, is not feasible without vendor collection. *See supra* notes 71-75 and accompanying text. *But see supra* note 80.

[165] It is worth keeping in mind that we are addressing here only *cross-border* transactions in services and intangibles, *i.e.*, services and intangible property that generally are capable of being delivered and consumed in a location different from the location in which the services or intangibles are performed or produced. *Cf.* OTTAWA FRAMEWORK, *supra* note 44, at 44-45. Because tangible services, such as services relating to specific property or services relating to physical performance, generally are performed where they are consumed, the supply of such services does not raise the problems to which this Article is addressed.

[166] There is a third possibility—"tax at source and transfer," *i.e.* "[a] business would collect consumption tax on 'exports' to non-residents and remit the amount to their domestic revenue authority, where it would be forwarded to the revenue authority in the country of consumption." *Id.* at 32. However, the political and administrative impediments to this solution, including the need for international agreements regarding the enforcement, collection, and revenue transfers, render this option highly impractical.

[167] Council Directive 2002/38/EC, *supra* note 55, art. 1(3); Council Regulation 792/2002, *supra* note 55, art. 1(4).

can or should be imposed. There can be no serious theoretical objection to the imposition of a consumption tax by the State of consumption.

Second, because the jurisdictional inquiries are different, there is no reason as a matter of principle why the jurisdictional standards should not likewise be different. To be sure, there must be some acceptable legal basis, beyond the mere say-so of the tax administration, for requiring remote and hitherto unregistered suppliers to participate in the tax collection process. But that legal basis need not necessarily be the same legal basis that would be required for exercising substantive tax jurisdiction. Whether the standard should be a defined threshold of sales, the "purposeful availment" of "the benefits of an economic market" in the State regardless of physical presence,[168] or a "bright-line rule"[169] requiring the supplier's physical presence in a State is a matter over which reasonable people can and do differ. But there is no reason in theory why rules developed, for example, to determine whether a person is consuming goods or services within a State, so that he may fairly be asked to contribute to that State's fisc by reference to such consumption, should be the same as those employed to determine whether a person has exceeded the threshold of activity that permits a State reasonably to demand that he collect and remit the tax obligation that, in an economic sense at least, is imposed on another.

Third, because the key issue is one of enforcement, it would seem that practical rather than theoretical concerns should be paramount in resolving it. Once "the conditions of state power to tax are satisfied,"[170] the question becomes whether the State can avail itself of "some practically effective device . . . in order to enable the state to collect its tax."[171] Perhaps this is the most important point. The practical considerations relating to enforcement of consumption tax obligations will substantially influence the jurisdictional inquiry.

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[168] Quill Corp. v. North Dakota, 504 U.S. 298, 307-08 (1992) (stating that Due Process Clause does not require physical presence to tax out-of-state person, so long as minimum contacts requirement is met).

[169] *Id.* at 314 (noting that Court's decisions applying "flexible substantive approach" in some Commerce Clause cases do not indicate Court's rejection of bright-line test in all Commerce Clause cases).

[170] Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 444 (1944).

[171] *Id.*

If there are administratively workable mechanisms for enlisting remote suppliers of services and intangibles into the consumption tax collection process at reasonable costs, such mechanisms are likely, in the end, to be accepted by all concerned as a "practically effective device . . . in order to enable the state to collect its tax."[172] In the absence of such mechanisms, however, enforcement jurisdiction in this context will remain problematic at best.

b. American Subnational RST Issues. There are obvious similarities between international VAT jurisdictional issues and American subnational RST jurisdictional issues, but there are significant differences as well. Accordingly, it may be worthwhile briefly to identify these differences before exploring in the American subnational consumption tax context the same "alignment" issues we have just examined in the international consumption tax context.[173]

First, there is a fundamental distinction between *international* VAT issues (*i.e.*, cross-border transactions between parties within and without the EU) and *subnational* RST issues (*i.e.*, cross-border transactions between parties within and without a particular American State). Transactions of the former type always traverse true fiscal frontiers, whether or not the fiscal authorities are capable of stopping the transactions at the border. Transactions of the latter type often do not. As we shall see, this difference has implications for enforcement under the two regimes with respect to the cross-border supply of goods.[174]

Second, the American States, unlike national States, are restrained by federal constitutional limitations in their assertions of jurisdiction to impose consumption taxes. It is these constitu-

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[172] *Id.* Consider, for example, the recent agreement of several large retailers to collect use taxes on internet purchases, despite the uncertainty surrounding their legal obligation to do so. *See* Lisa Brown, *Several Large Retailers This Week Began Collecting Sales Tax on Internet Purchases*, CNET NEWS.COM, Feb. 6, 2003, *at* http://news.com.com/2100-1017-983636.html.

[173] For purposes of this discussion, I will continue to use the EU VAT as my "model" for discussion of VATs. The ensuing discussion addresses *only* those differences with a direct relationship to the jurisdictional issues under consideration. There are other differences that lie outside the scope of the present discussion. *See* DOERNBERG ET AL., *supra* note 7, at 160-62.

[174] I consider below the analogy between the EU VAT and the American RST from the narrower perspective of intra-Community and interstate supplies of goods. *See infra* notes 185-99 and accompanying text.

tional limitations, applied largely in the context of interstate (rather than international) commerce, that are the principal source of jurisdictional restraints on the States' taxing authority.

Third, there is a significant difference in the scope of the EU VAT and the American RST that bears on the jurisdictional issues that the two regimes confront. The EU VAT applies generally to the supply of all goods and services; the American RST applies generally only to the sale of tangible personal property with limited application to services. The failure of the American RST to reach many services not only creates a gaping hole in the tax base,[175] but it also has implications for jurisdiction-to-tax issues. As noted above in the connection with the EU VAT, the most difficult jurisdictional issues relate to the taxation of services and intangibles. Because American RSTs apply only selectively to the taxation of services or digital products, these issues present a less immediate and more theoretical concern for American RSTs than they do for the EU VAT.

Finally, in examining the question of whether an American State has jurisdiction to impose a sales or use tax on goods or services provided by an out-of-state vendor, one should keep in mind that it makes no difference whether the vendor is based in some other American State or in another national State. In other words, the constitutional law governing an American State's power to tax generally does not distinguish between out-of-state enterprises established in other American States and out-of-state enterprises established in other countries. From the standpoint of an American State, both are simply out-of-state enterprises. Indeed, if an American State were to accord less favorable treatment to sales made by an out-of-state enterprise because it was established in a foreign State rather than in another American State, the State would violate the Commerce Clause doctrine barring taxes that discriminate against foreign commerce,[176] not to mention the

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[175] At least when viewed from the standpoint of an ideal levy on household consumption.

[176] *See* Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue, 505 U.S. 71, 82 (1992). Moreover, if an American State were to accord *more* favorable treatment to sales made by an out-of-state enterprise because it was established in a foreign State rather than in an American State, such discrimination would likewise raise constitutional concerns. *See* Sears Roebuck & Co. v. County of Los Angeles, 149 Cal. Rptr. 750 (Cal. Ct. App. 1978), *aff'd by an equally divided Court*, 449 U.S. 1119 (1981). For example, courts have held that an exemption for foreign but not interstate imports violates the Commerce Clause. Star-Kist Foods, Inc. v. County of Los

requirement of "national treatment" of foreign products under international trade agreements.[177]

Let us turn, then, to the question of the alignment between substantive jurisdiction to tax and enforcement jurisdiction in the context of American cross-border consumption taxation. With regard to the fundamental jurisdictional issues, the analysis in the American RST context closely parallels the analysis in the international VAT context. Substantive jurisdiction to tax under the RST exists in the place of consumption and in the place of sale, when this is different from the place of consumption.[178] Similarly, enforcement jurisdiction exists in the place of sale and, at least with respect to purchases by registered businesses, in the place of consumption.[179] However, because there are no fiscal borders within the United States, and because the Federal Government does not enforce subnational consumption taxes at American borders,[180] American subnational consumption taxes on cross-border sales of goods cannot (at least as a practical matter) be enforced through border controls.

Angeles, 719 P.2d 987, 996 (Cal. 1986); Zee Toys, Inc. v. County of Los Angeles, 149 Cal. Rptr. 750, 758 (Cal. Ct. App. 1978).

[177] General Agreement on Tariffs and Trade, Oct. 30, 1947, art. III, ¶ 1, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. In contrast to tax treaties, which generally do not apply to subnational governments, the provisions of GATT have generally been viewed as applicable to subnational governments. GATT article XXIV, paragraph 12 provides: "[e]ach contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories." *See generally* Walter Hellerstein, *Implications of the Uruguay Round Multilateral Trade Agreements for American Subnational Taxation of International Commerce*, 49 BULL. INT'L FISCAL DOC. 3 (1995); McLure & Hellerstein, *supra* note 147.

[178] *See supra* notes 44-69 and accompanying text.

[179] For purposes of the ensuing analysis, I ignore the possibility of enforcing consumption taxes directly against private consumers (as I did in the analysis of VAT) because of the practical difficulty of doing so, even though legal authority for such enforcement clearly exists in the American context. *See supra* notes 44-53, 70-84 and accompanying text.

[180] In principle, the U.S. Customs Service could assist the States in enforcing consumption tax obligations, but there is little coordination of this type between federal customs officials and state tax officials. Although the Customs Service does make available to the States information on imported goods, it leaves it to the States to pursue importers for any consumption tax that may be due. Indeed, any efforts by the States to enlist the Federal Government in an effort to impose greater collection responsibilities with respect to foreign than equivalent domestic (interstate) transactions might be regarded as an unconstitutional burden on foreign commerce and as a violation of "national treatment" requirements with respect to foreign products under international trade agreements. *See supra* notes 176-77 and accompanying text.

In this respect, then, there is less enforcement jurisdiction under the American RST than under the EU VAT as applied to international sales of goods.[181]

The jurisdictional problem is further complicated under the American RST (as it was under the EU VAT) if we pursue the "alignment" question on the assumption that consumption should be taxed only where consumption occurs, and that the State where consumption occurs will seek to exercise its enforcement jurisdiction to the limits of its authority. We can address the issues of aligning substantive and enforcement jurisdiction in the American subnational cross-border consumption tax context by reference to the same diagram that we employed above in addressing similar questions under the EU VAT:

B2B Tangible Property	B2B Services, Intangibles
B2C Tangible Property	B2C Services, Intangibles

The implications of this analysis are instructive especially by comparison to the implications of the same analysis in the context of the EU VAT as applied to international cross-border transactions. As in the case of the VAT analysis, there is substantive jurisdiction to tax in every category, because the place of taxation is, by hypothesis, the place of consumption. However, when we turn to enforcement jurisdiction, the alignment problems become apparent. Because there are no border controls, the enforcement jurisdiction that existed in the VAT context with respect to cross-border supplies of tangible property is unavailable. Consequently, for cross-border B2B sales of tangible property, the American States must rely entirely on their authority over their registered businesses for tax collection,[182] unless they can obtain enforcement jurisdiction over

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[181] This is not to suggest, however, that the authority that does exist is not sufficient for its purposes, an issue I consider further below when I examine the analogy between the EU VAT and the American RST from the narrower perspective of intra-Community and interstate supplies of goods. *See infra* notes 185-99 and accompanying text.

[182] In this connection, it is worth noting that despite the theoretical possibility of States exercising self-assessment or "direct pay" jurisdiction over their registered business, only thirty-three of the forty-five with sales and use taxes actually authorize direct payment of sales and use taxes, and there are often restrictions on the businesses that are entitled to apply for direct pay permits. Federation of Tax Administrators, *supra* note 83, at 36. The

the out-of-state vendor. Moreover, for cross-border B2C sales of tangible property, the States have no effective enforcement jurisdiction unless they can obtain enforcement jurisdiction over out-of-state vendors.[183] For cross-border B2B and B2C sales of services or intangibles, the analysis is the same with respect to the tangible property. The real point in this context, however, is that the issue is relatively insignificant, because the States generally do not tax services or intangibles under their sales and use taxes.

In the end, then, the States find themselves in an analogous position to that faced by the EU with respect to B2C cross-border supplies of services and intangibles, but with respect to a much more significant component of the consumption tax base, namely, B2C cross-border supplies of goods and, to the extent they have not provided for self-assessment or direct pay by registered businesses, B2B cross-border supplies of goods as well. As in the EU VAT context, the alignment of enforcement jurisdiction with substantive jurisdiction would require either the establishment of enforcement jurisdiction over the remote vendor or abandoning the principle that consumption should be taxed where it occurs. The latter option seems undesirable for the reasons suggested above. The former, however, runs headlong into the U.S. Supreme Court's decision in *Quill*,[184] unless Congress sees fit to overrule it.

How this issue should be resolved is, of course, one of the most—if not *the* most—contentious contemporary questions in American state taxation, and one that is fully explored in other articles in this symposium. Without entering the fray as an advocate for one position or another, I would simply urge that the debate be informed by the key lessons of the previous discussion. First, the issue is one of enforcement jurisdiction, not substantive jurisdiction, and the question is whether the tax can or should be

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Streamlined Sales Tax Project, a collective effort by the States to streamline and simplify their sales and use tax laws, requires that participating States provide for direct payment, although it permits States to establish their own limits for the direct pay permit. Streamlined Sales and Use Tax Agreement § 326, Nov. 12, 2002, *available at* http://www.streamlinedsalestax.org/FinalAgreementAdopted11-12-02.pdf.

[183] As noted *supra* note 179, for purposes of this analysis, I am ignoring the possibility of direct enforcement against the private consumer because of the practical problems associated with such enforcement.

[184] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

enforced, not on whether it can or should be imposed. Second, there is no reason as a matter of principle why the jurisdictional standards for enforcement jurisdiction should be the same as the jurisdictional standards for substantive tax jurisdiction. And third, because the key issue is one of enforcement, practical rather than theoretical concerns should be paramount in resolving it.

c. Borders, Federalism, and Collection of Consumption Taxes on Goods: What the U.S. and the EU Have to Teach Each Other. As we have observed at various points throughout the foregoing discussion, border controls are an effective mechanism for assuring collection of consumption taxes on cross-border supplies or sales of tangible personal property.[185] Thus, as noted immediately above in connection with the enforcement of the VAT with respect to international cross-border supplies of goods, border controls are central to enforcement in both B2B and B2C transactions. Moreover, we noted earlier that prior to the EU's creation of the Single Market in 1993, which effectively eliminated fiscal frontiers for intra-Community cross-border supplies of goods, supplies of goods between EU countries were taxed at the border of the importing Member State.[186]

By contrast, when borders have political significance, but no physical significance, they provide little assistance in the enforcement of consumption tax obligations even when the transactions involve cross-border supplies of goods. As we have just suggested, the American federal system is a case in point. The separate political identities of the individual States are self-evident, but the physical borders between the States are largely symbolic. Indeed, the very thought of exploiting those borders in the interest of more effective tax administration is wholly inconsistent with the overriding political commitment to national economic unity. For example, when the Governor of South Dakota remarked several years ago that his State had the power to enforce consumption taxes on goods shipped into the State by "stopping 'little brown trucks' at the South Dakota border,"[187] he evoked a storm of protest for even suggesting

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[185] *See supra* notes 93-95 and accompanying text.

[186] *See supra* notes 93-95 and accompanying text.

[187] Doug Sheppard, *Assessing New Congress's View on 'Streamlining' Premature Observers*

such a commercially disruptive measure, which would, in any event, be of questionable constitutionality.[188]

The EU's abolition a decade ago of intra-Community fiscal frontiers in the interest of furthering the Single Market reflects the tension between fiscal and economic considerations in the context of a "federal" system, or, to be politically correct, a "group of countries bound by a common legal framework for their consumption tax systems."[189] Clearly the EU made some sacrifices in the integrity of the VAT tax collection process with respect to intra-Community cross-border supplies of goods when it abandoned physical border controls in favor of reliance on detailed reporting requirements for business enterprises and greater cooperation between Member State taxing authorities.[190] But it did so with a clear goal in mind: To make the EU common market more closely resemble the American common market, at least insofar as the economic significance of state lines are concerned. While the American federal model of a relatively seamless internal market plainly had an economic lesson

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Say, 26 ST. TAX NOTES 386, 387 (Nov. 11, 2002); *see also* Doug Sheppard, *E-Commerce Commission Debates "Streamlined" Sales Tax Proposal*, 17 ST. TAX NOTES 1662, 1662-63 (Dec. 20, 1999). The reference to the "little brown trucks" was to the ubiquitous United Parcel Service delivery vans. South Dakota, incidentally, is a State without natural physical borders.

[188] The argument would be that such a measure would impose an unreasonable and discriminatory burden on interstate commerce in violation of the Commerce Clause. The counterargument would be that the U.S. Supreme Court's "cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988). Several years ago, the Maryland Comptroller announced that investigators from his office would periodically check the manifests of trucks coming into Maryland to scrutinize transactions and that

> [i]f we find that no sales tax has been paid on any major household items being delivered to Marylanders on those manifests, our Compliance Division will send letters to those people, explaining the law and informing them they may owe the state the 5% sales and use tax on their delivery.

Maryland Comptroller Announces Action to Collect Tax on Out-of-State Purchases, ST. TAX TODAY, June 4, 1999, LEXIS, 1999 STT 107-16. The legality of Maryland's actions was apparently never challenged in court, and, for the reasons suggested by the Supreme Court in *New Energy*, it is doubtful that such actions would have been found unconstitutional.

[189] OTTAWA FRAMEWORK, *supra* note 44, at 45 n.6. For ease of exposition, I will use the term "federal" (in quotes) to refer to the EU system with the recognition that the EU is not technically a federal system because each Member State retains its national sovereignty.

[190] FRIEDEN, *supra* note 82, at 375.

to teach to the EU, the EU's "federal" model of consumption tax harmonization and cooperation among Member State taxing authorities clearly has a fiscal lesson to teach the American States, whose level of harmonization and cooperation leaves considerable room for improvement. The EU VAT experience demonstrates that the absence of border controls within a "federal" common market does not lead inexorably to ineffective consumption tax administration with regard to cross-border supplies of goods between Member States.

The EU consumption tax experience contains yet another lesson, although its significance may be largely historical. It is unlikely that anyone would seriously recommend today that federal regimes should adopt border controls as a means of assuring effective consumption taxation of cross-border supplies of goods within their internal markets. Yet the EU experience suggests that it might not be such a bad idea for strategic political reasons for federal regimes to commence their interstate or intra-Community relationships with true fiscal frontiers. If federal regimes begin their political lives with "true" borders, traders within the federal system quickly learn two things. First, they learn that consumption taxes on cross-border transactions in goods will be paid, as trucks carrying their goods stand in long lines at Member State borders to permit customs officials to ensure that the appropriate consumption taxes are paid upon importation. Second, they learn that payment of consumption taxes through border controls has a high cost in economic efficiency and the smooth operation of a common market.

Consequently, as the federal regime matures and as the governing federal authority recognizes the inconsistency of such fiscal frontiers with a single internal market and seeks to eliminate them, the political task of persuading traders to cooperate in a consumption tax regime that incorporates measures to minimize consumption tax evasion in a borderless market becomes much easier than if such traders had never operated in an internal market with borders. In other words, if you operate in a regime in which "little brown trucks" have always been stopped at the border, the idea of a "distance selling rule" by which you are required to register and collect consumption tax on your mail-order sales to private consumers in a Member State when your sales to such consumers in that

State exceed a certain threshold[191] may seem like a small price to pay for allowing those "little brown trucks" carrying your goods to pass freely to their destination without stopping at Member State borders. By contrast, if you operate in a regime in which the thought of stopping "little brown trucks" at the border has always been anathema, then the idea of adopting a new "distance selling rule" as a mechanism for enforcing consumption taxes on your sales into other Member States, where you previously had no consumption tax collection obligation, may seem burdensome and unwarranted.

Finally, the EU experience with internal border controls is a reminder that in the "federal" context, as distinguished from the international context, the governing federal body possesses ample authority to resolve whatever intra-Community or interstate jurisdictional issues might otherwise inhibit effective tax enforcement between Member States.[192] The ultimate question is whether it has the political will to do so. Thus, there is no question that the U.S. Congress could, with the stroke of a pen, remove existing jurisdictional impediments that currently prevent the American States from effectively enforcing consumption taxes on distance sales.[193] These impediments are based on the restraints on state taxing and enforcement jurisdiction that the U.S. Supreme Court has articulated *in the absence of preemptive congressional legislation* fashioning these rules under the Commerce Clause. Because Congress has plenary power over the channels of interstate commerce, "Congress may keep the way open, confine it broadly or

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[191] *See* EU VAT Sixth Directive, *supra* note 55, art. 24 (establishing "special [tax] scheme for small undertakings").

[192] I am referring here only to the legal restraints on effective tax enforcement, not to the practical restraints.

[193] I wish to make it clear that I am not suggesting that Congress *should* exercise the power that it clearly possesses, at least not until the States significantly simplify and harmonize their consumption tax regimes to address the concerns that led the Court, in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), to reaffirm the Commerce Clause bar to enforcing state use tax collection obligations on out-of-state mail-order sellers without a physical presence in the State. Furthermore, I recognize that Congress may lack the authority to alter due process restrictions on state taxing jurisdiction, but these restraints, as the Court made clear in *Quill*, do not seriously inhibit the States' power to enforce consumption taxes on remote sellers. *See generally* Hellerstein, *supra* note 155, at 1323-24.

closely, or close it entirely,"[194] subject only to the limitations that the U.S. Constitution imposes on Congress's own power. Indeed, the U.S. Supreme Court has explicitly declared that "Congress is . . . free to decide whether, when, and to what extent the States may burden mail-order concerns with a duty to collect use taxes."[195]

Congress's enactment of the Mobile Telecommunications Sourcing Act (MTSA)[196] demonstrates the point. Under jurisdictional standards articulated in *Goldberg v. Sweet*[197] by the U.S. Supreme Court under the Commerce Clause, the "only" States with "a nexus substantial enough to tax a consumer's purchase of an interstate telephone call" are (1) "a State . . . which taxes the origination or termination of an interstate telephone call charged to a service address within that State" and (2) "a State which taxes the origination or termination of an interstate telephone call billed or paid within that State."[198] The implications of these standards for taxation of the wireless telecommunications industry are troublesome to say the least. Consider a business traveler who lives in State A, where she receives her monthly phone bill, but who, while in State B on business, makes a call to State C. Under *Goldberg*, none of these States can tax the charges for the call because none of them satisfies the foregoing test: Neither State A, nor State B, nor State C can claim that the call either originates or terminates in the State *and* is charged to a service address in the State or is billed or paid within the State.

The issues become even more complex if the customer is billed not on a transaction-by-transaction basis but instead pays, say, $50 per month for 500 minutes of calls regardless of where the calls originate or terminate. Indeed, if the customer were billed at a flat rate, the *Goldberg*-mandated inquiry would be virtually impossible because there would be no breakdown of the charges for the calls on a transaction-by-transaction basis. A typical wireless phone bill

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[194] Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 434 (1946).

[195] *Quill*, 504 U.S. at 318; *see generally* 2 HELLERSTEIN & HELLERSTEIN, *supra* note 6, ¶ 19.02[2][a] (discussing *Quill* Court's analysis of substantial nexus).

[196] Pub. L. No. 106-252, § 2(a), 114 Stat. 626 (2000) (codified at 4 U.S.C. § 116-126 (Supp. 2002)).

[197] 488 U.S. 252 (1989).

[198] *Id.* at 263.

simply shows the calls made and the minutes consumed with no itemized price allocation if one does not exceed the number of flat rate minutes. In fact, the "charge" shown for such individual calls is "$00.00."

The difficulties involved in taxing mobile telecommunications under the regime the Court established in *Goldberg* led Congress, with the joint support of the telecommunications industry and the States, to enact the MTSA, which permits the States to tax *all* mobile telecommunications charges (for services provided by the customer's "home service provider") at the customer's "place of primary use."[199] In practical terms, the MTSA eliminates the need

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[199] MTSA § 2(a). The (MTSA) defines the "home service provider" as "the facilities-based carrier or reseller with which the customer contracts for the provision of mobile telecommunications services." *Id.* § 124(5). The MTSA defines the "place of primary use" as "the residential street address or the primary business street address of the customer." *Id.* § 124(8)(A). The MTSA provides:

> Notwithstanding the law of any State or political subdivision of any State, mobile telecommunications services provided in a taxing jurisdiction to a customer, the charges for which are billed by or for the customer's home service provider, shall be deemed to be provided by the customer's home service provider.

Id. § 117(a). The key operative language of the MTSA, which both grants and limits state power to tax charges for mobile communications, provides:

> All charges for mobile telecommunications services that are deemed to be provided by the customer's home serve provider . . . are authorized to be subjected to tax, charge, or fee by the taxing jurisdictions whose territorial limits encompass the customer's place of primary use, regardless of where the mobile telecommunication [sic] services originate, terminate, or pass through, and no other taxing jurisdiction may impose taxes, charges, or fees on charges for such mobile telecommunications services.

Id. § 117(b).

The MTSA provides that a State or a company designated by the political subdivisions of a State may provide an electronic database identifying the proper taxing jurisdiction for each street address in that State. If the home service provider uses such a database, it will be held harmless from any tax otherwise due solely as a result of an error in the data base. *Id.* § 119. If no such database exists, the home service provider using an "enhanced zip code" (*i.e.*, the nine-digit zip code) to assign street addresses to a specific taxing jurisdiction and exercising due diligence in assigning such addresses will likewise be held harmless from any tax otherwise due solely as a result of an assignment of a street address to a specific taxing jurisdiction. *Id.* § 120. If an enhanced zip code overlaps boundaries of taxing jurisdictions, the home service provider must designate one specific jurisdiction within the enhanced zip code for use in taxing the activity for the enhanced zip code. *Id.*

Because the MTSA forbids the States from taxing wireless services except as provided under the Act, States have a strong incentive to amend their statutes to provide for taxation of wireless services in conformity with the Act. Unless and until the States take such affirmative action, they will lose tax revenue because the MTSA itself does not impose the

to determine the precise location of the sale of wireless telecommunications on a transaction-by-transaction basis. Instead it permits the State of the customer's "place of primary use"—and *only* that State—to tax the aggregate charges for wireless telecommunications services. In short, when the planets are properly aligned (*e.g.*, when Congress, the business community, and the States all agree on an appropriate taxing regime), it is apparent that perceived jurisdictional restraints on the power of States to tax within a federal system can be removed.

3. Towards a Unified Concept of an "Enforcement Establishment." The separate inquiry into substantive jurisdiction and enforcement jurisdiction that lies at the heart of this Article raises the issue of whether jurisdiction to enforce an income or consumption tax may not fairly be regarded as a single question to which there should be a single answer. In other words, whatever may be the substantive standards for determining whether a State may tax income (either because the taxpayer is a resident of the State or because the income has its source in the State), and whatever may be the substantive standards for determining whether a State may tax consumption (either because the consumption occurs in the State or because the supply or sale takes place in the State), once that determination has been made, why should there not be essentially a single inquiry into whether there is jurisdiction to enforce that tax, whether directly or through a withholding or collection agent?

After all, when courts have examined enforcement questions—whether in the income tax or consumption tax context—they have emphasized that matters of enforcement, as distinguished from matters of substantive jurisdiction, are practical administrative questions for which States may adopt practical solutions. Thus, the U.S. Supreme Court has observed in the income tax context that once "the conditions of state power to tax are satisfied,"[200] the question becomes whether the State can avail itself of "some practically effective device . . . in order to enable the state to collect

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tax; it simply "authorizes" the States to impose the tax in conformity with its provisions.

[200] Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 444 (1944).

its tax."[201] In the consumption tax context, it has similarly indicated that once a State's power to tax the consumer is established, the enforcement issue becomes a pragmatic inquiry into determining whether a State is in a position to employ the "familiar and sanctioned device"[202] of making the vendor the tax collector for State. Furthermore, it has emphasized that "the sole burden imposed upon the out-of-state seller . . . is the administrative one of collecting it."[203]

Without suggesting what the precise contours of an enforcement jurisdiction standard should be—I will graciously leave that to other participants in the symposium—I will advance the proposition that the standard should be essentially the same whether we are dealing with income or consumption taxes. My reasons for advancing this proposition should by now be self-evident.

First, I believe that at bottom these enforcement questions are basically the same, whether we are talking about an income tax or a consumption tax, namely, whether the State has authority to require a person to assist it with enforcing a tax it has the power to impose. In effect, once the substantive tax obligation has been established, we are asking the question as to what a State may do to collect a lawful debt. Whether the debt arose from an income tax obligation or a consumption tax obligation should not affect the scope of state power in this regard.

Second, there is no reason as a matter of principle why the jurisdictional standard for imposition of a tax obligation should be the same as the jurisdictional standard for enforcement of the tax obligation. The question of whether a person has derived income from sources within a State, and therefore fairly may be asked to contribute to its public fisc, is not the same question as whether a person fairly may be asked to assist the State in collecting and remitting that obligation, whose economic burden may fall on another. Likewise the question of whether a person is consuming goods or services within a State, and therefore fairly may be asked to contribute to its public fisc, is not the same question as whether

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[201] *Id.*

[202] Gen. Trading Co. v. State Tax Comm'n, 322 U.S. 335, 338 (1944).

[203] Nat'l Geographic Soc'y, Inc. v. Cal. Bd. of Equalization, 430 U.S. 551, 558 (1977).

a person fairly may be asked to assist in collecting and remitting that tax obligation, whose economic burden may fall on another. Because the substantive and enforcement questions are directed to different concerns and sometimes to different relationships, the jurisdictional standards should reflect those different concerns and relationships.

Third, the adoption of a unified concept of an "enforcement establishment" would have the salutary effect of simplifying and, one would hope, clarifying an area of law and practice that could benefit substantially from such simplification and clarification. Simplification would come from having a *single* inquiry into the question of whether a State has the power to require a person to assist it in the enforcement of a tax obligation rather than two separate inquiries into that question depending on the tax obligation involved. Simplification would also result from having a *discrete* inquiry into this question rather than an inquiry that was intertwined with the substantive power to tax. Finally, one would hope that this simplification would lead to clarification of the single jurisdictional standard for determining the circumstances under which a person can be required to assist tax administrations in the enforcement of legally recognized tax obligations.

a. "Enforcement Establishment" and the "Force of Attraction" Principle. If one were to pursue the suggestion that the concept of an "enforcement establishment" would facilitate the analysis of jurisdiction-to-tax issues, one issue that would surely arise is the extent, if any, to which a person that is deemed to have such an establishment may be held accountable for the collection of taxes that are not directly attributable to that establishment. The problem is analogous, of course, to the "force of attraction" principle that arises in connection with the taxation of business profits derived from a State in which an enterprise has a permanent establishment. As we observed earlier in this Article, some States take the position that when a foreign enterprise has set up a permanent establishment within a State, it has brought itself within that State's fiscal jurisdiction to such a degree that the State may properly tax all of the profits that the enterprise derives from

sources within the State.[204] Both the OECD and U.S. Model Income Tax Treaties, however, take the opposite view, namely, that "only so much of" the profits as are "attributable to" an enterprise's permanent establishment within a State are taxable.[205]

In fact, this "force of attraction" issue has arisen implicitly in the "enforcement establishment" context under American jurisprudence. In *National Geographic Society, Inc. v. California Board of Equalization*,[206] National Geographic, a District of Columbia corporation, made substantial mail-order sales of maps, atlases, globes, and books to California residents who responded to its magazine and direct mail solicitations.[207] The Society also maintained two California offices, which solicited advertising for its magazine, but it conducted no activities relating to its mail-order business at those offices.[208] California assessed a use tax against the Society on its mail-order sales to California customers. The Court first determined that the Society's maintenance of two offices in California and activities there constituted what I would call an "enforcement establishment"; that is, they "adequately establish[ed] a relationship or 'nexus' between the Society and the State"[209] that permitted the State to impose a use tax collection obligation on the Society.[210]

The Court then turned to the "force of attraction" issue. The Society contended that the in-state advertising offices played no role in furthering its mail-order sales to California customers and that it therefore could not be required to collect use taxes on such sales, because, in effect, there was no "enforcement establishment" in California directly related to such sales.[211] "The Society argues in other words that there must exist a nexus or relationship not only

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[204] *See supra* note 106 and accompanying text (discussing force of attraction rule).

[205] OECD MODEL, *supra* note 4, art. 7, ¶ 7; U.S. MODEL, *supra* note 31, art. 7.

[206] 430 U.S. 551 (1977).

[207] *Id.* at 552.

[208] *Id.* at 554 n.2.

[209] *Id.* at 556.

[210] *Id.* at 559.

[211] The Society argued that the case was controlled by *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 759-60 (1967), which held that a State could not impose a use tax collection obligation on an out-of-state mail-order vendor with no physical presence in the State. *Nat'l Geographic*, 430 U.S. at 560. The Court subsequently reaffirmed this position in *Quill Corp. v. North Dakota*, 504 U.S. 298, 301-02 (1992), although on somewhat narrower grounds.

between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller's activity within the State."[212] The Court tersely replied: "We disagree."[213] It explained that "[h]owever fatal to a direct tax a 'showing that particular transactions are dissociated from the local business . . .,' such dissociation does not bar the imposition of the use tax collection duty."[214] Rather, the Court continued, "the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate 'some definite link, some minimum connection, between [the State and] the *person* . . . it seeks to tax.' "[215]

Whether or not the "enforcement establishment" analysis in *National Geographic* will or should withstand additional scrutiny is a question, like virtually every other raised in this Article, over which reasonable people can and do differ. On one hand, there is surely something to be said for the Court's position that a State should be able to demand from those whose contacts with the State are sufficient to constitute an "enforcement establishment," and who make sales to consumers in the State, assistance in collecting taxes that are lawfully due, whether or not the sales are directly attributed to the "enforcement establishment." On the other hand, suppose, as the taxpayer in *National Geographic* suggested, that its only in-state activity was the ownership of a parking lot.[216] Would it still be required to collect taxes on its mail-order sales on the ground that the parking lot constituted an "enforcement establishment," regardless of the relationship of its sales to the parking lot?[217] The short answer that the Court gave to this question, namely, that the statute applied to National Geographic only

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[212] *Nat'l Geographic*, 430 U.S. at 560.

[213] *Id.*

[214] *Id.* (citation omitted).

[215] *Id.* at 561 (citation omitted). Although the consumer is the "taxpayer" under state use taxes, *see supra* notes 65-69, 87-90 and accompanying text, the vendor becomes a person liable for the tax (a "taxable person," in VAT terms) for any tax that it is required to collect, whether or not it collects the tax. *Nat'l Geographic*, 430 U.S. at 533 (quoting California statutes).

[216] 430 U.S. at 556 n.5.

[217] *Id.*

because it maintained offices in the State, which rendered it a "retailer engaged in business in this State" under the statute, was not entirely satisfactory.[218] Suppose the offices had been for the parking lot rather than for magazine advertising? At some point, the in-state activity becomes so attenuated from the mail-order sales that as a practical matter—if not as a legal matter—imposition of the tax collection obligation becomes problematic. Moreover, as we have emphasized throughout this discussion, when it comes to matters of enforcement jurisdiction, practical concerns often inform the legal analysis.

As the concept of an "enforcement establishment" is further refined, the "force of attraction" issue is one of many that will need to be addressed. For the moment, however, this is just one further loose end that I shall leave untied, because my principal purpose here, as throughout this Article, has been to raise questions, not to resolve them.

IV. CONCLUSION

This Article has attempted to shed light on the analysis of jurisdiction-to-tax issues. By separately addressing questions of substantive jurisdiction to tax and enforcement jurisdiction, and by focusing on the "alignment" of these two types of jurisdiction with respect to both income and consumption taxes and in both international and federal contexts, it has sought to identify the fundamental jurisdictional issues that are often obscured in the tangle of case-by-case controversies. Although this Article offers no definitive answers to the vexing jurisdiction-to-tax questions that are the subject of intense debate, it suggests ways of thinking about these questions that could help us find such answers.

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[218] *Id.* at 556 n.5 (quoting statute).