IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

NO. 052588

DALE W. STEAGER,

Petitioner below, Respondent,

v.

MBNA AMERICA BANK,

Respondent below, Petitioner.

TAX COMMISSIONER'S BRIEF IN OPPOSITION TO APPEAL

Respectfully submitted,

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OMISSIONS AND INACCURACIES IN MBNA'S STATEMENT OF THE CASE

The most glaring inaccuracy in MBNA's statement of the case occurs on page twenty-six (26) of its Brief to this Court. There MBNA asserts in a footnote that it pays taxes on one-hundred percent (100%) of its income to Delaware. This statement is suspect for several reasons, most importantly because there are no facts in the record of this case showing any payment of any taxes by MBNA to the State of Delaware. Additionally, it is clearly not a coincidence that MBNA is a Delaware corporation, because Delaware does not assess a corporate income tax. Assuming arguendo that MBNA did pay some taxes in Delaware, that fact alone would not prove that West Virginia's taxation of MBNA is either unconstitutional or unfairly apportioned. If Delaware is taxing a portion of MBNA's income attributable to another state, then MBNA's challenge to such taxation needs to be brought in Delaware.

Next, throughout its Brief MBNA makes reference to a memorandum written by a staff attorney for the Tax Department's Legal Division. A small portion of the document deals with credit card companies such as MBNA. At times, portions of the fifteen page document are taken out of context. Further, the Taxpayer makes a glaring misrepresentation, at least by implication, that the Legal Division's attorney made a conclusive or binding determination that the taxation of credit card companies is unconstitutional. To the contrary, when the memorandum was received by the Deputy Tax Commissioner, who was also an attorney, neither he nor the Department took any action to change or modify the statutes at issue.

Importantly, the stipulation as to this memorandum, referred to as Exhibit G, was limited to the fact that it was a genuine copy of a discovery document. There was no stipulation as to either materiality or relevance.

ARGUMENT I: NEXUS

THE PHYSICAL PRESENCE REQUIREMENT FOR COMMERCE CLAUSE "SUBSTANTIAL NEXUS" FOR SALES AND USE TAXES UNDER *QUILL CORP. v. NORTH DAKOTA* DOES NOT EXTEND TO CORPORATE NET INCOME TAXES AND BUSINESS FRANCHISE TAXES.

The Circuit Judge correctly ruled that MBNA's lack of physical presence in West Virginia is not determinative of either the statutory or the constitutional nexus issue. (*See* COL 4)

a. The Statutes: W.Va. Code §11-23-5a(d) and §11-24-7b(d)

Nothing in either of the challenged statutes makes physical presence a requirement for nexus; in fact, the statutes both define nexus as requiring only that a foreign corporation solicits business with **twenty or more persons** within the state **or** receives gross receipts attributable to income received from any West Virginia sources equal to or in excess of One Hundred Thousand Dollars ($100,000.00).[1]

[1] The nexus required for business franchise tax is found at W.Va. Code §11-23-5a(d):

In tax year 1998, MBNA had gross receipts of Eight Million, Four Hundred Nineteen Thousand, Four Hundred Thirty-One Dollars ($8,419,431.00) including interest income, service charges, fees, and other receipts from credit cards attributable to customers with West Virginia addresses. *See Stipulation No. 17.* In tax year 1999, MBNA's gross receipts attributable to customers with West Virginia addresses totalled Ten Million, One Hundred Sixty-Three Thousand, Seven Hundred Eighty-Eight Dollars ($10,163,788.00). Thus, for tax year 1998, MBNA's gross receipts for corporate net income taxes and business franchise taxes (hereinafter "CNT" and "BFT") were eighty (80) times greater than the statutorily prescribed threshold for nexus. For tax year 1999, its gross receipts were one hundred (100) times greater than the statutory threshold.

It has been stipulated that MBNA has no physical presence in West Virginia, *i.e.*, no real estate, offices, employees, representatives or tangible property. This fact is not determinative of the nexus question. MBNA repeatedly and, as will be discussed *infra*, erroneously, suggests that its lack of physical presence is a bar to West Virginia's imposition of CNT and/or BFT. Contrary to

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> Engaging in business - nexus presumptions and exclusions. A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars. . . .

The nexus required for corporate net income tax is found at W.Va. Code §11-24-7b(d):

> Engaging in business - nexus presumptions and exclusions. A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars. . . .

these repeated assertions, however, the lack of physical presence does not rebut a finding of nexus under the West Virginia statutes. The plain language of the statutes defines nexus in terms of the number of persons solicited or the amount of gross receipts attributable to income from those sources, *not* physical presence.

b. <u>The Constitution: U.S. Const., art. I, §8, clause 3</u>

Similarly, the United States Supreme Court has made clear that the Commerce Clause of the United States Constitution, U.S. Const., art. I, §8, clause 3, requires physical presence as a *sine qua non* of nexus only for sales and use taxes, not for corporate income or business franchise taxes.

In this regard, *Quill Corporation v. North Dakota,* 504 U.S. 298, 112 S.C. 1904, 119 LED.2d 91 (1992), upon which MBNA relies, does not compel the result it seeks. In *Quill,* the United States Supreme Court held that a mail order business whose products are brought into a state by mail or common carrier must have a physical presence in that state in order for the state to impose a use tax collection obligation.[2] The Court explicitly limited its decision to sales and use taxes, and in the fourteen years since *Quill* was decided, has never expanded the scope of that decision.[3]

THE COURT USED SPECIFIC LANGUAGE IN *QUILL* EXCLUDING APPLICATION OF THE PHYSICAL PRESENCE REQUIREMENT TO OTHER TAXES.

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[2] North Dakota imposes a use tax as a complimentary tax to its sales tax. North Dakota attempted to force Quill to collect a use tax from residents in the state; failing such collection, Quill was assessed the taxes owed. The use tax was imposed in lieu of a state sales tax on products purchased outside the State. In the present case, the corporate net income and business franchise taxes are imposed on MBNA's gross receipts which are attributable to its activities in West Virginia.

[3] While this brief primarily addresses why physical presence is not required for imposition of an income tax, and why *Quill* does not apply to income taxes, the same analysis applies equally to the business franchise tax.

There is no language in *Quill* which supports the extension of a physical presence requirement to the imposition of any other tax; to the contrary, the Court was clear that the physical-presence requirement applies **only** in the area of use tax collection, noting that when it had affirmatively reviewed "other types of taxes [it had not] articulated the same physical presence requirement." *Quill*, 504 U.S. at 314. Thus, we need not look beyond *Quill* itself for authority that the physical presence requirement for substantial nexus is limited to the mail order, use tax situation: "In sum, . . . in our cases subsequent to *Bellas Hess [National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967)]* and concerning other types of taxes we have not adopted a similar bright-line . . . ." *Quill*, 504 U.S. at 317. This observation is as true today as it was in 1992. In the fourteen years since *Quill* has been decided, the Court has not expanded the physical presence requirement to any tax other than a use tax.

In addition to mischaracterizing the *Quill* opinion, MBNA mischaracterizes the nexus jurisprudence of the United States Supreme Court. At page 18 of MBNA's brief to this Court it states: "Physical presence, though not always explicitly articulated by the Court as such, nevertheless has been the inherent bright-line, base-line fact in every tax nexus case handed down by the U.S. Supreme Court since its watershed decision in *Complete Auto [Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)]* – the hallmark of the Court's nexus jurisprudence across the decades." Brief of MBNA America Bank, N.A. at page 18 (footnote omitted)[4]. This is flatly wrong. The *Quill* Court clearly limited application of the physical presence requirement to nexus in the

[4]To determine whether a state tax violates the Commerce Clause, courts apply the four factor test set out in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). The test indicates that a tax does not violate the Commerce Clause if it 1) is applied to an interstate activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce and 4) is fairly related to the services provided by the taxing state.

mail-order sales and use tax context, contrary to what can most charitably be characterized as MBNA's blinkered reading of the case. In fact, MBNA simply ignores the clear holding of *Quill* because the opinion goes down a road that MBNA does not want to travel. Further, MBNA's claim that physical presence is a prerequisite for nexus in a non-sales and use tax context conflates the **existence** of tangible physical presence, which it admittedly does not have in West Virginia, with a **legal requirement** for physical presence, which our statutes do not contain and the Commerce Clause does not compel.

THE IMPORTANCE OF *STARE DECISIS* IN ANALYZING THE DECISION IN *QUILL*

a. *Stare Decisis* Was an Important Basis for the Decision in *Quill*, Where Sales and Use Taxes Were at Issue

The *Quill* opinion, and the basis for the Court's decision to maintain a sales and use tax immunity in the absence of physical presence for vendors with no physical presence in a state, cannot be divorced from the Court's prior decision in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S.C. 1389, 18 L.Ed.2d. 505 (1967), which required that out-of-state mail order companies had to have a physical presence in a state to compel the vendor to collect use tax from the state's residents. Twenty-five years of reliance upon *Bellas Hess* established a reliance interest in the mail-order industry and compelled application of the doctrine of *stare decisis* in the area of sales and use taxes.

In this regard, MBNA mischaracterizes the *Quill* opinion when it states, at page twenty-one (21) of its brief, that:

> The *Quill* decision provided no indication that the physical presence requirement would have been abandoned but for *stare decisis*. Quite the contrary, the Court stated categorically that 'the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause'.

> The Commissioner's inference that some of the Justices would have discarded the physical presence requirement in the absence of *stare decisis* is mere speculation and is utterly unsupportable.

To the contrary, the opinion in *Quill* makes clear that without the precedent of *Bellas Hess* the outcome could well have been different. "While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases." *Quill* at 504 U.S. 311.

Similarly, Justice Scalia, whose concurring opinion was joined by Justices Kennedy and Thomas, relied even more heavily on the doctrine of *stare decisis* in *Quill*, where the sales and use tax issue was being revisited twenty-five years after *Bellas Hess*:

> I also agree that the Commerce Clause holding of *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*. *American Trucking Assns., Inc. v. Smith,* 496 U.S. 167, 204, 110 S.C. 2323, 2345, 110 L.Ed.2d 148 (1990)(SCALIA, J., concurring in judgment). Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so. We have long recognized that the doctrine of *stare decisis* has "special force" where "Congress remains free to alter what we have done." *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-173, 109 S.C. 2363, 2370, 105 L.Ed.2d 132 (1989). See also *Hilton v. South Carolina Public Railways Comm'n,* 502 U.S. 197, 202, 112 S.C. 560, 564, 116 L.Ed.2d 560 (1991); *Illinois Brick Co. v. Illinois,* 431 U.S. 720, 736, 97 S.C. 2061, 2069, 52 L.E.2d 707 (1977).

Quill, 504 U.S. 320.

b. <u>*Stare Decisis* Supports the State's Position With Respect to Income and Business Franchise Taxes</u>.

As discussed *supra*, the Court indicated great concern with *stare decisis*. Three concurring Justices based their decision entirely on *stare decisis*. In the 25 years after *Bellas Hess*, the mail order industry had relied on this bright-line rule and had not collected use tax from its customers.

Even though the Court acknowledged that current Commerce Clause jurisprudence might lead it to a different conclusion if it were writing on a clean slate, it felt constrained by industry's settled expectation. *Quill*, 504 U.S. at 311.

When one shifts to non-sales and use taxes, however, considerations of *stare decisis* lead to the opposite conclusion: no physical presence is required. Clear United States Supreme Court precedent has long supported the imposition of state income taxes on non-residents without the kind of physical presence in the taxing State for which MBNA argues.

In *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937), and *International Harvester Co. v. Wisconsin Dept. of Taxation,* 322 U.S. 435 (1944), the Court found nexus over income of a person not physically present in a state against Fourteenth Amendment due process challenges. Commerce Clause "substantial nexus" was not discussed because there was no separate commerce clause "substantial nexus" until *Quill*; prior to *Quill* there was only one kind of nexus.[5] No physical presence requirement was articulated as being applicable in those income tax cases. Indeed, these decisions are obvious examples of cases the Supreme Court may well have had in mind when stating in *Quill* that "we have not, in our review of other types of taxes, articulated the same physical presence requirement that *Bellas Hess* established for sales and use taxes . . . ." 504 U.S. at 314. Thus, no Supreme Court decision has applied the *Quill* physical presence requirement to a state income tax.[6] No taxpayer could reasonably have expected constitutional protection from paying an

[5] Indeed, the physical presence requirement in *Bellas Hess*, affirmed in *Quill*, derives from due process nexus concepts. Although the Court in *Quill* recognized that it had abandoned a physical presence requirement for due process nexus, it retained the requirement for commerce clause substantial nexus in the context of use tax collection obligations.

[6] Since the Court has denied review in both *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993), and *J.C. Penney Nat'l Bank v.*

income tax to a State in which it earns income because of its activities in the State. Consequently, *stare decisis*, so strongly the basis for the Court's retaining the bright-line test in *Quill*, points the other way in the income tax area. Settled precedent supports nexus to impose income tax on nonresidents without physical presence in the taxing State. Such precedent removed any basis for "settled expectations" that physical presence in a State is a prerequisite to States' imposing income tax.

THE SUBSTANTIVE BASIS FOR THE *QUILL* DECISION, UNDUE BURDEN, LIMITS ITS APPLICATION TO THE USE TAX COLLECTION OBLIGATION.

The substantive basis articulated by the United States Supreme Court for its decision in *Quill* further supports limitation of the physical presence requirement to use tax collection for mail order sellers.

The Court in *Quill* gave two principal reasons for retaining the bright-line physical presence requirement from *Bellas Hess*. First, as discussed *infra,* the Court relied on *stare decisis* to preserve "settled expectations" in the mail order industry:

> a bright-line rule in the area of sales and use taxes also encourages settled expectations . . . it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess* . . . the *Bellas Hess* rule has engendered substantial reliance and . . . therefore counsels adherence to settled precedent.

Quill, 504 U.S. at 316, 317.

Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000), it is up to the state courts in the first instance to determine whether the physical presence requirement applies to income taxes.

Second, the Court noted the undue burden that could result from requiring remote sellers to comply with the disparate use taxes of potentially 6,000 sales and use tax jurisdictions requiring monthly tax returns as a basis for its opinion. The Court identified the second basis for its decision in Quill in its discussion of the difference between Due process and Commerce Clause nexus standards.

> The two standards are animated by different constitutional concerns and policies.
>
> Due process centrally concerns the fundamental fairness of governmental activity. . . . In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.... Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce and bars state regulations that *unduly burden* interstate commerce.
>
> The first and fourth prongs [of *Complete Auto Transit, Inc. v. Brady*], which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not *unduly burden* interstate commerce. Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for *limiting state burdens* on interstate commerce.

504 U.S. at 312- 313 (emphasis added, citations and footnote omitted). Emphatically, undue burden is the essence of Commerce Clause "substantial nexus"; as described by the Court in *Quill,* it was a *compliance* burden with diverse and complicated state and local taxes.

> North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce . . . [when] similar obligations might be imposed by the Nation's 6000-plus taxing jurisdictions ...[such] that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations."

504 U.S. at 313 n 6, quoting *Bellas Hess*, 386 U.S. at 759-760.

The burden at issue is not the burden of paying taxes. Only the Court's earliest cases created a tax free zone for products moving in interstate commerce. The Court's Commerce Clause jurisprudence has evolved over time. Characterization of a tax as either a direct or indirect burden on interstate commerce has been abandoned. Therefore, MBNA's argument that it is less burdensome to collect taxes from customers than it is to pay income and business and franchise taxes to a state reflects a complete misunderstanding of the holding and rationale of *Quill*.

As is reflected in *Quill*, the appropriate inquiry is whether the imposition of the tax or taxes is an undue burden. In *Quill*, the Court found that the imposition of a collection burden on a mail order catalog business with no physical presence in North Dakota was an undue burden. The fact that Quill might have to comply with monthly collection obligations in at least 6,000 jurisdictions was found to be an undue burden.[7] The burden on the taxpayer in *Quill* was further exacerbated by the fact that 25 years earlier the *Bellas Hess* Court had ruled that interstate mail order companies without a physical presence in a state had no obligation to collect use tax from their customers.

West Virginia's imposition of corporate net income and business franchise taxes on MBNA's gross receipts derived from its activities in West Virginia differs from the imposition of a use tax. Moreover, the taxes at issue here contrast with the taxes to be collected in *Quill* because the taxes in *Quill* could have been collected from the North Dakota residents using the products, rather than from Quill, the seller of the products. The taxes at issue here, namely corporate net income tax and

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[7]By way of example, West Virginia alone has 47 exemptions to its consumers sales tax all of which require the use of an exemption certificate. *See* West Virginia Code Section 11-15-9. These same exemptions are incorporated into West Virginia's use tax obligations. *See* West Virginia Code Section 11-15A-3(a)(2).

business franchise tax, are collectable only from MBNA and such collection is appropriate because the taxes relate to its activities in West Virginia. None of the West Virginia Supreme Court cases which have examined the nexus requirement for the imposition of tax have held that the taxpayer must have a physical presence in the State. While it is true that the cases which will be described below were decided before *Quill*, it must be remembered that *Quill* has no application to anything other than a foreign corporation's obligation to collect use tax from its customers. Thus, the Court's finding of nexus in *Western Maryland*, and *Cincinnati Milacron,* are not affected or disturbed by *Quill.*

In *Western Maryland Railway Co. v. Goodwin*, 167 W.Va. 804, 809, 282 S.E.2d 240, 244 (1981), the Court examined whether the railway had "purposive revenue generating activities in the State [which were] sufficient to render a person liable for taxes." The interstate haulers passing through West Virginia had to pay business and occupation taxes on an apportioned share of their gross receipts. Likewise, in *Cincinnati Milacron Company v. Hardesty*, 170 W.Va. 138, 290 S.E.2d 902 (1982) the company's lack of business location or a resident sales or engineering staff did not invalidate the business and occupation tax imposed. Both the circuit court and the West Virginia Supreme Court of Appeals in *Cincinnati Milacron* upheld a tax on services provided which is similar to the net income and business franchise tax here. Not only are the taxes at issue here similar to the business and occupation taxes upheld in *Cincinnati Milacron*, but also the taxes in *Cincinnati Milacron* and at issue here are different than the tax invalidated in *Quill*. Thus, no West Virginia case requires that an out-of-state company have a physical presence in order to properly impose income and business franchise taxes upon a corporation, like MBNA whose activities in West Virginia resulted in substantial income to the corporation.

MBNA HAS SUBSTANTIAL NEXUS BECAUSE ITS BUSINESS ACTIVITIES AND RELATIONSHIPS IN WEST VIRGINIA GENERATE MILLIONS OF DOLLARS.

The statutes as discussed *supra* require that to establish nexus a foreign corporation must solicit business with **twenty or more persons** within the state **or** receive gross receipts attributable to income received from any West Virginia sources equal to or in excess of One Hundred Thousand Dollars ($100,000.00). Therefore, it is uncontroverted that MBNA meets the statutory requirements for nexus in this State. MBNA asserts that West Virginia's CNT and BFT statutes are not constitutional. MBNA's basis for asserting the statutes' unconstitutionality stems from its misguided and unsupported belief that it must have physical presence in a state before there is nexus for the state to impose any tax.

As previously discussed, MBNA's lack of physical presence is not an impediment to West Virginia's imposition of the taxes in question. MBNA has nexus with West Virginia because the revenue generated from West Virginia sources is substantial. This revenue generation relies upon a system of intertwined business relationships in West Virginia. It defies both logic and reality for MBNA to attempt to suggest that its substantial revenue generation in this state is realized without any business activity occurring here. The fact that MBNA is able to realize millions of dollars of revenue attributable to purchases in West Virginia renders its lack of a physical presence immaterial. The fact that MBNA is able to make this money without representatives in this state is, likewise, immaterial. What it needs and what is has are business relationships with West Virginia citizens, banks, and thousands of stores and businesses in the state. Absent its business relationships with retail stores, restaurants, movie theaters, hospitals and companies of every stripe, MBNA would make no money which is attributable to a West Virginia source.

The United States Supreme Court has not defined "substantial nexus" in the context of taxes other than sales and use tax; rather, it has told us what substantial nexus is *not*. However, the case of *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 97 S.C. 1386, 51 L.Ed.2d 631 (1977), a post *Quill* sales and use tax case, provides guidance. In *National Geographic*, the taxpayer was not relieved from collecting sales and use tax, becuase it had two (2) offices with eight (8) employees who solicited advertising for National Geographic magazine.[8] These employees' activities had nothing to do with National Geographic's mail order business, from which California sought collection of the sales and use tax. The Court found nexus even though National Geographic's physical presence through its stores and employees was completely unrelated to its mail order business: "We conclude that the Society's continuous presence in California in offices that solicit advertising for its magazine provides a sufficient nexus to justify that State's imposition upon the Society of the duty to activities as collector of the use tax." *Id*, at 562.

Here, MBNA's business relationships with thousands of stores are directly related to its receipt of income. It is these relationships which create MBNA's continuous presence in West Virginia. Therefore, the facts in West Virginia support a finding of substantial nexus, as the circuit court correctly concluded. In its Final Order the court stated:

> MBNA's business activities in West Virginia include the extension of unsecured credit to West Virginia citizens who use these credit cards at stores located in West Virginia and elsewhere. MBNA also receives income attributable to that extension of credit by receipt of payments made in West Virginia.

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[8] The California statute requiring sales and use tax collection mandated, in a manner consistent with *Quill*, that a retailer maintain, occupy, or use an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business. *National Geographic*, 430 U.S. 552 n.1.

(Judge Bloom's Final Order, Findings of Fact No. 5)

MBNA MISUNDERSTANDS THE INTERRELATIONSHIP BETWEEN PRONGS ONE AND FOUR OF THE *COMPLETE AUTO* TEST.

MBNA argues that the circuit court "misunderstood" the substantial nexus requirements of the Commerce Clause and confused them with the minimum contacts requirements of Due process. MBNA's assertion completely ignores the interrelationship of the first and fourth prong of the *Complete Auto* [9] test. In *Quill*, the United States Supreme Court described *Complete Auto* as follows:

> The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce. Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.

Quill, 504 U.S. 313 (footnote omitted).

Additionally, in *National Geographic, supra*, the Court analyzed nexus in conjunction with the activities and services provided by the state. The interrelationship between prongs one (1) and four (4) of *Complete Auto* was described:

> 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.

National Geographic, 430 U.S. at 561, quoting *Monamoter Oil Co. v. Johnson*, 292 U.S. 86, 54 S.C. 575, 78 LED. 1141 (1934).

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[9] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Underscoring the interrelationship between prongs one and four of the *Complete Auto* test, the Court also noted in *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 625-626 (1981) that:

> The relevant inquiry under the fourth prong of the *Complete Auto Transit* test is not as appellants suggest, the *amount* of the tax of the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities. *Rather, the test is closely connected to the first prong of the Complete Auto Transit test. Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied on it. See National Bellas Hess, Inc. v. Illinois Revenue Dept.*, 386 U.S.753, 97 S.C. 1389, 18 L.Ed.2d 505 (1967).

(Emphasis added.) (Footnote omitted.)

STATE COURTS HAVE EXAMINED THE ISSUE OF WHETHER PHYSICAL PRESENCE IS A SINA QUA NON OF TAXES OTHER THAN SALES AND USE TAXES; NONE OF THESE CASES CONTROL THE OUTCOME OF THE INSTANT CASE, ALTHOUGH THE BETTER REASONED CASES SUPPORT THE POSITION OF THE TAX COMMISSIONER.

Several state court cases deal with the issues involved in the instant case, although none are squarely on point.

In *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), *cert. denied,* 510 U.S. 992 (1993), the issue was whether South Carolina could collect income tax and a corporate license fee based on Geoffrey's royalties for South Carolina stores' use of the "Toys R Us" trademark. Toys R Us reported the aggregate sales of all stores to Geoffrey in a single figure on a monthly basis; the royalty payment was made annually via wire transfer from a Pennsylvania Toys R Us account to a New York Geoffrey Account. 437 S.E.2d at 15.

The South Carolina Supreme Court held that the taxes were properly levied, because "[b]y electing to license its trademarks and trade names for use by Toys R Us in many states, Geoffrey contemplated and purposefully sought the benefit of economic contact with those states." Id., 437 S.E.2d at 16. Further:

> We reject Geoffrey's claim that its intangible assets are located exclusively in Delaware. Accordingly, we find that Geoffrey's purposeful direction of activity toward South Carolina as well as its possessing intangible property here provide a definite link between South Carolina and the income derived by Geoffrey from the use of its trademarks and trade names in this state.

Id., 437 S.E.2d at 17.

Further, the court found that South Carolina had conferred benefits upon Geoffrey to which the challenged tax was rationally related.

> The real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers. By providing an orderly society in which Toys R Us conducts business, South Carolina has made it possible for Geoffrey to earn income pursuant to the royalty agreement. That Geoffrey has received protection, benefits, and opportunities from South Carolina is manifested by the fact that it earns income in this state. That the tax is rationally related to these protections, benefits, and opportunities is evidenced by the fact that the State seeks to tax only that portion of Geoffrey's income generated within its borders.

Id., 437 S.E.2d at 18 (citations and internal quotes omitted).

The observations of the South Carolina Supreme Court apply with force to the situation in this case, where MBNA has directed purposeful activity toward West Virginia – soliciting credit card customers and establishing relationships with stores, restaurants and other establishments which entice consumers to make credit purchases [10] – and in return has realized millions of dollars of

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[10] There's no difference, for purposes of nexus analysis, between a "Toys R Us" sign and a "MasterCard Accepted" sign in the window of a commercial establishment. Both are there to bring in customers; the former results in income for Geoffrey, the latter in income for MBNA.

income generated within West Virginia's borders as a result of the protections, benefits and opportunities afforded by the State.

In *Lanco, Inc. v. Director, New Jersey Division of Taxation*, 879 A.2d 1234 (N.J.SuperA.D. 2005), the Superior Court of New Jersey reached a similar result. The *Lanco* court began by recognizing that Quill "reflects the express limitation for sales and use taxes...." 879 A.2d at 1237 n.2. Relying on the analysis set forth in *Geoffrey, supra*, as well as *A & F GTrademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C.App. 2004) (upholding North Carolina's assessment of corporate franchise and income taxes against wholly-owned, non-domiciliary subsidiary corporations of Limited, Inc.), and *Secy, Dep't of Revenue v. Gap (Apparel), Inc.*, 886 So.2d 459 (La.Ct.App. 2004) (per curiam) (upholding Louisiana's assessment of corporate income tax on Gap Apparel, a Delaware corporation, despite the absence of real or personal property, employees or other presence in Louisiana and the absence of the entry of any licensing agreement there), the *Lanco* court concluded:

> We are satisfied that the physical presence requirement applicable to use and sales taxes is not applicable to income tax and that the New Jersey Business Corporation Tax may be constitutionally applied to income derived by plaintiff from licensing fees attributable to New Jersey.

Lanco, 879 A.2d at 1242.

MBNA attempts to distinguish the *Geoffrey/Lanco* analysis on the ground that these are intellectual property cases and thus part of a separate body of law. Admittedly the facts of *Geoffrey*, *Lanco* and the cases cited therein are not squarely on point with those of the instant case; however, the analysis is easily transferrable and provides persuasive authority for the position of the Tax Commissioner.

MBNA relies heavily on *J.C. Penney National Bank v. Johnson*, 19 S.W.2d 831 (Tenn.Ct.App. 1999), where the Court of Appeals of Tennessee, Western Division, adopted the argument made by MBNA in this case. In *J.C. Penney*, the Commissioner of Revenue for the State of Tennessee attempted to impose franchise and excise taxes on the J. C. Penney National Bank, which supplied credit cards that were used in J. C. Penney stores located in Tennessee.

After finding that the taxes in question satisfied due process, the court began its Commerce Clause analysis by noting that "phrases such as 'minimum contacts' and 'substantial nexus' do not really mean anything." Id. at 838. It went on to hold that "[w]hile it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case ... we are not in a position to speculate as to how the Supreme Court might decide future cases. We are only able to rely on past decisions. Any constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in *Bellas Hess* and *Quill* are not within the purview of this court to discern. As such, we feel that the outcome of this case is governed by *Bellas Hess* and *Quill*, as those decisions interpret the first prong of the Complete Auto test." Id. at 839.

The court's analysis in *J. C. Penney* was, in short, no analysis at all, and the court abrogated its duty to decide the question before it. State courts decide federal constitutional questions every day; they don't just apply inapposite law on the ground that it's the only law that currently exists. In *Quill*, the Supreme Court expressly limited its decision to the area of sales and use taxes, leaving other courts in the first instance to decide Commerce Clause questions in non-sales and use tax situations.

This Court, which has never been afraid to decide the issues before it, should not follow the flabby intellectual reasoning displayed in *J. C. Penney*. The Tax Commissioner respectfully urges the Court to follow the *Geoffrey/Lanco* analysis, which leads to the conclusion that MBNA's millions of dollars of income generated in West Virginia are subject to the State's income and business franchise taxes.

ARGUMENT II: APPORTIONMENT

BECAUSE MBNA IS A FINANCIAL ORGANIZATION, IT IS NOT ENTITLED TO HAVE ITS INCOME APPORTIONED UNDER THE STATUTE APPLICABLE TO CORPORATIONS AND PARTNERSHIPS THAT ARE NOT FINANCIAL ORGANIZATIONS.

The Taxpayer's second assignment of error challenges the way in which West Virginia computes its business franchise tax and corporate net income tax liability.[11] MBNA acknowledges that it is a "financial organization" for purposes of the West Virginia BFT and CNT. Notwithstanding this admission, MBNA seeks to invalidate West Virginia's apportionment method for all financial organizations in the state. Contrary to MBNA's claims of discrimination, West Virginia treats MBNA the same as it treats every financial organization, both those domiciled here and in other states.

This part of the argument deals with the constitutionality of the computation of the BFT and CNT for similarly situated financial organizations.[12] The computation is based upon a calculation

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[11] *See* W. Va. Code §11-23-1 *et seq.*, and W. Va. Code §11-24-1 *et seq.*

[12] As set forth earlier in this Brief, MBNA asserts in a footnote to its Brief that it is paying taxes to Delaware on 100% of its income. Interestingly, MBNA does not discuss these alleged payments in the apportionment section of its Brief, where the argument would make the most sense. While the alleged payments to Delaware are not part of the record, assuming *arguendo* that they were made, MBNA fails to discuss how this would violate *Complete Auto,* which mandates that all

which apportions all similarly situated financial organizations' taxable income based upon their gross receipts attributable to West Virginia residents. As discussed herein, West Virginia's tax on income resulting from MBNA's sales attributable to West Virginia residents is constitutional as a fairly apportioned tax. In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), the United States Supreme Court found a tax based upon income resulting from sales alone to be constitutional, and the holding in *Moorman* remains intact. Moreover, the taxes at issue here are imposed as a result of activities in West Virginia. Contrary to MBNA's assertion, there is economic justification for the tax because MBNA extends substantial credit to West Virginians to facilitate purchases at thousands of West Virginia stores and businesses – stores and businesses with whom MBNA has a business arrangement. These business arrangements are essential to the purchases in West Virginia from which MBNA earns millions of dollars in income from West Virginia residents. It is these millions in income upon which West Virginia imposes its five percent (5%) tax.

The Tax Commissioner asks this Court to uphold Judge Bloom's denial of the Taxpayer's Cross Appeal challenging the legislatively-mandated formula for apportionment of all financial organizations.

THE COMMERCE CLAUSE DOES NOT PREVENT WEST VIRGINIA FROM ASSESSING TAXES FROM MBNA PURSUANT TO THE APPORTIONMENT STATUTE APPLICABLE TO FINANCIAL ORGANIZATIONS.

Not surprisingly, MBNA would prefer to have its taxes calculated pursuant to the corporation and partnerships apportionment statutes rather than the apportionment statutes applicable to financial

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taxes must be fairly apportioned to satisfy the Commerce Clause. This silence on MBNA's part is presumably a reflection of the fact that West Virginia's apportionment formula only taxes income attributable to West Virginia sources.

organizations. Significantly, the Taxpayer makes no argument that financial organizations domiciled in West Virginia receive more favorable tax treatment than MBNA. For purposes of apportionment, the Legislature has made a specific and deliberate distinction which treats corporation and partnership organizations differently from financial organizations. For business franchise tax, the plain language of the apportionment statute applicable to financial organizations, W. Va. Code § 11-23-5a(a), states in pertinent part:

> (a) *General.* - The Legislature hereby finds that the general formula set forth in section five of this article for apportioning the tax base of corporations and partnerships taxable in this state as well as in another state is inappropriate for use by financial organizations due to the particular characteristics of those organizations and the manner in which their business is conducted. **Accordingly, the general formula set forth in section five of this article may not be used to apportion the tax base of such financial organizations which shall use only the apportionment formula and methods set forth in this section.** (Emphasis added.)

W. Va. Code § 11-23-5a(a).

The same plain language evincing legislative intent can be found in Article 24 regarding corporate net income tax for financial organizations:

> (a) *General.* - The Legislature hereby finds that the general formula set forth in section seven of this article for apportioning the business income of corporations taxable in this state as well as in another state is inappropriate for use by financial organizations due to the particular characteristics of those organizations and the manner in which their business is conducted. **Accordingly, the general formula set forth in section seven of this article may not be used to apportion the business income of such financial organizations, which shall use only the apportionment formula and methods set forth in this section.** (Emphasis added.)

W. Va. Code § 11-24-7b(a).

Thus, when the Legislature enacted both the corporate net income and business franchise taxes, it chose a different apportionment formula for financial organizations than corporations and partnerships because it found that financial organizations had particular characteristics which made the apportionment formula for corporations and partnerships inappropriate. Specifically, then, the

Legislature chose not to use the three-factor apportionment formula for corporations and partnerships when determining how financial organizations such as MBNA should have their gross receipts apportioned for either of the taxes at issue here.[13]

Absent from the Taxpayer's argument is any suggestion that the West Virginia Legislature lacked a rational basis to classify financial organizations differently than it classifies partnerships and corporations. Perhaps no such argument was made because of the recognition that states have been given wide latitude with regard to tax classification within their jurisdiction. *See, e.g., Capitol Cablevision Corp. v Hardesty*, 285 S.E.2d 412 (1981)(where the similarity between two businesses is only superficial and they provide different services, differential treatment in tax assessment will be upheld); *Allied Stores of Ohio, Inc. v. Bowers* 358 U.S. 522 (1959) (the State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products); *White Packing Co. v. Robertson*, 89 F.2d 775 (4th Cir.1937) (wide discretion must be accorded legislative authority in the matter of classifying for purposes of taxation, and classification will be upheld if any state of facts reasonably can be conceived to sustain it). Moreover, Taxpayer's burden in making a rational basis argument, if it were to take on such a challenge (which it has not), would be high, and there is no factual support in the record to sustain a finding that the Legislature's different classification of financial organizations from corporations and partnerships lacked a rational basis.

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[13]The apportionment urged by the Taxpayer, which specifically does not apply to financial organizations, can be found at W. Va. Code §11-23-5 (business franchise apportionment formula for corporations and partnerships) and W. Va. Code §11-24-7 (corporate net income apportionment formula for corporations and partnerships).

MBNA HAS FAILED TO DEMONSTRATE BY CLEAR AND COGENT EVIDENCE THAT THE APPORTIONMENT FORMULA FOR FINANCIAL ORGANIZATIONS IS ARBITRARY.

MBNA's challenge to West Virginia's apportionment provisions for financial organizations is similar to its challenge to the alleged lack of nexus, in that the arguments share a common goal as well as a common flaw. The goal: although the Taxpayer's gross receipts attributable to West Virginia exceed eight million dollars for each of the tax years in question, it seeks to pay no BFT or CNT to West Virginia. The flaw: the applicable statutes support the imposition of the taxes and the constitutional challenges raised by the Taxpayer fall short of the mark. As discussed *infra*, nexus exists because neither the statutes nor the United States Constitution requires that a company have physical presence in a state in order for nexus to exist. Likewise, the apportionment statutes for financial organizations look only to a company's gross receipts from a West Virginia source. Thus, the Taxpayer's argument that its taxes should be computed by factoring in its lack of property and payroll in West Virginia (a calculation which would wipe out its tax liability) is contrary to W. Va. Code § 11-23-5a(f) and W. Va. Code § 11-24-7b(g). This is yet another attempt by MBNA to make physical presence a prerequisite to the levy of taxes.

A critical reading of Taxpayer's Petition reveals that MBNA has no statutory or constitutional basis to invalidate West Virginia's BFT or CNT. [14]

WEST VIRGINIA'S APPORTIONMENT OF MBNA'S INCOME MEET THE CONSTITUTIONAL REQUIREMENTS OF FAIRNESS.

For financial organizations which, like MBNA, are not domiciled in West Virginia, BFT and CNT are computed by taxing only the portion of their income attributable to gross receipts received from a West Virginia source.[15]

This Court must now determine whether West Virginia's apportionment of a financial organization's gross receipts, done by taxing only that fraction of its income attributable to a West Virginia source, violates the Commerce Clause. In *Moorman Mfg. Co. v. Bair, supra*, the United States Supreme Court examined a constitutional challenge similar to the one presented here. Iowa imposed a single factor tax on income realized from the sales in Iowa of products manufactured in Illinois. The Moorman Company argued that because some portion of value occurred outside of Iowa, where the animal feed was manufactured, the single factor tax imposed in Iowa unfairly apportioned Illinois' value to Iowa. Accordingly, Moorman asked the Court to rule that Iowa must use a three-factor formula taking into account (a) sales, (b) property, and © payroll, which Iowa had allowed them to use in previous years. [16]

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[15]W. Va. Code § 11-23-5a(f) and W. Va. Code § 11-24-7b(g) share common language regarding the calculation of the Special Gross Receipts factor which apportions income to West Virginia. In pertinent part the statutes provide:

> The gross receipts factor is a fraction, the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable year and the denominator of which is the total gross receipts of the taxpayer wherever earned during the taxable year . . . .

[16]As noted *infra*, the Tax Commissioner of West Virginia, unlike his counterpart in Iowa, has not and cannot allow MBNA as a financial organization to apportion its income by using a three factor formula.)

The Taxpayer's apportionment challenge in this case is similar to the one made in *Moorman*. Specifically, the *Moorman* Court was asked, as this Court is asked, to mandate the apportionment formula that a state can use to apportion income of interstate corporations such as MBNA.[17]

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[17] The crediting provision applicable to West Virginia domiciliaries which have all their gross receipts deemed to this State provides in pertinent part:

> (a) Effective for taxable years beginning on or after the first day of January, one thousand nine hundred ninety-one, notwithstanding any provisions of this code to the contrary, any financial organization **having its commercial domicile in this state** shall be allowed a credit against the tax imposed by this article for any taxable tear for taxes paid to another state. That credit shall be equal in amount to **the lessor of**
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> . . .
>
> (2) The portion of the tax actually paid that the financial organization would have paid if the **rate of tax imposed by this article is applied to the tax base determined under the law of such other state**. (Emphasis added.)

W.Va. Code § 11-23-27 (a)(1)(2).

Likewise the crediting provision in W. Va. Code § 11-24-24 is identical in effect to the previously cited crediting provision.

> (a) Effective for taxable years beginning on or after the first day of January, one thousand nine hundred ninety-one, and notwithstanding any provisions of this code to the contrary, any **financial organization, the business activities of which take place, or are deemed to take place, entirely within this state**, shall be allowed a credit against the tax imposed by this article for any taxable year for taxes paid to another state. That credit shall be equal in amount to the **lesser of**:
>
> (1) The taxes such financial organization shall actually have paid, which payments were made on or before the filing date of the annual return required by this article, to any other state, and which tax was based upon or measured by the financial organization's net income and was paid with respect to the same taxable year; or
>
> (2) The amount of such tax the financial organization would have paid **if the rate of tax imposed by this article is applied to the tax base determined under the laws of such other state.**
>
> (b) Any additional payment of such tax to other states, or to political

The court assumed, for purposes of decision, that Moorman's out-of-state activities contributed to the profitability of the Iowa sales being taxed. Notwithstanding this assumption, the Court held that the contribution to value from Illinois activities did not invalidate the tax. As to the effect of value contributed out-of-state, the *Moorman* Court stated:

> Yet even were we to assume that the Illinois activities made some contribution to the profitability of the Iowa sales, appellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State is incorrect.

437 U.S. 272 (emphasis added.)

The Court then reiterated its previous holdings in *Underwood Typewriter Co. v. Chamberlin*, 254 U.S. 113 (1920), in which it upheld the use of net income alone to apportion income, and *Standard Pressed Steel and General Motors Corp. v. Washington*, 377 U.S. 436 (1975), which imposed a tax on a company's gross receipts. Thus, the *Moorman* Court reiterated that a single factor tax based on a company's gross receipts tax is valid.

Here, there is no question of the appropriateness of West Virginia tax because the gross receipts being taxed come from a West Virginia source.

> subdivisions thereof, by a financial organization described in this section, and any refunds of such taxes, made or received by such financial organization with respect to the taxable year, but after the due date of the annual return required by this article for the taxable year, including any extensions, shall likewise be accounted for in the taxable year in which such additional payment is made or such refund is received by the financial organization.

W. Va. Code § 11-24-24(a)(1)(2)(b)

Inasmuch as MBNA is being taxed solely on its gross receipts attributable to a West Virginia source, no gross receipts from outside West Virginia are being used in MBNA's apportionment calculation. The lack of deemed income makes a credit unnecessary and irrelevant.

The *Moorman* Court, in refusing to create uniform apportionment rules for all of the states, held that a state's single-factor formula would be upheld unless it could be shown that the formula resulted in arbitrary results. No such showing can be made in this case, because West Virginia apportions MBNA's income based only on gross receipts attributable to a West Virginia source.

In *Moorman*, the Court chose not to interfere with state taxation by engaging in the practice of establishing uniform rules for apportionment for all the states. In refusing to invalidate a state's choice of apportionment formulas, the Court indicated that if uniformity was to be accomplished, the United States Congress would have to activities. In the nearly thirty years since the *Moorman* decision was announced, the Court has not deviated from the *Moorman* rule to micro-manage a state's choice of an apportionment formula, unless arbitrariness resulted. Nothing in *Container Corp. of American v. Franchise Tax Bd.*, 463 U.S. 159 (19__) or any of the Court's subsequent decisions signals a change with regard to the Court's unwillingness to chose between two competing types of apportionment in the situation where the taxpayer proffers one formula and a state chooses another. *Moorman* remains good law after the Court's decisions in *Complete Auto Transit, Inc. v. Charles R. Brady, Jr.*, 430 U.S. 274 (19__), *Container Corp* and *Goldberg v. Sweet*, 488 U.S. 252 (citing *Container Corp* and *Moorman* for the proposition that a single constitutionally mandated method of taxation is a legislative function).

In *Container Corp.,* the Court once again examined the issue of apportionment of income for an interstate corporation. The Court quoted *Moorman* with approval:

> At least in the interstate commerce context, however, the anti-discrimination principle has not in practice required much in addition to the requirement of fair apportionment. In *Moorman Mfg. Co. v. Bair, supra,* in particular, we explained that *eliminating all overlapping taxation would require this Court to establish not only a single constitutionally mandated method of taxation, but also rules regarding the application of that method in particular cases.* 437 U.S. at 278-280, 98 S. Ct. at

> 2347-2348. *Because that task was thought to be essentially legislative, we declined to undertake it, and held that a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States.*

(Emphasis supplied.) The fact that MBNA prefers the three-factor formula which would eliminate its tax responsibility to West Virginia in no way supports a claim that there has been a constitutional violation.

In Goldberg, the Court dealt with a taxpayer's challenge that a gross charge on interstate telephone calls was discriminatory even though in Goldberg, as here, the tax on similarly situated intrastate taxpayer was at the same rate.[18] Also as here, the gross receipts were taxed based upon billings in the state. The Goldberg Court found no discrimination because, as here, it would not be feasible to track all West Virginia purchases of every MBNA credit card.

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[18]Coincidentally the tax, as here, was imposed at 5%.

CONCLUSION

For all of the reasons set forth herein and apparent on the face of the record, the Taxpayer requests that the Court affirm the decision of the Circuit Court of Kanawha County. MBNA has not rebutted the statutory presumption of constitutional correctness which attaches to West Virginia's corporate net income and business franchise taxes. MBNA depends on business activities and its business relationships in West Virginia in obtaining millions of dollars of revenue from West Virginia residents. MBNA's request for tax immunity is not supported by any relevant legal authority and is not supported by the United States Constitution.

Respectfully submitted,

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IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

NO. 052588

DALE W. STEAGER,

Petitioner below, Respondent,

v.

MBNA AMERICA BANK,

Respondent below, Petitioner.

CERTIFICATE OF SERVICE

I, Katherine A. Schultz, Senior Deputy Attorney General, do hereby certify that the foregoing "Tax Commissioner's Brief in Opposition to Appeal" was served upon opposing counsel by depositing a true copy thereof, postage prepaid, in the regular couse of the United States mail, this 26th day of June, 2006, addressed as follows:

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