ON THE THRESHOLD OF RESOLVING THE NEXUS PROBLEM

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The recent Supreme Court decision of *Scripto Inc. v .Carson*[1] has placed the states on the threshold of knowing once and for all the extent of their power to compel out-of-state vendors to act as the collection agent of state transaction privilege taxes. Prior to *Scripto,* the validity of the privilege transaction tax was well established.[2] The problem involved here is that of the state imposing the burden of collecting this tax upon out-of-state vendors.[3] Whether or not these vendors may be compelled to collect this tax depends upon the establishment of certain minimum contacts,[4] nexus, within the taxing state.

The minimum nexus problem has been a burning issue for the past several years. *Scripto* will not settle all the problems, but it does a great deal for finding the proper solution. The test established by *Scripto* for settling the nexus problem[5] is this:

> First, the tax is a nondiscriminatory exaction levied for the use and enjoyment of property which has been purchased by Florida residents and which has actually entered the mass of property in the state. . . . [Scripto] is charged with no tax — save when, as here, he fails or refuses to collect it from the Florida customer.[6]

In this case, under the Florida statute[7] the burden of the tax was placed upon the purchaser — he enjoys the use of the property regardless of its source. The only nonlocal incident of the transaction is the

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[1] 362 U.S. 207 (1960). In this case, the defendant Georgia corporation, having made sales in Florida without collecting the Florida use tax, was held personally liable. The defendant did not own, lease, or maintain any office, distribution house, warehouse, or other place of business in Florida or have any regular employee in Florida. Ten "so called" independent contractors solicited sales — which sales contracts were accepted in Georgia. The Supreme Court held that, as between the Scripto Corp. and the State of Florida, there was sufficient nexus and activity to enable Florida to collect a use tax from Scripto under the Florida statute imposing a use tax on purchasers and render the dealer liable if he fails to collect the tax.

[2] Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1938).

[3] Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954); General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335 (1944).

[4] Miller Bros. Co. v. Maryland, 347 U.S. 340, 345 (1954). "For the state to impose a tax there must be some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."

[5] The "nexus problem," as used in this article, deals with the jurisdiction of the state taxing authorities to compel out-of-state business interests to collect the state transaction privilege tax. In this context, jurisdiction is dependent upon the establishment, by the out-of-state business concern, of certain minimal contacts within the taxing state.

[6] Scripto Inc. v. Carson, 362 U.S. 207, 211 (1960).

[7] FLA. STAT. ANNO. § 212.06 (1958). If the out-of-state vendor fails to collect the use tax, the vendor is held personally liable for the amount which should have been collected.

acceptance of the order. To call salesmen "independent contractors" does not alter the situation. Finally, from a constitutional standpoint, it is not important that the agent worked for several principals.

In light of modern business activity it would seem that the decision is correct. The state which offers its protection to a business may now use that business as its tax collector. Moreover, the court has closed at least one avenue to tax avoidance.[8] To doubt the wisdom of this decision would seem to indicate a lack of understanding of just what a use tax is.[9]

The Supreme Court of Arizona decided the case of *State Tax Comm'n v. Murray Corp. of Texas,*[10] just nine days[11] after the decision in the *Scripto* case was handed down. The facts involved were similar to those of the principal case. The court construed the applicable taxing statutes[12] as applying only to intrastate transactions. After rehearing was denied,[13] the Arizona Tax Commissioner petitioned the Supreme Court for a writ of certiorari,[14] and the petition was granted.[15]

At the time certiorari was granted, the Supreme Court, in a per curiam decision, vacated the judgment and remanded the case for clarification. It would seem that the Justices of the Supreme Court did not know on what grounds the Arizona court held the tax inapplicable. Thus, it was the duty of the Arizona court to dissect out the federal question or in the alternative clearly separate the state and federal questions.[16]

On remand,[17] the Supreme Court of Arizona said: "No question was raised as to the sufficiency of the Arizona Transaction Privilege Taxes Act to reach the sales if made within Arizona."[18] The conclusion reached was that the sales involved were interstate rather than intra-

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[8] Thomas Reed Powell, *Sales and Use Taxes: Collection From Absentee Vendors,* 57 HARV. L. REV. 1086 (1944). The article presents a good discussion of the conflict and confusion in this area of taxation before the principal case was handed down.

[9] *Supreme Court says Scripto must Collect Florida Use Tax; brokers there its agents,* 12 J. TAXATION 306 (1960). Generally, a use tax is designed to supplement a state sales tax, and to close an avenue of tax avoidance; however, such a tax, in effect, is rendered impotent if the taxing state is denied a means of compelling out-of-state vendors to collect it.

[10] 87 Ariz. 268, 271, 350 P.2d 674, 676 (1960). The court said that the cases upholding the collection of a use tax are largely based upon the fact of an established business in the state.

[11] The principal case was decided on March 21, 1960, and State Tax Comm'n v. Murray Corp. of Texas, *supra* note 10, was decided on March 30, 1960. Due to the fact that the Arizona court did not consider the principal case, the writers herein have concluded that the court had no notice of it.

[12] ARIZ. REV. STAT. ANN. §§ 42-1301 - 1347 (1956).

[13] State Tax Comm'n v. Murray Corp. of Texas, 87 Ariz. 268, 350 P.2d 674 (1960).

[14] Docket No. 168.

[15] 364 U.S. 289 (1960).

[16] Minnesota v. Nat'l Tea Co., 309 U.S. 551 (1940).

[17] 358 P.2d 167 (Ariz. 1960).

[18] *Id.* at 168.

state, and thus were protected by the interstate commerce clause of the Federal Constitution.

The decision is important in two respects. First, the court based its decision on federal constitutional grounds and not on the construction of the local taxing statutes.[19] The Supreme Court of the United States is now free to reverse the Arizona decision unhampered by the well established rule that the application by the high court of a state of its local laws will be controlling.[20] Second, the Arizona court intimated that the Arizona statutes are broad enough to include the tax sought to be collected in the *Murray Corp.* case.

The question still remains: How far can the state go in imposing upon foreign corporations the obligation to collect the transaction privilege tax without violating either the commerce or the due process clause?[21] This will be only the eighth time the Supreme Court has had occasion to decide this problem.[22] Of late, much has been written on this question.[23] The authorities on this subject do not agree with the decided cases and are in disagreement among themselves as to how the problem should be solved. Congress is aware of this perplexing and important situation, and last year considered a bill which was introduced in the Senate.[24] To date, this bill, which was designed to settle state taxation of interstate commerce questions, has been read twice on the Senate floor and referred to the Committee on Finance.[25]

Conceding that a federal statute might possibly be the answer sought in this area, it should not be adopted in the form of the Senate Bill referred to above; for in its present form it would preclude the state of the purchaser from imposing a transaction privilege tax upon the vendor, if his only business within the state is sales in interstate commerce. Such a statute should be designed so as merely to clarify and codify the existing law as interpreted in the light of the *Scripto* decision. The statute should be couched in terms whereby the state of the purchaser will be the state with the taxing authority. The reason

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[19] ARIZ. REV. STAT. ANN. §§ 42-1301 - 1347 (1956).

[20] See, *e.g.*, Scripto Inc. v. Carson, 362 U.S. 207 (1960); General Trading Co. v. State Tax Comm'n of Iowa, 322 U.S. 335 (1944).

[21] Kust and Graham, *State Taxation of Interstate Sales*, 46 VA. L. REV. 1290 (1960).

[22] Scripto Inc. v. Carson, 362 U.S. 207 (1960); Miller Bros. v. Maryland, 347 U.S. 340 (1954); General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944); McLeod v. J. E. Dilworth Co., 322 U.S. 327 (1944); Nelson v. Montgomery Ward & Co., 312 U.S. 373 (1941); Nelson v. Sears Roebuck & Co., 312 U.S. 359 (1941); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939).

[23] See, *e.g.*, Britton, *Taxation Without Representation Modernized*, 46 A.B.A.J. 370 (1960); Kust and Graham, *State Taxation of Interstate Sales*, 46 VA. L. REV. 1290 (1960); *Out of State Tax Collection; The Scripto Case*, 22 CORP. J. 343 (1960); *Supreme Court says Scripto must Collect Florida Use Tax; brokers there its agents*, 12 J. TAXATION 306 (1960).

[24] S. 3549, 86th Cong., 2d Sess. (1960).

[25] *Supra* note 24.

is clear; for to allow otherwise would be to induce persons domiciled in one state to purchase in a state with a lower tax.

In order to avoid unjust discrimination against interstate sales, a federal statute must necessarily include a provision whereby a purchaser would never be subjected to paying, in the aggregate, a tax in excess of that which would be exacted had he purchased in the state of his domicil.[26]

The *Scripto* decision is merely a reflection of the political and economic development in this country. The Supreme Court of the United States, in this and other decisions, has indicated a willingness to recognize the needs of the states in the modern business world.[27] One need only look at the break-down of revenue collection in Arizona to recognize the importance of protecting it.[28]

California, too, has been faced with the minimum nexus problem. *Felt & Tarrant Mfg. Co. v. Gallagher*[29] was very similar to the *Murray Corp.* case with one major factual exception: in the California case, the out-of-state vendor, through his agents, maintained office space in California. The Supeme Court of the United States held:

> Things acquired or transported in interstate commerce may be subject to a property tax, nondiscriminatory in its operation, when they have become part of the common mass of property within the state of destination. *A tax upon the privilege of use or storage when the chattel used or stored has ceased to be in transit is now an impost so common that its validity has been withdrawn from the area of debate.*[30] (Emphasis added.)

It should be noted that in the *Murray Corp.* case the taxing authorities of Arizona are merely seeking to enforce a general statute of the state which does no more than require distributors or retailers doing business[31] in the state to act as the agent for the state in collecting from the customers of that business a valid excise tax upon the products sold by it. That this tax can and should be collected is beyond question.[32]

It is time for Arizona to put to intelligent use the Arizona Transaction Privilege Tax statutes[33] by giving to them an interpretation in

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[26] ARIZ. REV. STAT. ANN. § 42-1409 (2) (1956) contains such a provision.

[27] See General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939).

[28] THE TWENTY-FIFTH BIENNIAL REPORT OF THE STATE TAX COMM'N OF ARIZONA (1960). This report shows that the sales tax revenue for the fiscal year ended June 30, 1960, amounted to $43,608,271.36.

[29] 306 U.S. 62 (1939).

[30] *Id.* at 67. The Court relied upon Henneford v. Silas Mason Co. Inc., 300 U.S. 577 (1937).

[31] See International Shoe Co. v. Washington, 326 U.S. 310 (1945).

[32] Scripto, Inc. v. Carson, 362 U.S. 207 (1960); General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939).

[33] ARIZ. REV. STAT. ANN. §§ 42-1301 - 1347 (1956).

keeping with the legislative intent. We must have the fortitude to intelligently apply the principle of our statutes to out-of-state sellers in order to preserve and improve the finances of our state. The late Justice Levi S. Udall, one of Arizona's most distinguished jurists[34] and the only member of the Arizona Court who recognized the true issues in the *Murray Corp.* case, expressed the convictions of the writers in his dissenting opinion:

> I have a deep and abiding conviction that my brethren of the majority, . . . are departing from sound principles of tax law to the serious detriment of all other taxpayers in the state.[35]

[34] A Tribute By Lawyers, Arizona Supreme Court's MR. JUSTICE LEVI S. UDALL, August 1960.

[35] 87 Ariz. 268, 275, 350 P.2d 674, 679 (1960).