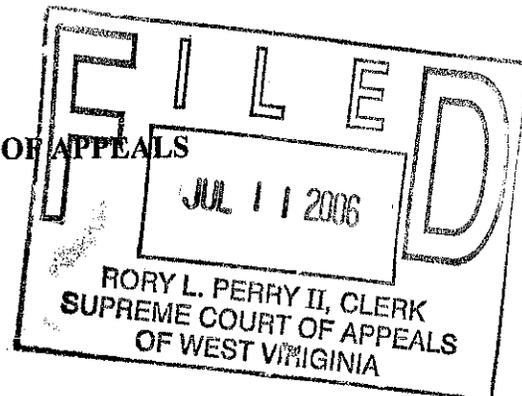


IN THE WEST VIRGINIA SUPREME COURT OF APPEALS



MBNA America Bank, N.A.,
Petitioner,

v.

No. 33049

West Virginia State Tax Commissioner,
Respondent.

REPLY
of
MBNA AMERICA BANK, N.A.

G. Thomas Battle
Craig Griffith
SPILMAN, THOMAS & BATTLE, PLLC
300 Kanawha Boulevard, East
Charleston, WV 25321

Arthur R. Rosen (admitted pro hac vice)
Donald M. Griswold (admitted pro hac vice)
McDERMOTT WILL & EMERY LLP
340 Madison Avenue
New York, NY 10017

Counsel for Petitioner
MBNA America Bank, N.A.

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ARGUMENT

This case presents one question: Did the Commissioner violate the constitutional bar on extra-territorial taxation when he refused to follow the “physical presence” nexus standard articulated in *Quill*?¹

I. SUMMARY: WEST VIRGINIA HAS NO JURISDICTION TO TAX MBNA

No court in this country has ever condoned the imposition of state tax on an independently viable operating business solely because that business availed itself of the in-state market. This Court should not be the first to do so.

It is settled law that the Commerce Clause of the United States Constitution bars a state from imposing tax on an out-of-state corporation unless there exists a “substantial nexus” between them.² Although the Commissioner and MBNA agree that West Virginia must satisfy this substantial nexus requirement before the State can impose any type of tax on MBNA, they disagree about the governing standard for satisfying that requirement in the income tax context.

An analysis of decades of dormant Commerce Clause jurisprudence, culminating in the U.S. Supreme Court’s decision in *Quill Corp. v. North Dakota*,³ resolves this disagreement. The only governing standard the Court has ever provided for any type of tax is “physical presence.”⁴

¹ In its Petition for Leave to Appeal to this Court and in its opening brief, MBNA also raised an assignment of error concerning fair apportionment. MBNA now withdraws any portion of its refund claim that is dependent upon this issue. (Should this Court rule for MBNA on nexus, apportionment will be irrelevant in any event because no portion of MBNA’s income can be subjected to tax by West Virginia. Should this Court rule to the contrary, MBNA does not contest the applicability of the State’s statutory apportionment scheme.)

² *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

³ 504 U.S. 298, 312 (1992); *see also*, *National Bellas Hess v. Dept.*, 386 U.S. 753 (1967).

⁴ See MBNA’s opening brief in this case (“*MBNA Br.*”), 18-23.

Applying that standard, this Court must conclude that the constitutionally required substantial nexus between MBNA and West Virginia does not exist because MBNA is not physically present in the State.

The Commissioner's Brief in Opposition to Appeal ("*Comm. Br.*") fails to justify the Circuit Court's erroneous holding "that the 'bright-line physical presence test' established in *Bellas Hess* and adhered to in *Quill* has no application in this matter because the taxes at issue here are not sales and use taxes."⁵ The Commissioner's central argument is that the physical presence standard today should be limited only to use tax collection disputes simply because the Court's most recent nexus decision, *Quill*, was such a case. *Quill* did not, however, repudiate its decades-old standard: In the context of all types of taxes, the U.S. Supreme Court has consistently found the substantial nexus requirement satisfied only in those cases where the putative taxpayer had an in-state physical presence.⁶ Facing the utter absence of U.S. Supreme Court authority for any alternative to the physical presence standard, the Commissioner and the Circuit Court below invent four alternatives of their own: market exploitation, undue burdens, intertwined business relationships, and fair relation to government services.⁷ As discussed below, none of these alternatives satisfies the Commerce Clause substantial nexus requirement.

⁵ *Steager v. MBNA America Bank, N.A.*, No. 04-AA-157 (W.V. Cir. Ct. 2005) ("*Steager v. MBNA*"), conclusion of law #5.

⁶ Part III.A of this Reply elaborates upon this point.

⁷ See part III.B, below.

II. CORRECTION OF FACTUAL AND LEGAL INACCURACIES

Before explaining why the Commissioner's arguments must fail, it is necessary to address and correct some of the most serious inaccuracies in his brief.

A. MBNA IS NOT A PASSIVE INVESTMENT COMPANY

The baseless innuendo with which the Commissioner begins his brief colors his entire line of argument, for this error is the factual foundation upon which much of his brief is built. "[I]t is clearly not a coincidence that MBNA is a Delaware corporation, because Delaware does not assess a corporate income tax," writes the Commissioner,⁸ in an apparent attempt to lead this Court into thinking that MBNA is "gaming the system" in order to pay no state tax. The Commissioner seems to be attempting to persuade this court that MBNA is a special-purpose Passive Investment Company ("PIC")⁹ and that the cases involving such entities should therefore have some bearing on the resolution of this matter.

This suggestion is patently false. Delaware law does indeed impose a corporate franchise tax, and a hefty one at that, on all "banking organizations" – defined to include any national bank that (like MBNA) has its principal office in Delaware.¹⁰ The record in this case includes the stipulation that MBNA is a national bank, chartered and headquartered in Wilmington,

⁸ *Comm. Br.*, 1.

⁹ The most common type of PIC is exemplified by the arrangement established by mass retailer Toys R Us. The company's PIC subsidiary owned the corporate group's trademarks, including the company name and its "Geoffrey the giraffe" mascot. The affiliate that operated the group's retail stores licensed these marks from the PIC in exchange for payments of royalties. As a result, the stores affiliate obtained significant state tax deductions across the country. The PIC's royalty income, however, was exempt from tax in its home state, Delaware, because of a special rule for passive investment companies. State revenue departments commonly challenge the tax benefits produced by such PICs, often by asserting jurisdiction to tax them. *See, Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993).

¹⁰ 5 DEL. CODE REGS. §1103; DEL. CODE ANN. tit. 5 § 1105(a), in effect for the years at issue in this case.

Delaware, and that its “principal business was issuing and servicing VISA and MasterCard credit cards for customers throughout the United States.”¹¹ In other words, MBNA is fully taxed by Delaware as an independently viable operating business enterprise – the antithesis of a PIC.

Consequently, the Commissioner must fail in his attempt to convince this Court that this controversy ought to be governed by the *Geoffrey* case¹² and other state court decisions involving PICs. Rather, the principles articulated by the U.S. Supreme Court decision in *Quill* must govern this income/franchise tax case because, just like the present controversy, the reasoning in that case applied to an independently viable operating business enterprise.

B. SEVERAL KEY CASES DO NOT STAND FOR THE CITED PROPOSITIONS

The Commissioner repeatedly bases his arguments on incomplete case-quotes that, torn from their context, appear to stand for principles they do not support. A few examples illustrate this problem:

1. Geoffrey’s Due Process Analysis Should Not Have Been Presented as Commerce Clause Analysis

A significant part of the Commissioner’s argument is an effort to convince this Court to substitute the less restrictive “minimum contacts” requirement of the Due Process Clause for the more stringent “substantial nexus” requirement of the Commerce Clause in this case, where the issue is Commerce Clause nexus.¹³ It is totally improper to present a court’s Due Process analysis as if it were Commerce Clause analysis. That, however, is precisely what the

¹¹ Stipulation of Facts and Exhibits, December 23, 2003 (“*Initial Stip.*”), Nos. 1–3.

¹² 437 S.E.2d 13 (S.C. 1993). See parts II.B.2 and III.B.1 of this Reply.

¹³ See *MBNA Br.*, 14-18, and part III.B.1 below.

Commissioner does in his brief,¹⁴ where he argues his Commerce Clause point with large block quotes from the Due Process portion (part II.A) of the South Carolina Supreme Court's decision in *Geoffrey*.¹⁵

2. **J.C. Penney National Bank Did Not Fail to Distinguish Due Process "Minimum Contacts" from Commerce Clause "Substantial Nexus"**

The Commissioner attempts to substitute the irrelevant Due Process "minimum contacts" requirement (with its market exploitation standard) in place of the dispositive Commerce Clause "substantial nexus" requirement (with its physical presence standard) in this case. This attempt, based on the PIC cases discussed below,¹⁶ encounters an insurmountable obstacle in *J.C. Penney National Bank v. Johnson*,¹⁷ the Tennessee Court of Appeals decision that rejected this argument in a case involving strikingly similar facts. Rather than a PIC like *Geoffrey*, the putative taxpayer in *JCP Bank* – as in the present controversy – was an independently viable commercial enterprise, an out-of-state bank that issued credit cards to consumer borrowers. In eleven pages of scholarly analysis, including an historical review of developments in Due Process¹⁸ and Commerce Clause¹⁹ jurisprudence, the *JCP Bank* court analyzed in depth the reasons that "the Commerce Clause imposes a greater limitation on Tennessee's right to tax JCPNB than does the Due Process Clause," concluded that there was no legitimate basis for failing to apply the Commerce Clause physical presence standard in the income tax (financial

¹⁴ *Comm. Br.*, 16-17.

¹⁵ 437 S.E.2d at 17, 18. For another instance in which the Commissioner presents a court's Due Process nexus analysis as if it were Commerce Clause analysis, see footnote 44, below.

¹⁶ See part III.B.1 of this Reply, below.

¹⁷ 19 S.W.3d 831 (Tenn. Ct. App. 1999) ("*JCP Bank*").

¹⁸ *JCP Bank*, 19 S.W.3d at 836, 837.

¹⁹ *JCP Bank*, 19 S.W.3d at 838.

institutions franchise tax) case before it, and held that the State had no jurisdiction to impose tax on the bank.²⁰

Faced with an on-point decision that destroys his argument, the Commissioner quotes out-of-context the court's comment that "phrases such as 'minimum contacts' and 'substantial nexus' do not really mean anything" on their own,²¹ and draws from this introductory remark the astounding conclusion that the *JCP Bank* case can be ignored because it involved "no analysis at all, and the court abrogated its duty to decide the question before it."²² To the contrary, *JCP Bank*, a thorough and thoughtful decision that is directly on point, both factually and legally, provides an excellent model for this Court to follow in analyzing the instant case.

3. **National Geographic and Commonwealth Edison Do Not Equate the First and Fourth Prongs of the Complete Auto Test**

The Commissioner also attempts to justify the decision of the Circuit Court below by erroneously substituting an entirely different Commerce Clause standard for the firmly-established substantial nexus standard. As explained in MBNA's opening brief,²³ the four parts of the test articulated by the U.S. Supreme Court in *Complete Auto*²⁴ – (1) substantial nexus, (2) fair apportionment, (3) non-discrimination, and (4) fair relation to State services – are separate and distinct requirements. The Circuit Court confused the fourth prong of this test, a rather easy requirement to satisfy, with the first prong (substantial nexus) that governs this case.

²⁰ *JCP Bank*, 19 S.W.3d at 838, 839, 842.

²¹ *JCP Bank*, 19 S.W.3d at 838.

²² *Comm. Br.*, 19.

²³ *MBNA Br.*, 28-29.

²⁴ *Complete Auto*, 430 U.S. at 279.

In an attempt to validate this confusion as clear-headed, the Commissioner lifts an inapposite quote from the U.S. Supreme Court's decision in *National Geographic*,²⁵ asserting that in this quote the "interrelationship between prongs one (1) and four (4) of *Complete Auto* was described."²⁶ This is patently false; *National Geographic* devotes not a single word to an analysis of the fourth prong of *Complete Auto*'s four-prong test.²⁷

On the same topic, the Commissioner cuts off a quote from the U.S. Supreme Court's decision in *Commonwealth Edison*²⁸ right before the Court makes a statement that invalidates the argument made here by the Commissioner – that the first prong (substantial nexus) is satisfied whenever the fourth prong (fair relation to services) is satisfied. After quoting the beginning of the Court's discussion of these two prongs, ending with the statement that, under the first prong, the company "must have a substantial nexus with the State before any tax may be levied on it,"²⁹ the Commissioner fails to continue with the Court's following dispositive statement: "Beyond that threshold requirement [the first prong, substantial nexus], the fourth prong of the *Complete Auto Transit* test imposes the additional limitation that the measure of the tax must be reasonably related to the extent of the contact"³⁰

Thus, if the Commissioner had placed his selected quote in context, he would have seen that satisfaction of the "fairly related" requirement (which focuses on whether the

²⁵ *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 561 (1977).

²⁶ *Comm. Br.*, 15.

²⁷ Decided just one month after *Complete Auto*, *National Geographic* merely references the "fairly related" prong without analyzing it. 430 U.S. at 558. Furthermore, the Court's nexus analysis in this case focuses on the Due Process "minimum connection" nexus requirement, citing *Miller Bros. v. Maryland*, 347 U.S. 340, 344-345 (1954), and does not even mention that *Complete Auto* articulated a "substantial nexus" requirement under the Commerce Clause.

²⁸ *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981).

²⁹ *Comm. Edison*, 453 U.S. at 626 (emphasis supplied).

³⁰ *Comm. Edison*, 453 U.S. at 626 (emphasis supplied).

measure of the tax passes constitutional muster) has nothing whatsoever to do with satisfaction of the substantial nexus requirement (which, by contrast, focuses on whether the imposition of the tax is constitutional).

III. THE “PHYSICAL PRESENCE” STANDARD GOVERNS THIS CASE

The Commissioner misinterprets decades of U.S. Supreme Court jurisprudence, ignores the underlying rationale of *Quill*, and misstates the facts of this case in an effort to persuade this Court to reach a conclusion that no final court case has ever reached – that the Commerce Clause of the United States Constitution allows imposition of income tax on an operating business solely because that business availed itself of the benefits of the in-state market.

A. ALL TAX TYPES ARE SUBJECT TO THE SAME NEXUS STANDARDS

For three decades or more, it has been settled law that the Commerce Clause of the United States Constitution bars a state from reaching outside its borders to impose tax on any company that does not have a “substantial nexus” with the State.³¹ Ever since its decision in *Complete Auto*, whatever the type of tax involved – income/franchise tax, gross receipts tax, sales/use tax, etc. – the U.S. Supreme Court has found this substantial nexus requirement satisfied only in cases where the putative taxpayer had a physical presence in the taxing state.³² Furthermore, the Court has never set forth an alternative to this physical presence standard for satisfying the Commerce Clause substantial nexus requirement.

The Commissioner contends that, after decades in which it never once ruled inconsistently with the physical presence standard, the U.S. Supreme Court decided in *Quill* to

³¹ *Complete Auto*, 430 U.S. at 279.

³² See the cases cited at *MBNA Br.*, fn. 66 and 72; see also, *Quill*, 504 U.S. at 314 (“[A]ll of these cases involved taxpayers who had a physical presence in the taxing State”).

repudiate that standard for income/franchise taxes and to limit its application only to sales/use taxes.³³ Nowhere in its opinion does the Court make such a repudiation. Indeed, it would have been extraordinary for the Court to make such a ruling in a case where income/franchise taxes were not at issue. When, in *Quill*, the Court applied the physical presence standard to a case involving imposition of a use tax collection obligation,³⁴ it was simply following in that context the same standard it had always followed in the context of other types of taxes.

Indeed, despite its understandably frequent references to use taxes (after all, that was the case before it), the Court in *Quill* concluded that the bright-line physical presence standard “furthers the ends of the dormant Commerce Clause.”³⁵ From this it must be concluded that the physical presence standard has broad application to all types of taxes, because this standard is essential to the overriding national policy of preserving open interstate markets by placing meaningful limits on the states’ exercise of jurisdiction to impose any type of tax on out-of-state companies. *Quill* enunciated and confirmed the physical presence standard that underpins all Commerce Clause nexus analysis.

1. **The Majority Opinion in *Quill* Was Not Grounded on *Stare Decisis***

As justification for his strained contention that the decades-old physical presence standard was repudiated for income taxation after *Quill* reaffirmed the continuing vitality of that standard in the use tax context, the Commissioner argues that the U.S. Supreme Court would have scuttled the physical presence standard entirely, but for the mail-order industry’s reliance

³³ *Comm. Br.*, 4.

³⁴ *Quill*, 504 U.S. at 314.

³⁵ *Quill*, 504 U.S. at 314.

on the predecessor case, *National Bellas Hess*, and principles of *stare decisis*.³⁶ The authority cited by the Commissioner is not, however, the five-judge majority opinion of the Court in *Quill*, but a three-judge concurring opinion that actually criticizes the majority for basing its holding, not on *stare decisis*, but on the continuing vitality (on the merits) of the physical presence standard: “Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*.”³⁷

The Commissioner’s argument thus backfires, demonstrating that the opinion of the Court was not based solely on *stare decisis*, and that the physical presence standard thus was not limited by the *Quill* Court to the use tax context of *National Bellas Hess*. In fact, the better view is that taxpayers today have a reasonable case for assertion of a reliance interest, based upon *Quill*, in the broad application of the physical presence standard to income taxes. Contrary West Virginia cases cited by the Commissioner³⁸ were made obsolete by *Quill*’s distinction between Due Process minimum contacts nexus and Commerce Clause substantial nexus, and the U.S. Supreme Court has not addressed a single tax nexus issue since its decision in *Quill* over a dozen years ago.

2. ***Quill* Did Not Repudiate the Physical Presence Standard for Income Tax**

The physical presence standard at issue in this case was famously articulated in *National Bellas Hess*.³⁹ That case involved jurisdiction to impose a use tax collection obligation on an out-of-state mail-order retailer. No matter what type of state tax has been at issue, however,

³⁶ *Comm. Br.*, 7.

³⁷ *Quill*, concurring opinion, 504 U.S. at 320.

³⁸ *Comm. Br.*, 12.

³⁹ 386 U.S. 753 (1967).

physical presence has been the underlying fact in every single U.S. Supreme Court Commerce Clause nexus decision since its watershed opinion in *Complete Auto*.⁴⁰ For all his misplaced reliance on *stare decisis*, the Commissioner never refutes this inescapable fact. When it opined only in the context of use taxes in *Quill*, the Court was merely declining to address a question that was not before it, consistent with the “case or controversy” requirement of the American legal system. The Commissioner argues that *Quill* expressly repudiated the physical presence standard for income taxes, based on the Court’s comment that it has not explicitly “articulated” the physical presence standard in all cases.⁴¹ There is nothing in this statement, or anywhere else in the Court’s opinion, that constitutes an express repudiation by the Court of the continuing vitality of the decades-old physical presence standard in the context of income taxation.

Indeed, the Court in *Quill* showed that it knows how to repudiate a doctrine when it wants to do so: “Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a state for the imposition of duty to collect a use tax, we overrule those holdings as superceded by developments in the law of due process.”⁴² The Court never comes remotely close to repudiating the physical presence standard under the Commerce Clause for income taxes.

B. NO AUTHORITY EXISTS FOR AN ALTERNATIVE TO THE PHYSICAL PRESENCE STANDARD

Further evidence of the broad, multi-tax applicability of the physical presence standard is found in the absence of any articulation by the U.S. Supreme Court of any alternative standard for satisfaction of the Commerce Clause substantial nexus requirement. There has been no need

⁴⁰ 430 U.S. 274 (1977). See cases cited at *MBNA Br.*, 18-23.

⁴¹ *Comm. Br.*, 5; *Quill*, 504 U.S. at 314.

⁴² *Quill*, 504 U.S. at 308.

for the articulation of such an alternative, of course, because physical presence is the standard for all types of taxes.

The Commissioner, however, seeks to persuade this Court that it should scuttle the physical presence standard and adopt in its stead one of four novel candidates for a new standard: “market exploitation,” “undue burdens,” “intertwined business relationships,” and the “fairly related” prong of the *Complete Auto* four-prong test. Each of these will be refuted briefly in turn below.

1. **“Market Exploitation” Is Not the Commerce Clause Standard**

The Commissioner aims to substitute a lesser jurisdictional requirement (Due Process minimum contacts with its market exploitation standard) in the place of the more stringent jurisdictional requirement that governs this case (Commerce Clause substantial nexus with its physical presence standard). As explained below, it is constitutionally irrelevant that MBNA derives “millions of dollars”⁴³ of revenue from the West Virginia market because “market exploitation” is not the standard for determining whether the Commerce Clause substantial nexus requirement has been satisfied.

a. **Courts in PIC Cases Substituted the Due Process Standard for that of the Commerce Clause**

The Commissioner cites three state court cases that, in the context of PICs (special-purpose subsidiaries that have no substantial physical presence anywhere), distinguished *Quill* and refused to follow its physical presence standard.⁴⁴ Beginning with the South Carolina

⁴³ *Comm. Br.*, 13.

⁴⁴ *Geoffrey, Inc. v. South Carolina Tax Comm’n*, 437 S.E.2d 13 (S.C. 1993); *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004); *Lanco, Inc. v. Dir., Division* (continued...)

Supreme Court's decision in *Geoffrey*, these courts substituted "market exploitation" (established by the U.S. Supreme Court as the standard for satisfaction of the Due Process minimum contacts nexus requirement) for physical presence as an alternative standard for satisfaction of the Commerce Clause substantial nexus requirement. Although it did not cite these cases, the Circuit Court below essentially adopted this incorrectly substituted Due Process standard when it upheld the State's jurisdiction to tax MBNA based, in part, upon MBNA's "generation of income" from West Virginia sources.⁴⁵

These PIC decisions, nominally grounded on a strained argument of *stare decisis* or administrative burdens like those set forth in the Commissioner's brief in this case,⁴⁶ lead to the extraordinary conclusion that the standard for satisfying the Commerce Clause's substantial nexus requirement can vary by tax type – and thus eviscerate *Complete Auto*'s substantial nexus requirement for corporate income taxes.⁴⁷ The real reason these courts distinguished *Quill*, of course, is that a physical presence standard is arguably inappropriate for an entity – like a PIC – that typically has nothing but an immaterial physical presence anywhere. These courts expressed

of Taxation, 879 A.2d 1234 (N.J. Super. 2005). The Commissioner actually cited four cases in support of its proposition that physical presence is not the standard for Commerce Clause nexus, but the fourth case, *Dep't of Revenue v. Gap (Apparel), Inc.*, 886 So.2d 459 (La. Ct. App. 2004), expressly addressed only personal jurisdiction under the Due Process Clause. Here again, the Commissioner falsely presents Due Process Clause precedent as if it were Commerce Clause precedent.

⁴⁵ *Steager v. MBNA*, conclusions of law # 8, 23, insisting that MBNA satisfies the substantial nexus requirement because of "the substantial revenue that MBNA generates from West Virginia citizens." The primary rationale for the Circuit Court's holding, however, was its misunderstanding of the fourth prong of the *Complete Auto* test, which actually has nothing whatsoever to do with either Due Process or Commerce Clause nexus. *Id.*, conclusions of law # 8, 9, 10, 11, 14, 23. See parts II.B.3 and III.B.4 of this Reply.

⁴⁶ *Comm. Br.*, 6, 9.

⁴⁷ *Complete Auto*, 430 U.S. at 279.

their displeasure with the “tax-shelter” nature they perceived in these PIC situations;⁴⁸ this appears to be a primary reason for their decision to distinguish *Quill*.⁴⁹

Having persuaded themselves that they could distinguish *Quill* and scuttle its physical presence standard, these courts could find no U.S. Supreme Court precedent to guide their effort to identify an alternative standard for satisfaction of the substantial nexus requirement because there is no such precedent. The U.S. Supreme Court has never articulated any such standard other than physical presence within the taxing state. The courts in these PIC cases therefore had to speculate about what sort of alternative standard the U.S. Supreme Court *might* provide for the Commerce Clause substantial nexus requirement in cases where the physical presence standard arguably may have had no meaning (because the putative taxpayer had no material physical presence anywhere).

This speculation led the courts in these PIC cases astray, just as it led astray the Circuit Court below. Finding no U.S. Supreme Court guidance concerning an alternative standard for satisfaction of the substantial nexus requirement, the courts in these cases, beginning with *Geoffrey*, created their own alternative standard, holding that a corporation acquires a substantial nexus merely by availing itself of the in-state market. Under this incorrectly substituted Due Process standard,⁵⁰ a company arguably can be taxed by any state where the company has

⁴⁸ *A&F Trademark*, 605 S.E.2d at 193-195; *Geoffrey*, 437 S.E.2d at 16-18; *Lanco*, 879 A.2d at 1239-1241.

⁴⁹ The more intellectually honest state courts have analyzed the PIC cases, not under this strained, *Quill*-distinguishing nexus analysis, but under business purpose and economic substance principles. See, e.g., *The Sherwin-Williams Co. v. Massachusetts Comm’r. of Revenue*, 778 N.E.2d 504 (Mass. 2002).

⁵⁰ Although this market-exploitation / customer-presence standard was created nearly thirteen years ago by the South Carolina Supreme Court, *Geoffrey*, 437 S.E.2d at 18, it remains
(continued...)

customers. Put another way, these courts concluded that, in contrast to the case of sales/use tax jurisdiction, there exists absolutely no meaningful Commerce Clause limitation on state income/franchise tax jurisdiction.

An erroneous confusion of two distinct constitutional requirements led *Geoffrey* and its progeny to eviscerate the substantial nexus requirement for corporate income taxes, adopting an analysis that improperly “obliterated the distinction between the Due Process Clause and the Commerce Clause.”⁵¹ Their creation and adoption of a customer-presence / market-exploitation standard in these PIC cases was based upon the courts’ failure to distinguish the standards for satisfaction of the rather easily-satisfied requirement for enforcement of any tax that a state properly imposed, from the more stringent requirement for imposition of that tax in the first place.

**b. Tax Enforcement Is Limited by the Due Process
“Market Exploitation” Standard**

As the U.S. Supreme Court explained in parts II and III of its decision in *Quill*, the first of two jurisdictional inquiries in any tax case is the Due Process personal jurisdiction requirement, which addresses whether the State can accomplish “enforcement” of a validly-imposed tax assessment against an out-of-state corporation:⁵²

“novel” today in the sense that this legal conceit finds no support anywhere in the jurisprudence of the U.S. Supreme Court.

⁵¹ *JCP Bank*, 19 S.W.3d at 839.

⁵² *Quill*, 504 U.S. at 305, 308.

Building on the seminal case of *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction⁵³

When evaluating whether this jurisdictional limitation on tax-enforcement (the Due Process “minimum contacts” requirement) has been satisfied, the standard that must be met is mere exploitation of the in-state consumer marketplace:

[I]f a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State’s *in personam* jurisdiction even if it has no physical presence in the State.⁵⁴

As explained above, this market exploitation standard is one of the standards upon which the court below relies in order to justify the Commissioner’s imposition of tax on MBNA.⁵⁵ Similarly, it was this standard upon which *Geoffrey* and its progeny relied in the PIC nexus cases. There are two fundamental problems with this reliance in the present case: (1) MBNA does not contest personal jurisdiction in this case; and (2) the Due Process minimum-contacts requirement (with its market exploitation standard) is only the first of the two separate, constitutionally mandated jurisdictional inquiries.

It is the second requirement – substantial nexus under the Commerce Clause – that bars the Commissioner from imposing tax on MBNA in this case.

⁵³ *Quill*, 504 U.S. at 307; see also, *JCP Bank*, 19 S.W.3d at 836 (“The due process analysis in the area of state taxation of interstate commerce derives from the rules for *in personam* jurisdiction expressed in *International Shoe Co. v. Washington*, and its progeny.”)

⁵⁴ *Quill*, 504 U.S. at 307, citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

⁵⁵ *Steager v. MBNA*, conclusions of law # 8, 23.

**c. Tax Imposition Is Limited by the Commerce Clause
“Physical Presence” Standard**

Once personal jurisdiction for tax enforcement is established (or, as here, conceded) under the Due Process Clause, the next jurisdictional inquiry is whether the State had jurisdiction under the Commerce Clause to impose the tax in the first place.⁵⁶

The centerpiece of the U.S. Supreme Court’s decision in *Quill* (part IV of the opinion) was its articulation of this second of the two constitutionally mandated jurisdictional inquiries.⁵⁷ In contrast to the Due Process “minimum contacts” notice requirement for tax enforcement, the Commerce Clause requires a “substantial nexus” before the burden of tax imposition⁵⁸ will be countenanced:

[T]he “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. Accordingly, contrary to the State’s suggestion, a corporation may have the “minimum contacts” with a taxing State as required by the Due Process Clause, and yet lack the “substantial nexus” with that State as required by the Commerce Clause.⁵⁹

⁵⁶ From the standpoint of orderly logic, it may be objected that tax imposition is the threshold inquiry, followed by authority to enforce the tax that has been properly imposed. Courts, however, typically address the *in personam* personal jurisdiction question before addressing the merits of any case. The U.S. Supreme Court used this order of analysis in *Quill*, and we do so in this Reply as well. The order of the analysis has no impact on the conclusion, in any event.

⁵⁷ *Quill*, 504 U.S. at 309-318.

⁵⁸ “Tax imposition” for income tax actually concerns the imposition of two types of burden: (A) economic burden (the obligation to pay with one’s own funds) and (B) administrative burden (compliance and remittance). For use tax, on the other hand, tax imposition concerns solely the administrative burden (collection and remittance of a third-party’s funds). See, *National Geographic*, 430 U.S. at 558. Furthermore, the compliance burden is significantly heavier for income tax (which involves a host of complex tax legal issues) than for use tax (which primarily involves differences in tax rates and exemptions); corporate tax departments typically devote far greater resources to income tax issues than to use tax issues. For both of these reasons, income taxes are properly considered far more burdensome than use taxes.

⁵⁹ *Quill*, 504 U.S. at 313.

The handful of PIC cases upon which the Commissioner relies – *Geoffrey, Lanco* and *A&F* – impermissibly substitute the Due Process tax-enforcement requirement (market exploitation) in the place of the Commerce Clause tax-imposition requirement (physical presence). The importation by these courts of the market exploitation standard into an inappropriate context is – charitably viewed – highly suspect in light of the foregoing analysis and of the long line of U.S. Supreme Court precedents discussed in MBNA’s opening brief.⁶⁰ The only standard that the U.S. Supreme Court has ever provided for determining whether a corporation has satisfied this tax-imposition “substantial nexus” requirement is an in-state physical presence of the taxpayer.

The error or authority of these PIC decisions should be of little more than academic interest in the present case, however, because the feature that may have arguably allowed these courts to distinguish their PIC cases from that of Quill Corporation – a lack of any significant physical presence anywhere – is not even remotely a feature of the case presently before this Court. The PIC courts speculated about the nature or existence of an alternative standard for satisfaction of the substantial nexus requirement because the putative taxpayers in those cases were (arguably) merely special-purpose PICs that had little substance or presence anywhere. Here, there is no reason for this Court to join in that speculation because the entity upon which West Virginia seeks to impose tax is not a PIC. Unlike the PICs in those earlier cases, the putative taxpayer in the present case has a major physical presence at its Wilmington headquarters.⁶¹

⁶⁰ *MBNA Br.*, 18-20.

⁶¹ The Commissioner nevertheless leads off his brief by equating MBNA with a PIC. *MBNA Br.* 1. This inaccurate characterization of the facts of this case sets up the
(continued...)

In contrast to the entities in the PIC cases upon which the Commissioner centrally relies, MBNA is an independently viable business enterprise with a major physical presence in other states. When, in the *JCP Bank* case, a Tennessee court considered the income tax nexus issue for a strikingly similar business enterprise, that court got the analysis right. It held that the U.S. Supreme Court's decision in *Quill* (articulating and applying the physical presence standard under the Commerce Clause substantial nexus requirement) bars the State's jurisdiction to impose income/franchise tax in the case of an out-of-state bank issuer of credit cards to in-state customers when that bank has no physical presence in the State.⁶² The physical presence standard – the only standard articulated for tax-imposition jurisdiction by the U.S. Supreme Court – is directly applicable in this case. MBNA had no physical presence in West Virginia. Therefore, West Virginia had no jurisdiction to impose tax on MBNA.

2. **“Undue Burdens” Analysis Explains the Reason for the Commerce Clause Substantial Nexus Requirement, Not the Standard for Satisfying It**

The Commissioner contends that an alternative standard for satisfying the substantial nexus requirement may be found in *Quill*'s “undue burdens” analysis, which the Commissioner erroneously calls “the essence of Commerce Clause ‘substantial nexus.’”⁶³ This contention is fundamentally flawed, for the Commissioner confuses the reason for the substantial nexus requirement with the standard for satisfying it. The reason the U.S. Supreme Court developed a dormant Commerce Clause jurisprudence that limits the extra-territorial reach of state tax jurisdiction was “structural concerns about the effects of state regulation upon the national

Commissioner's discussion, throughout his brief, of inapposite law. See the discussion in part II.A of this Reply, above.

⁶² *JCP Bank*, 19 S.W.3d at 839. See part II.B.2 of this Reply, above.

⁶³ *Comm. Br.*, 10.

economy.”⁶⁴ Specifically, there must be “a means for limiting state burdens on interstate commerce.”⁶⁵ This reason for the substantial nexus requirement (undue burdens) is wholly independent of the standard (physical presence) for satisfying it.

From this perspective, it is once again clear that the substantial nexus requirement applies to all tax types and does not inquire as to the degree of the burden in any particular case. It simply takes cognizance of the drag that a multiplicity of sub-national taxes inevitably have on an integrated national economy, setting up the need for a jurisdiction-limiting rule. The standard (for determining whether this substantial nexus requirement has been satisfied in a particular case) is similarly not tax-specific, for it aims to define broadly the limits of extra-territorial taxation in a manner that balances state revenue needs with the overriding national interest in a unified “national economy.”⁶⁶ Contrary to the Commissioner’s contention, the U.S. Supreme Court has never said that the level of burden on an individual putative taxpayer is the standard. As explained above, the only standard the Court has ever provided is the physical presence standard.

3. “Intertwined Business Relationships” Are Not the Standard

The Commissioner also contends that “a system of intertwined business relationships in West Virginia” supports a finding of substantial nexus, but offers no support for this contention because there is none. He suggests that MBNA has West Virginia nexus based upon the presence of “MasterCard Accepted” signs in restaurant windows, even though the MasterCard

⁶⁴ *Quill*, 504 U.S. at 312.

⁶⁵ *Quill*, 504 U.S. at 313.

⁶⁶ *Quill*, 504 U.S. at 312.

logo is the property of an independent third-party.⁶⁷ His argument is analytically identical to the baseless suggestion that Google, for example, has nexus wherever a cyber-café advertises a Wi-Fi zone, or that a wholesaler has nexus wherever a retailer sells its products. The Macy's Department Store in Huntington may make it possible for a customer to purchase a computer made by an out-of-state manufacturer, the electricity sold by Appalachian Power may make it possible for that customer to use the computer, and a cyber-café in Shepherdstown may make it possible for that customer to use Google's internet services in the State. No one would seriously suggest, however, that these intertwined business relationships provide Google with a constitutionally-significant substantial nexus with the State. There is no such standard for satisfaction of the Commerce Clause substantial nexus requirement.

4. **The "Fairly Related" Prong of *Complete Auto* Evaluates the Proper Measure of a Tax, Not Jurisdiction for Imposing It**

The Commissioner breaks no new ground in his repetition of the Circuit Court's erroneous confusion of the first and fourth prongs of the *Complete Auto* test.⁶⁸ As discussed in depth at part II.B.4 of this Reply, the "fairly related" fourth prong limits the measure of the tax, while the "substantial nexus" first prong limits the imposition of the tax. The fourth prong is not an alternative to the physical presence standard for substantial nexus, as the Commissioner suggests and the Circuit Court holds. The only relation between the two prongs is that they are both constitutionally-based limitations on an aspect of state taxation.

⁶⁷ *Comm. Br.*, 17.

⁶⁸ *Comm. Br.*, 15-16.

**C. THE "PHYSICAL PRESENCE" STANDARD OF THE COMMERCE CLAUSE'S
"SUBSTANTIAL NEXUS" REQUIREMENT BARS IMPOSITION OF TAX ON MBNA**

The Commissioner and the Circuit Court have attempted to place three distinct constitutional requirements at issue in this case: (I) the Commerce Clause nexus requirement, (II) the Commerce Clause "fair relation" requirement, and (III) the Due Process nexus requirement. As explained at length above, however, the answer to the question at issue in this case — jurisdiction for tax imposition — is governed solely by the first of the three.

The critical features of these three constitutional limitations on state taxation that have been placed at issue in this case can be summarized as follows: (I) The Commerce Clause, in order to protect the national economy from the burdens of excessive impositions of tax, requires "substantial nexus" for tax-imposition jurisdiction, which requirement can be satisfied only by the putative taxpayer's in-state "physical presence." (II) The Commerce Clause, in order to protect the national economy from the burdens of unreasonably measured taxes, also requires a "fair relation" between the measure of the tax and the government services received, which requirement can be easily satisfied by the mere fact that government provides the "benefits of a civilized society," including access to its court system. (III) The Due Process Clause, in order to provide fair notice to parties in connection with the burden of tax enforcement actions, requires "minimum contacts" for personal jurisdiction in such lawsuits, which requirement arguably can be easily satisfied by the putative taxpayer's mere "market exploitation."

The fundamental flaw in the Commissioner's argument and the Circuit Court's decision below is that they failed to understand the differences between these three constitutional requirements. It may be that the second and third of these requirements were satisfied by MBNA, but those requirements are not properly at issue in this case and have no bearing on its

outcome. The only question in this case is whether MBNA had a physical presence in West Virginia, such that the Commerce Clause substantial nexus requirement could be satisfied. It did not.

CONCLUSION

The question presented by this case must be answered in the affirmative: The Commissioner did indeed violate the constitutional bar on extra-territorial taxation when he refused to follow the "physical presence" standard articulated in *Quill*.

In order to effectuate the protections provided to our national economy by the Commerce Clause substantial nexus requirement, the U.S. Supreme Court has consistently approved a finding of substantial nexus only in cases where the physical presence standard has been met, regardless of the type of tax at issue. The Court has never repudiated its physical presence standard for income taxes, nor has it ever articulated any alternative standard. The Circuit Court's invention and application of alternative standards is reversible error. None of the Commissioner's arguments in his brief can make the decision of the Circuit Court below into good law. The Commissioner is barred by the Commerce Clause from imposing tax on MBNA in this case.⁶⁹

For the foregoing reasons, and for those reasons set forth in MBNA's opening brief, Petitioner MBNA America Bank, N.A. respectfully requests that this Court: (1) reverse the decision of the Circuit Court below; (2) reinstate the decision of the Office of Tax Appeals

⁶⁹ For future years, the Commissioner could ask Congress to pass a federal law governing the tax-imposition jurisdictional question. As the Court pointed out in *Quill*, an exercise of Congress' active Commerce Clause power would trump (for subsequent years) the dormant Commerce Clause principles that govern this case. 504 U.S. at 318.

below; (3) award MBNA the full amount of its refund claims for Business Franchise Tax and Corporation Net Income Tax for tax years 1998 and 1999, together with statutory interest; and (4) award MBNA such further relief as the Court may deem appropriate.

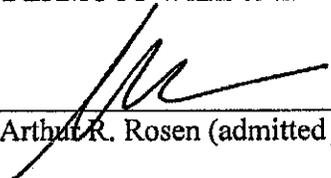
Dated: July 11, 2006

Respectfully submitted,

SPILMAN, THOMAS & BATTLE, PLLC

By: 
G. Thomas Battle

MCDERMOTT WILL & EMERY LLP

By: 
Arthur R. Rosen (admitted *pro hac vice*)

**COUNSEL FOR PETITIONER
MBNA AMERICA BANK, N.A.**

IN THE WEST VIRGINIA SUPREME COURT OF APPEALS

MBNA America Bank, N.A.,
Petitioner,
v.
West Virginia State Tax Commissioner,
Respondent.

No. 33049

CERTIFICATE OF SERVICE

I, Craig A. Griffith, hereby certify this 11th day of July, 2006, the foregoing "*Reply Brief of MBNA America Bank, N.A.*" of Petitioner, has been served upon the following parties, by placing exact and true copies thereof, in the United States mail, first class and postage pre-paid, in envelopes addressed as follows:

Katherine A. Schultz, Esq.
Senior Deputy Attorney General
Office of the Attorney General
State Capitol – Building 1, Room W435
Charleston, West Virginia 25305



Craig A. Griffith (WV State Bar #8549)