Who Can Tax Telecommuters?: A Case for an Economic Presence Regime

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Should telecommuters who work across states be taxed by the state that they are physically working in? By the state their office is located in? By both? This issue was raised in New Hampshire v. Massachusetts*. There, New Hampshire challenged the taxing authority of a Massachusetts rule that taxed New Hampshire residents who had worked within a Massachusetts office prior to COVID-19 related restrictions but were telecommuting from New Hampshire. New Hampshire argued that the Massachusetts rule violated both the Due Process Clause and Commerce Clause. Since the Supreme Court had denied certiorari for this case, the constitutionality of the Massachusetts rule is in question and states continue to have their own tax treatment for interstate telecommuters.*

After the 2018 case of South Dakota v. Wayfair*, physical presence is no longer necessary for a state to subject an out-of-state business to state sales taxation. Yet there is no consensus regarding the extent of Wayfair's holding to other taxes or how much physical presence should be relied upon as a basis for taxation. Without a principle to ground taxation, multiple states may exercise taxing authority over the same income, exposing taxpayers to burdensome double taxation. The issue of interstate telecommuting introduces a more fundamental issue for state taxation: should tax authority be based on physical presence or some form of economic presence?*

This Comment will argue that the Massachusetts tax rule should be upheld under an economic presence analysis. The Comment will then argue that because of the taxing jurisdiction granted to the state where the telecommuter has an economic presence, the state of the telecommuters' physical presence should generally not have taxing jurisdiction. Finally, this Comment will argue that an economic presence regime should be adopted to replace the outdated physical presence regime, ensuring that state tax regimes are grounded on principle rather than a desire for revenue.

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I. INTRODUCTION

Technology and the COVID-19 pandemic have reshaped the market and led to the rise of telecommuting.[1] One survey found that during the pandemic, nearly 70 percent of US full-time workers were working from home.[2] And, currently, 80 percent of US employees expect to work from home for at least three days a week even after the pandemic.[3] Telecommuting, once a fringe benefit, will likely have a lasting and significant presence in our economy. However, with this development, the geography of employment transactions has been reshaped. Congress has not yet legislated any standardized treatment for state taxation on

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[1] Adam Ozimek, *Economist Report: Future Workforce*, UPWORK, https://perma.cc/B9V2-AU6K (last visited Feb. 7, 2022).

[2] *Statistics on Remote Workers That Will Surprise You*, APOLLO TECH. LLC (Jan. 16, 2022), https://perma.cc/SGV7-HEHC.

[3] *Id.*

telework,[4] leading to states creating separate and conflicting tax laws on telework—to the detriment of taxpayers. Telecommuting represents the latest challenge for state tax regimes in the face of technological change.

This Comment will examine the recent *New Hampshire v. Massachusetts*[5] case to address the issue of state taxation on interstate telecommuters. In this case, New Hampshire challenged a temporary Massachusetts tax rule. The rule stated that the income earned by out-of-state employees—who had previously commuted physically into Massachusetts but were working remotely due to the COVID-19 pandemic—was still subject to the Massachusetts income tax. Several states have had rules like Massachusetts's even before the pandemic.[6] However, these rules have generated significant controversy as the Supreme Court has not confirmed their constitutionality. The Comment will review and apply constitutional principles developed in case law to determine the constitutionality of the Massachusetts rule.

This Comment will argue that to resolve state taxing authority issues in interstate telecommuting, courts should rely on a taxpayer's economic presence. Part II will review existing constitutional limitations to state taxation and state sourcing rules. Part III will then argue that tax rules like Massachusetts's are constitutional under the Due Process Clause and the Dormant Commerce Clause, particularly after the 2018 case of *South Dakota v. Wayfair*.[7] This argument will be based on an economic presence analysis, which seeks to determine taxing authority based on the benefit principle of taxation.[8] Part IV will argue that states like New Hampshire must provide its telecommuting residents with a tax credit for the taxes paid to the state into which they telecommute. This argument will be based on the constitutional prohibition on discriminating against interstate commerce,

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4 Congress has the authority to legislate tax rules which states must abide by to conform with the Commerce Clause. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992) ("Congress is free to decide whether, when, and to what extent the states may burden interstate mail-order concerns with a duty to collect use taxes.").

5 141 S. Ct. 2848 (2021) (mem.).

6 Jared Walczak, *Teleworking Employees Face Double Taxation Due to Aggressive "Convenience Rule" Policies in Seven States*, TAX FOUND. (Aug. 13, 2020), https://perma.cc/C6B3-K28Q ("Six states—Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania—had implemented so-called convenience rules prior to the COVID-19 pandemic").

7 138 S. Ct. 2080 (2018).

8 RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 71–89 (7th ed. 1959) (explaining the "benefit approach" for financing public goods).

as espoused in the 2015 case of *Comptroller of the Treasury of Maryland. v. Wynne*.[9] Finally, Part V will argue that courts should adopt an economic presence analysis when applying the Dormant Commerce Clause, as many state courts already have.

II. STATE TAX LAW LANDSCAPE

A. Constitutional Restrictions on State Taxing Powers

States may tax income that is earned by their residents or nonresidents who generate income from within the state.[10] However, taxing authority exercised on either basis must still be within the bounds of the Due Process Clause[11] and Commerce Clause.[12] The due process requirement for taxation is similar to the due process requirement for personal jurisdiction,[13] as the Due Process Clause has been interpreted to require "merely the purposeful direction of activities to the state."[14] When a state imposes a tax without having residence or source jurisdiction, the tax is deemed extraterritorial and in violation of due process.[15]

Courts have interpreted the Constitution's Commerce Clause as having a negative command, known as the "Dormant Commerce Clause," which prohibits states from discriminating against interstate commerce.[16] Courts have used a four-prong test

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9 575 U.S. 542, 554 (2015) ("[I]f a State's tax unconstitutionally discriminates against interstate commerce, it is invalid regardless of whether the plaintiff is a resident voter or nonresident of the State.").

10 *See* Curry v. McCanless, 307 U.S. 357, 368 (1939) (citation omitted) ("[I]ncome may be taxed both by the state where it is earned and by the state of the recipient's domicile. Protection, benefit, and power over the subject matter are not confined to either state.").

11 U.S. Const. amend. XIV, § 1 ("[N]or shall any state deprive any person of life, liberty, or property, without due process of law").

12 U.S. Const. art I, § 8, cl. 3 (granting Congress the power "to regulate commerce . . .among the several states. . . ."); *see also* Lunding v. N.Y. Tax Appeals Trib., 522 U.S. 287, 314 (1998) ("While States have considerable discretion in formulating their income tax laws, that power must be exercised within the limits of the Federal Constitution.").

13 *See* Quill Corp. v. North Dakota, 504 U.S. 298, 307 (1992) (citing Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945)) (applying the existing legal doctrine of due process in personal jurisdiction to due process in state taxation). *See generally* Michael T. Fatale, *The Evolution of Due Process and State Tax Jurisdiction*, 55 SANTA CLARA L. REV. 565, 585 (2015) (discussing the development of due process in state taxation and how it has been influenced by due process as developed in personal jurisdiction).

14 Whirlpool Props., Inc. v. Dir., Div. of Tax'n, 208 N.J. 141, 164 (2011).

15 *See* Miller Bros. Co. v. Maryland, 347 U.S. 340, 342 (1954) (stating that state taxation of nonresidents without jurisdiction "is simple confiscation").

16 *See* United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 338 (2007) ("Although the Constitution does not in terms limit the power of States to regulate commerce, we have long interpreted the Commerce Clause as an implicit restraint on state authority, even in the absence of a conflicting federal statute.").

developed in *Complete Auto Transit, Inc. v. Brady*[17] to determine a tax's adherence with the clause.[18] The test requires that the taxed entity has a "substantial nexus with the taxing State" and that the tax "is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."[19] The "fair apportionment" prong of the *Complete Auto* test is the most substantive limitation. To determine whether a tax satisfies this prong, courts use both the "internal consistency" test and the "external consistency" test.

The internal consistency test looks at "whether a tax's identical application by every State would place interstate commerce at a disadvantage as compared with intrastate commerce."[20] The external consistency test "looks to the economic justification for the State's claim upon the value taxed, to discover whether the tax reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State."[21] A tax must pass both tests to safely abide by the fair apportionment prong.[22] The two tests are also interrelated; if all state tax regimes are externally consistent by only taxing the value attributable to its own state, then there would be no overlapping claims that would create double taxation, which would disadvantage interstate commerce.

The Dormant Commerce Clause analysis is somewhat bloated, relying on a four-prong test, with a single prong containing two more tests. This Comment will argue that, to determine if a tax regime abides by the Due Process Clause and Dormant Commerce Clause, courts should rely on the benefit principle, which establishes taxing authority based on the benefits provided by the taxing state. The benefit principle especially has served as the basis underlying state taxing authority, as developed by case law.[23]

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17 430 U.S. 274 (1977).

18 *Id.* at 279.

19 *Id.*

20 Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 175 (1995).

21 *Id.* at 175–76.

22 Goldberg v. Sweet, 488 U.S. 252, 261 (1989) ("[W]e determine whether a tax is fairly apportioned by examining whether it is internally and externally consistent.").

23 *See, e.g.*, Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (stating "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.").

B. *Wayfair* and Taxing the Digital Economy

Originally, in *National Bellas Hess, Inc. v. Department of Revenue,*[24] the Supreme Court held that a use tax imposed on an out-of-state seller who lacked a physical presence in the state violated both the Due Process Clause and Commerce Clause.[25] Then, in 1992, the *Quill* case upended the physical presence requirement to establish due process for a state sales tax while maintaining the requirement for the Commerce Clause.[26] Twenty-six years later, in 2018, *Wayfair* overturned *Quill* and *Bellas Hess* by upholding a state tax on an out-of-state vendor who lacked a physical presence in the state but sold goods to in-state consumers.[27] This ruling effectively allowed states to use an economic nexus standard when applying a sales tax on out-of-state entities.

The *Wayfair* Court based its overruling of *Quill* on the decision's underlying flaws and the physical presence rule's incompatibility with economic reality. First, the Court recognized the legal inconsistency created in *Quill*, in which the Court removed the necessity of physical presence for due process but maintained the requirement for the Commerce Clause.[28] Second, the Court identified that *Quill* had created a market distortion, which provided an opportunity for tax avoidance for vendors who lacked a physical presence in the state.[29] Third, the Court rejected *Quill*'s "arbitrary, formalistic distinction" in favor of "a sensitive, case-by-case analysis of purposes and effects."[30] Additionally, *Wayfair* based its ruling on several practical concerns, including reliance interests, administrative costs, and the increasing importance of digital commerce.[31] The Court also expressed caution when overruling *Quill* and adopting an economic presence analysis. The challenged South Dakota tax provided a safe harbor for vendors who did limited business in the state, and it did not apply retroactively.[32]

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24 386 U.S. 753 (1967).

25 *Id.* at 758.

26 Quill Corp. v. North Dakota, 504 U.S. 298, 307–09 (1992) (citing Burger King Corp. v. Rudzewicz, 471 U.S. 462, (1985)) (holding that a state subjecting a foreign corporation that lacks a physical presence within the state to state taxes violates the Commerce Clause but not the Due Process Clause).

27 South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2084 (2018).

28 *Id.* at 2085 ("When considering whether a State may levy a tax, Due Process and Commerce Clause standards, though not identical or coterminous, have significant parallels.").

29 *Id.*

30 *Id.* (citing W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 201 (1994)).

31 *Id.* at 2086.

32 *Id.* at 2089.

Currently, forty-two states impose a personal income tax,[33] creating a risk that interstate telecommuters may be taxed twice on the same income if states use different source rules. While *Wayfair* recognized that physical presence does not always correspond with economic presence, there is no consensus on this notion when applied to income taxation, as shown by the controversy over the Massachusetts temporary tax rule on nonresident telecommuters.

C. *Wynne* and Double Taxation

State tax regimes that lead to double taxation may provide evidence of unconstitutionality, but double taxation in and of itself is not unconstitutional.[34] While there is no *per se* restriction on state tax laws leading to multiple states taxing the same income, courts have struck down tax regimes deemed to have discriminated against interstate taxation through double taxation.[35] The *Wynne* case provides helpful guidance for determining the extent to which double taxation should be a concern.

The *Wynne* decision struck down a Maryland tax regime that unconstitutionally discriminated against interstate commerce.[36] This regime taxed its residents on income earned from both within and outside of the state.[37] However, the tax regime did not provide residents with a tax credit for taxes paid to other states, resulting in double taxation.[38] The *Wynne* Court based its ruling on the fact that Maryland's tax regime "might have resulted in the double taxation of income earned out of the State and that discriminated in favor of intrastate over interstate economic activity" in violation of the Dormant Commerce Clause.[39]

The Court illustrated its reasoning by comparing the tax outcomes of two hypothetical residents of "State A": Alice and Bob.[40] While Alice and Bob are both residents of State A, Alice earns her

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[33] *States with the Lowest Taxes and the Highest Taxes*, TURBOTAX (Sept. 23, 2021), https://perma.cc/UQ5R-AMFJ.

[34] *See* Gwin, White & Prince v. Henneford, 305 U.S. 434, 439 (1939) (finding that a Washington State tax was unconstitutional where the tax was not properly apportioned and created a risk of multiple taxation); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 276 (1978) (upholding Iowa's single-factors sales formula to apportion income despite the fact that most states use of a three-factor formula would create multiple taxation).

[35] *See generally* 84 C.J.S. TAXATION § 59 (2010) (reviewing cases that had evaluated the constitutionality of tax regimes which had created double taxation).

[36] Comptroller of Treasury of Md. v. Wynne, 575 U.S. 542, 551 (2015).

[37] *Id.* at 545.

[38] *Id.* at 548.

[39] *Id.* at 551.

[40] *Id.* at 565.

income within State A while Bob earns his income in State B.[41] The Court then showed that without Bob receiving a full credit for the taxes he paid to State B, in order to reduce the residence-based taxes he owes to State A, Bob would face a higher tax burden than Alice, and he would consequently be discouraged from engaging in employment in State B. The Maryland tax regime therefore effectively operated as a tariff against interstate commerce.[42] Since tariffs are "[t]he paradigmatic example"[43] of discrimination against interstate commerce, Maryland's tax regime was held to have violated the Dormant Commerce Clause.

The Court had not used the internal consistency test to strike down a state tax regime in thirty years prior to *Wynne*, as noted in Justice Ginsburg's dissent.[44] The case thus generated a newfound importance for the internal consistency test and concern against double taxation. Double taxation is also disfavored from an economic perspective, as it overburdens transactions and leads to market distortions. To determine whether a tax regime creates unconstitutional double taxation, courts would look at the regime's real economic effects rather than their intended consequences.[45]

D. Source Rules for State Taxes

States' source rules determine which jurisdiction has the right to tax a transaction. The source rules for the taxation of goods have been well-developed, particularly after *Wayfair*. Most states use a "destination-based" rule which sources transactions in the state in which the consumer receives the good.[46] This is

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41 *Id.* at 564–65.

42 *Id.* at 567.

43 W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 193 (1994).

44 *Wynne*, 575 U.S. at 594 (Ginsburg, J., dissenting) (citing Am. Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 284–87 (1987)).

45 Two amicus briefs submitted to the Supreme Court in the *Wynne* case explained how Maryland's tax regime has the economic effect of discriminating against interstate commerce, although not by design. *See* Brief of the Tax Economists as Amici Curiae in Support of Respondents, Comptroller of the Treasury of Md v. Wynne, No. 13–485 (Sept. 26, 2014); Brief of Michael S. Knoll and Ruth Mason as Amici Curiae in Support of Respondents, Comptroller of the Treasury of Md v. Wynne, No. 13–485 (Sept. 26, 2014); *see also* Ryan Lirette & Alan D. Viard, *State Taxation of Interstate Commerce and Income Flows: The Economics of Neutrality* (Am. Enter. Inst. Econ. Pol'y, Working Paper No. 2014–07, 2014); Michael Knoll & Ruth Mason, *What Is Tax Discrimination?*, 121 YALE L.J. 1014 (2012).

46 *See* BLOOMBERG TAX & ACCT., 2021 SURVEY OF STATE TAX DEPARTMENTS: EXECUTIVE SUMMARY 22 (2021); JEROME HELLERSTEIN ET AL., STATE TAXATION ¶ 18.05, at 1 (3d ed. 2020) (citations omitted) ("[I]n contrast to the rules regarding the appropriate place of taxation for cross-border sales of goods, which generally adhere to the destination

opposed to "origin-based" rules, which sources a good's sales tax in the state in which the good is produced.[47] However, states are still split on which source to use when taxing services.[48] While services are often physically consumed in the same state in which they are performed, there has been less of a need to update the sourcing rules for services as for goods. Yet, with the rise of telecommuting, the need for a uniform principled rule for taxing remote workers is now especially important.

As will be argued below, the reasons for adopting destination-based source rules for sales taxes apply just as well (and possibly even more so) for adopting destination-based source rules for income. Yet some commentators have argued to the contrary; that *Wayfair*'s ending of the physical presence requirement for state sales taxation should not apply to state income taxation.[49] Nevertheless, courts have been moving away from an emphasis on physical presence and toward an emphasis on economic presence. Even before *Wayfair*, certain income tax applications were upheld by courts despite the taxed entity not having a physical presence in the state.[50] The courts in these cases upheld the challenged state tax regimes based on the entity's economic presence, founded on the understanding that the challenged state is adding value to the taxed transaction.[51] However, economic presence has not yet been examined much less endorsed by the Supreme Court. While ending the physical presence regime was the correct step,

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principle, the rules regarding the appropriate place of taxation for cross-border sales of services are neither as consistent nor as well established as they are with respect to goods.").

47 *Id.*

48 Maria Tanski-Phillips, *Sales Tax Laws by State: What're Your State's Rules?*, PATRIOT SOFTWARE (Feb. 3, 2022), https://perma.cc/GD7E-6MEF.

49 *See* Edward A. Zelinsky, *Taxing Interstate Remote Workers After* New Hampshire v. Massachusetts*: The Current Status of the Debate*, FLA. TAX REV. (forthcoming) (manuscript at 17) (Cardozo Law Faculty Research Paper No. 656) (arguing that the *Wayfair* ruling does not justify upholding the Convenience Rule); *see also* Nathan Townsend, Note, *Winding Back Wayfair: Retaining the Physical Presence Rule for State Income Taxation*, 72 VAND. L. REV. 1391, 1395 (2019) (arguing that the Court in *Wayfair* erred in failing to apply the physical presence rule and that the physical presence rule should be codified with respect to state income taxation).

50 *See* Adam B. Thimmesch, *The Illusory Promise of Economic Nexus*, 13 FLA. TAX REV. 157, 176 n.111 (2012) (listing cases that rejected physical presence and upheld a tax based on an economic presence).

51 *See* Tax Com'r of State v. MBNA Am. Bank, N.A., 220 W. Va. 163, 171 (2006) ("[T]he growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there."); KFC Corp. v. Iowa Dep't of Revenue, 792 N.W.2d 308, 316 (Iowa 2010) ("The dormant Commerce Clause worm seemed to have turned once again in *Complete Auto* in favor of utilization of a realistic assessment of economic impacts rather than formal doctrinal categories.").

without replacing it with a new standard, states tax regimes will remain uncoordinated, discourage interstate commerce, and focus more on extracting value rather than being compensated for value added.

E. The Convenience of the Employer Rule

Through the Massachusetts rule, which taxed telecommuters at their office of employment rather than their physical location, Massachusetts effectively created a "convenience of the employer" test ("Convenience Rule"). A Convenience Rule allows a state to source an out-of-state employee's income within the state if the employee is working from home for the employee's own convenience.[52] Seven states currently use a Convenience Rule.[53] While the Supreme Court has not ruled on the Convenience Rule's constitutionality, other courts have held that the rule conforms with the Due Process Clause[54] and the Dormant Commerce Clause.[55]

The first challenge to the Convenience Rule was in *Zelinsky v. Tax Appeals Tribunal of the State of New York*.[56] In this case, Zelinsky's office of employment had been in New York, but he performed some of his services while physically in his Connecticut home. Yet New York taxed all of his income under the state's Convenience Rule while Connecticut taxed a portion of his income based on the number of days he worked from home. Zelinsky argued to the court that New York's Convenience Rule was unconstitutional because it violated the fair apportionment prong of the *Complete Auto* test. The court disagreed, holding that the Convenience Rule was both internally and externally consistent and therefore not in violation of the second *Complete Auto* prong.[57] The *Zelinsky* court based its holding on the benefits provided by New York, which financed services that accounted for Zelinsky's income and gave the state the authority to tax it.[58] Additionally, like in *Wayfair*, the court in *Zelinsky* was concerned about

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52 TECH. SERVS. DIV., N.Y. STATE DEP'T OF TAX'N & FIN., NEW YORK TAX TREATMENT OF NONRESIDENTS AND PART-YEAR RESIDENTS: APPLICATION OF THE CONVENIENCE OF THE EMPLOYER TEST TO TELECOMMUTERS AND OTHERS (May 15, 2006), https://perma.cc/W6AP-2V8G.

53 Eric Rosenbaum & Korey Matthews, *How U.S. States Tax Wage Income May Be Forever Changed by Remote Work*, CNBC (Nov. 5, 2020), https://perma.cc/G4VM-BZW5.

54 Huckaby v. N.Y. State Div. of Tax Appeals, 4 N.Y.3d 427 (2005).

55 Zelinsky v. Tax Appeals Tribunal, 1 N.Y.3d 85 (2003).

56 *Id.*

57 *Id.* at 91.

58 *Id.* at 95 (recognizing that New York "provides a host of tangible and intangible protections, benefits and values to the taxpayer and his employer, including police, fire and emergency health services, and public utilities.").

opportunities for tax avoidance that striking down the Convenience Rule would create.[59] The Convenience Rule was also held to be constitutional under the Due Process Clause in *Huckaby v. New York State Division of Tax Appeals*.[60]

The legitimacy of the Convenience Rule plays a role in a larger debate on how courts should apply constitutional restrictions to state tax regimes in a non-physical economy. Importantly in this debate, the Convenience Rule represents an economic presence rule, where taxing jurisdiction is properly exercised by the state which added value to the taxed transaction. Whether or not to uphold the Convenience Rule would be determined by the choice to either adopt an economic presence rule or to retain the physical presence rule.

F. The Convenience Rule as a Market-Based Source Rule

An economic presence analysis may favor a market-based source rule. This rule sources a transaction in the state in which the purchaser receives the benefit of the transaction. This is opposed to a "cost of performance" method, which sources the transaction where the seller creates the product or service. Market-based source rules are justified because the taxed entity owes its sales partially to the marketplace and institutions of the state in which the sale is generated. The Convenience Rule may be considered a market-based source rule as it taxes income from labor in the state in which the benefit of the labor is received, rather than the state in which the labor is performed.

Like state income taxes on out-of-state telecommuters currently, market-based source rules on sales taxes have been challenged on the ground that they are extraterritorial and that the out-of-state entity lacks a sufficient connection with the state.[61] However, *Wayfair* affirmed that taxes on out-of-state entities that conduct business within the state are constitutional.[62]

There has been a statewide trend towards adopting market-based source rules.[63] Most states even use single sales factor

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[59] *Id.* at 94 (recognizing that upholding the Convenience Rule would "enable [the taxpayer] to avoid paying taxes that his colleagues who do that work at home in New York—or at the law school—pay.").

[60] Huckaby v. N.Y. State Div. of Tax Appeals, 4 N.Y.3d 427, 439 (2005) (finding that the "convenience test constitutes an across-the-board standard designed to comply with both due process and the Commerce Clause.").

[61] *See* Quill Corp. v. North Dakota, 504 U.S. 298, 306–08 (1992).

[62] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2084 (2018).

[63] *See* Shirley Sicilian, *Market-Based Sourcing on Cusp of Becoming General Rule*, J. MULTISTATE TAX'N & INCENTIVES, May 2015, at 40 ("Market-based sourcing—of one type

apportionment for taxing businesses, which determines taxable income solely by the sales generated from within the state.[64] A more origin-based apportionment formula, meanwhile, would also factor in the property and employees located physically within the state. This trend can be explained by states' desires to encourage economic development and state courts increasing recognition of "economic nexus."[65] The Multistate Tax Commission, an intergovernmental agency that seeks to promote tax uniformity among states, has even recommended that states adopt uniform market-based sourcing rules for sales taxes.[66] However, a minority of states still maintain origin-source rules for services,[67] leading to the potential for double taxation. This Comment will not argue that market-based source rules should always be used but rather that they are constitutional and are generally more favored under an economic presence test than under origin-based or "place-performed" rules.[68] Under existing case law, both origin-based and destination-based taxes have been upheld under the *Complete Auto* test.[69]

As stated by the Court in *Wayfair*, the fact that a taxpayer lacks a physical presence with a state does not mean that it lacks an economic presence with that state, particularly when it generates sales from in-state consumers.[70] And even prior to *Wayfair,* courts have upheld tax enforcement against entities based on the entities' economic presence despite their lack of a physical presence in the taxing jurisdiction.[71] In such instances, the entity was found to be purposefully directing their activity to the jurisdiction and receiving benefits from that jurisdiction. An economic presence analysis has been argued for in the past,[72] including by the

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or another—has been adopted in 20 of the 47 states with a corporate income or franchise tax, and, as this column goes to press, is being considered in six more.").

64 *See State Apportionment of Corporate Income*, FED'N OF TAX ADM'RS (Jan. 1, 2021), https://perma.cc/F4A9-5G3V.

65 Sicilian, *supra* note 63, at 40 ("Will the trend persist? It seems likely. At least two of the underlying policies driving it are unlikely to stall any time soon. These are the focus on economic development and the rise of economic nexus.").

66 MULTISTATE TAX COMPACT, art. IV, § 17 (MULTISTATE TAX COMM'N 2015), https://perma.cc/9GTV-HCVJ.

67 *See* BLOOMBERG TAX & ACCT., *supra* note 46.

68 *Id.*

69 *See* Quotron Sys., Inc. v. Limbach, 62 Ohio St. 3d 447, 450 (1992) (holding that a tax which used destination-based source rule is constitutional); Evco v. Jones, 409 U.S. 91 (1972) (holding that a place-of-performance based tax is constitutional).

70 South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2094 (2018).

71 *See* Thimmesch, *supra* note 50, 176 n.111.

72 *See, e.g.*, Tax Comm'r v. MBNA Am. Bank, N.A., 640 S.E.2d 226, 234 (W. Va. 2006); KFC Corp. v. Iowa Dep't of Rev., 792 N.W.2d 308 (Iowa 2010).

dissent in *National Bellas Hess*, the same case that established the physical presence regime.[73] With *Wayfair* putting an end to the physical presence regime, state tax policy now needs a new principle on which to be grounded.

There is also an economic rationale for market-based, or "destination-based," source rules.[74] Some evidence has shown that destination-based source rules are both more likely to be based on benefits provided by public institutions and less prone to tax planning, since businesses cannot control which states their customers are from.[75] Businesses would be less likely to base their decision of where to establish a physical location on tax considerations if their tax liability is based solely on where their customers are located. While market-based source rules are favored in some respects, its application to income taxation remains more controversial. Oddly, while commentary had been largely critical of *Quill*'s physical presence rule, it has also been largely critical of the Convenience Rule.[76]

G. Authorities that Restrict State Taxing Powers

Because Congress is the arbitrator of the Commerce Clause, it may legislate explicit rules to which states must conform. Yet Congress's inaction ultimately leaves the job of interpreting the Commerce Clause to the courts.[77] So long as state tax regimes are within constitutional bounds, states are free to craft them as they wish.

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[73] Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 761–62 (Fortas, J., dissenting) (arguing that Bellas Hess's "large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient 'nexus' to require Bellas Hess to collect from Illinois customers and to remit the use tax").

[74] *See* Reuven S. Avi-Yonah et al., *Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split*, 9 FLA. TAX REV. 497, 509–10 (2009) ("The key advantage of a sales-based formula is that sales are far less responsive to tax differences across markets than investment in plant, and employment, as the customers themselves are far less mobile than firm assets").

[75] Charles E. McLure, Jr., *Electronic Commerce and the State Retail Sales Tax: A Challenge to American Federalism*, 6 INT'L TAX & PUB. FIN. 193, 199 (1999) ("Destination-based taxes are more likely to reflect the provision of benefits of public services and are less likely to be exported inappropriately to residents of other jurisdictions.").

[76] Edward A. Zelinsky, *Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause*, 28 VA. TAX REV. 1, 46–47 (2008) ("While the post-*Quill* literature is largely critical of that decision and its physical presence standard, the commentary on New York's employer convenience doctrine is, if anything, even more negative.").

[77] S. Pac. Co. v. Arizona ex rel. Sullivan, 325 U.S. 761, 769 (1945) ("[W[here Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter of the competing demands of state and national interests.")

States can also become parties to agreements to properly source income to prevent their residents from being subject to multiple taxation. For example, many states have voluntarily joined the Streamlined Sales and Use Tax Agreement (SSUTA), which simplifies and sets uniform tax rules for states' sales and use taxes. SSUTA membership serves such an important tax coordination function that South Dakota's membership in the Agreement was given weight in the *Wayfair* decision.[78] Where courts establish guiding principles that states' tax regimes must abide by, tax policy could be more finely tuned by state legislatures and through interstate agreements.

III. THE MASSACHUSETTS CONVENIENCE RULE IS CONSTITUTIONAL

In the *New Hampshire* case, New Hampshire challenged the Massachusetts temporary tax rule that taxed the income of out-of-state telecommuters who had physically worked within Massachusetts prior to the COVID-19 pandemic.[79] New Hampshire claimed that the Massachusetts rule violated both the Due Process Clause and Dormant Commerce Clause.[80]

First, New Hampshire maintained that the Massachusetts rule violated due process on the grounds that out-of-state telecommuters lack a sufficient nexus with Massachusetts. New Hampshire noted that the Due Process Clause prohibits states from "tax[ing] value earned outside [their] borders."[81] New Hampshire argued that because Massachusetts claimed the right to tax individuals working outside of its borders, the Massachusetts rule represented an unconstitutional extraterritorial tax.[82]

Second, New Hampshire claimed that the Massachusetts rule violated all four prongs of the *Complete Auto* test, making the rule unconstitutional under the Dormant Commerce Clause.[83] Under the first prong, New Hampshire argued that there is no substantial nexus that would allow Massachusetts the right to tax income from New Hampshire telecommuters.[84] Under the second prong, the Massachusetts tax rule was claimed to be unfairly

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78 South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2098 (2018).

79 Massachusetts Source Income of Nonresidents Telecommuting Due to the COVID-19 Pandemic, 830 Mass. Code Regs. 62.5A.3 (2020).

80 Motion for Leave to File Bill of Complaint at 25–30, New Hampshire v. Massachusetts, 141 S. Ct. 2848 (2021) (No. 22O154) [hereinafter New Hampshire's Complaint].

81 *Id.* at 3 (quoting Allied-Signal, Inc. v. Dir., Div. of Tax'n, 504 U.S. 768, 777 (1992)).

82 *Id.* at 2.

83 *Id.* at 26.

84 *Id.*

apportioned since it sought to tax work performed in New Hampshire.[85] New Hampshire argued that the Massachusetts rule violated the third prong by discriminating against interstate commerce through double taxation.[86] Finally, New Hampshire argued that the Massachusetts tax is not "fairly related to the services provided by" Massachusetts, thereby violating the fourth *Complete Auto* prong.[87]

A. The Massachusetts Convenience Rule Does Not Violate the Due Process Clause

Quill overturned *Bellas Hess*'s holding regarding the Due Process Clause but not regarding the Commerce Clause based on the recognition that establishing minimum contacts is relatively undemanding.[88] Due process has been held by one court to be "merely the purposeful direction of activities to the state, whereas the Commerce Clause requires more of a connection."[89] In *Quill*, the Court relied on *Burger King Corp. v. Rudzewicz*'s holding that due process did not require a physical presence in the state to establish personal jurisdiction.[90] Being an employee of a company is not a random or fortuitous contact[91] but rather is a contact purposefully directed towards the state of employment that would justify personal jurisdiction.[92] While one commentator suggested the Massachusetts Convenience Rule may be described as "nexus on steroids,"[93] it is in line with our ordinary understanding of

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85 *Id.* at 27–28.

86 *Id.* (citing Comptroller of Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1795 (2015)).

87 *Id.* at 29.

88 Quill Corp. v. North Dakota, 504 U.S. 298, 308 (1992) ("[T]here is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State.").

89 Whirlpool Props., Inc. v. Dir., Div. of Tax'n, 208 N.J. 141, 164 (2011).

90 Quill Corp. v. North Dakota, 504 U.S. 298, 308 (1992) (quoting Burger King Corp. v. Rudzewicz, 105 S. Ct. 2174, 2184 (1985)).

91 Burger King Corp. v. Rudzewicz, 105 S. Ct. 2174, 2183 (1985).

92 *Id.* at 2176 ("A forum may assert specific jurisdiction over a nonresident defendant where an alleged injury arises out of or relates to actions by the defendant *himself* that are purposefully directed toward forum residents, and where jurisdiction would not otherwise offend "fair play and substantial justice.").

93 Richard Pomp, New Hampshire v. Massachusetts*: Taxation Without Representation?*, 39 J. ST. TAX. 19 (2021).

nexus, which does not require physical presence for personal jurisdiction[94] nor sales taxes.[95]

In addition to the taxpayer's purposeful direction of activities, courts have also asked if the taxing jurisdiction provides anything of value to the taxpayer when determining adherence to due process.[96] Minimum contacts with a state are met if the taxpayer can be said to be benefiting directly from the state's fiscal and legal institutions. Commentators who argue that the Convenience Rule violates due process must explain why a physical presence requirement is necessary to justify state income tax authority despite virtual contacts being sufficient for due process in other domains.[97]

In its complaint, New Hampshire cited *Allied-Signal v. Director, Div. of Taxation*,[98] where the Court stated that for due process to be preserved on a tax on an activity, there "must be a connection to the activity itself, rather than a connection only to the actor."[99] Massachusetts has a clear connection to the income being generated by the telecommuter, despite lacking a more formal physical connection with the telecommuter. Additionally, the same case also asserts that taxing authority is determined by the "protection, opportunities and benefits"[100] provided by the state. The question of which state is benefiting the interstate telecommuter will be examined in the next section.

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94 Int'l Shoe Co. v. Wash. Off. of Unemployment Comp. & Placement, 326 U.S. 310, 316 (1945) ("[D]ue process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'").

95 Quill Corp. v. North Dakota, 504 U.S. 298, 308 (1992) ("The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State.").

96 *See* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (stating "[t]he test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state.").

97 *See* Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1126–28 (W.D. Pa. 1997) (holding that the minimum contacts requirement for a state to exercise personal jurisdiction may be satisfied through online contacts).

98 New Hampshire's Complaint, *supra* note 80, at 26 (citing Allied-Signal, Inc. v. Dir., Div. of Tax'n, 504 U.S. 768, 777–78 (1992)).

99 Allied-Signal, Inc. v. Dir., Div. of Tax'n, 504 U.S. 768, 778 (1992).

100 *Id.*

B. The Massachusetts Convenience Rule Does Not Violate the Dormant Commerce Clause

The Convenience Rule abides by all four prongs of the Commerce Clause. The second prong of the *Complete Auto* test overlaps significantly with the other three prongs, and it was also the only prong challenged in the *Zelinsky* case.[101] Therefore, this Comment will first show that the Massachusetts Convenience Rule abides by the second prong by applying the internal consistency and external consistency tests. Then, this Comment will briefly explain that, based on these tests, the Convenience Rule also abides by the first, third, and fourth prongs of the *Complete Auto* test.

1. Internal Consistency of the Convenience Rule

Under the internal consistency test, a court would ask whether the tax would hinder interstate competition if every state adopted the challenged tax regime.[102] If it would, the tax regime would be unconstitutional. Applying this test, if every state were to tax telecommuters using a Convenience Rule, then there would be no resulting double taxation that would discriminate against interstate commerce.

Permitting states to tax interstate telecommuters would allow employees to better choose states to work in by allowing workers to factor states' fiscal regimes into their employment decisions. With telecommuters having a greater choice in the tax regime that they choose to subject themselves to, telecommuters would be more likely to work across states in response to a better fiscal regime. This decision could consider *both* taxes and benefits, rather than only benefits. Meanwhile, if telecommuters were only to pay taxes to the state in which they are physically present, they would not receive the full benefits (nor pay the full costs) of another state's fiscal regime. They would therefore have less of an incentive to work across states. For example, if a Nevada business offers a higher after-tax income for a Californian telecommuter, but that telecommuter must continue to pay higher California taxes despite only receiving Nevada benefits, the telecommuter would have less of an incentive to work for the Nevada business. Massachusetts's treatment of interstate

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[101] Zelinsky v. Tax Appeals Tribunal, 1 N.Y.3d 85, 91 (2003) ("Here, the taxpayer challenges only the second prong of this four-part test—that the tax be fairly apportioned—conceding that the remaining three criteria are met.").

[102] *See* Okla. Tax Comm'n v. Jefferson Lines, *Inc.*, 514 U.S. 175, 175 (1995).

telecommuters is more favorable to interstate commerce than New Hampshire's.

The Court in *Wayfair* expressed the concern of subjecting in-state and out-of-state vendors, who earned income through the same means within the state, to different tax regimes.[103] Without the Convenience Rule, interstate telecommuters would receive different tax treatment than physically mobile commuters, despite the two groups being economically equivalent entities, thus creating an arbitrary market distortion.[104]

Yet most importantly, the Convenience Rule is internally consistent because it is externally consistent. If all states tax only the value fairly attributable to their own states, then there would be no resulting double taxation that would discriminate against interstate commerce. External consistency creates internal consistency.[105] Because the Massachusetts Convenience Rule taxes only the value fairly attributed to the state, as will be argued below, the tax does not discriminate against interstate commerce.

2. External Consistency of the Convenience Rule

The external consistency test requires that a state tax only tax the value which is fairly attributable to the state.[106] This test seeks to ensure that a state's taxing jurisdiction is based on the value being added by the taxing state.[107] The state from which an out-of-state employee is telecommuting does not need to provide benefits to increase the telecommuter's income but would still seek to extract value from the telecommuter. Instead, workers should have the power to shop around and choose a place of employment with a fiscal and legal regime of their preference. States would thus need to be more competitive with their institutions since employees could subject themselves to a different tax regime without the difficulty of moving.

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103 South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2094 (2018).

104 *See* David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 43 (2006) (evaluating the principle of "horizontal equity" which "demands that similarly situated individuals face similar tax burdens").

105 *Jefferson Lines*, 514 U.S. at 185 ("A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax.").

106 *Id.* at 175.

107 *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) (stating that for a tax to be externally consistent "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.").

Massachusetts could easily show that changing its services and institutions would affect the telecommuter's income. For New Hampshire, improving its fiscal and legal institutions would affect only a telecommuter's property value. Local property taxes are best equipped to capture this benefit. Meanwhile, any change in New Hampshire's fiscal or legal institution would be unlikely to affect the Massachusetts market wage that telecommuters would receive. New Hampshire would not need to provide services of sufficient quantity to attract business so long as network infrastructure is made available for telecommuters to have access to another state's marketplace and institutions.

If New Hampshire were to tax its residents on income earned from telecommuting into another state, the tax would constitute what I call a "residence rent." This residence rent represents income that is extracted by New Hampshire, but which New Hampshire played no role in generating. A residence rent is a "rent" in the economic sense since it extracts value without providing value, antithetical to the benefit principle of taxation.[108] As emphasized throughout this Comment, a telecommuter's income is set by the market in the location of the office from which they are working, not the physical location the telecommuter happens to be in. This is made clear by the fact that telecommuters' incomes are not comparable with those of their neighbors but rather with those of their coworkers in the physical office to which they are telecommuting.

Take the example of crime and public safety spending. It can be assumed that an increase in crime in a local area would reduce the area's overall income. If Massachusetts were to increase its security spending and reduce crime, this would increase income through agglomeration and creating a wealthier market. Meanwhile, an increase in safety in New Hampshire would not affect the telecommuter's market income.

Unless New Hampshire can show that interstate telecommuters receive higher earnings from telecommuting than they otherwise would from physically commuting due to New Hampshire's fiscal and legal institutions, New Hampshire has no claim to an apportionment of an interstate telecommuter's income. New Hampshire might still show it is providing value to the

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[108] *See* Anne O. Krueger, *The Political Economy of the Rent–Seeking Society*, 64 AM. ECON. REV. 291 (1974) (developing the concept of "rent-seeking" as a method of generating wealth through political influence rather than producing value). My argument is similar but applies to states rather than private actors. Here, states are extracting value rather than receiving compensation for value provided through taxation.

transaction if the telecommuter is in a physical location that would somehow raise the telecommuter's productivity, which would justify taxation under economic presence. For instance, this may exist if the telecommuter is physically in a state to better meet with clients. I refer to this potential court scrutiny of a transaction as a "benefit to the employer" test.

Massachusetts does have a fiscal and legal regime that would affect telecommuters' incomes. In its response to New Hampshire's complaint, Massachusetts offered the examples of its high minimum wage, earned sick time, paid family and medical leave laws, and its generous unemployment benefits.[109] Economic evidence also shows that the market rate of a locality is set by the conditions of the local labor market.[110] Much has been written about the urban wage premium, agglomeration, and the spillovers of localized human capital, which help explain the high incomes of cities.[111] While the telecommuter enjoys the wage premium associated with working from a particular office, they would only pay for these benefits through a Convenience Rule.[112] And if the physical establishment were to move to another locality, the wage of the telecommuter would be affected, since the new state would offer a different institutional regime that fosters a different agglomeration premium.

Meanwhile, the telecommuter can move anywhere without changing this local wage premium. Many state decisions, like *Geoffrey, Inc. v. S.C. Tax Comm'n*, have recognized that a state has taxing authority for providing an "orderly society" which benefits taxpayers who purposefully direct their economic activities in the state.[113] It might be argued that a tax on telecommuting is meant to maintain local services used by the telecommuter. However, this compensation is best achieved through property taxes,

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[109] Brief of Defendant at 30–31, New Hampshire v. Massachusetts, 141 S. Ct. 2848 (2021) (No. 22O154) (citations omitted) ("Massachusetts also provides protections benefiting employees regardless of their state of residence, such as its high minimum wage, its Earned Sick Time and Paid Family and Medical Leave laws, and the most generous unemployment benefits in the Nation.").

[110] *See generally* David Card et al., *Location, Location, Location* (U.S. Census Bureau, Ctr. for Econ. Stud., Working Paper No. 21–32, 2021), https://perma.cc/FJ39-P5CL.

[111] *See* Edward L. Glaeser & David C. Maré, *Cities and Skills*, 19 J. LAB. ECON. 316 (2001); Jeffrey J. Yankow, *Why Do Cities Pay More? An Empirical Examination of Some Competing Theories of the Urban Wage Premium*, 60 J. URB. ECON. 139 (2006); E. D. Gould, Cities, *Workers, and Wages: A Structural Analysis of the Urban Wage Premium*, 74 REV. ECON. STUD. 477 (2007).

[112] Matthew Clancy, *The Case for Remote Work* (Apr. 13, 2020) (unpublished manuscript), https://perma.cc/3SVZ-CYQA (showing the similar productivity of remote workers with their colocated peers).

[113] Geoffrey, Inc. v. S.C. Tax Comm'n, 313 S.C. 15, 19 (1993).

rather than a tax on income that is divorced from local benefits provided. Residents are often tied to their place of birth due to social ties, moving costs, and regulations.[114] Further, the literature has shown that interstate mobility has been in decline in recent decades likely due to some combination of these and other factors.[115] The rise of telecommuting, however, would provide workers with autonomy over their place of employment. The location of an employer's physical office would be a better reflection of the benefits received by the employer, since a profit-maximizing institution would be more likely to base its decisions on where to have its offices on a cost-benefit analysis that includes the marketplace and institutions of the state. This recognition of how market wages are set for telecommuters shows that the Convenience Rule is fairly apportioned, as is required by the second prong of the *Complete Auto* test.

3. First, Third, and Fourth Prongs of Complete Auto Applied to the Convenience Rule

The other prongs of *Complete Auto* are less substantive and are significantly related to the second prong. The first prong requires a "substantial nexus," which has been equated to the requirements of due process as established in *Wayfair*.[116] The Massachusetts rule meets the substantial nexus prong based on telecommuters' purposeful direction of activities in the taxing state and the fact that, since *Quill*, physical presence has not been a requirement for due process. The third prong requiring non-discrimination only requires that "the tax is applied at the same rate to intrastate and interstate business."[117] Since interstate

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[114] *See generally* David Schleicher, *Stuck! The Law and Economics of Residential Stagnation*, 127 YALE L.J. 78 (2017) (reviewing existing legal restrictions to help explain the decline of American interstate mobility).

[115] *See generally* Greg Kaplan & Sam Schulhofer-Wohl, *Understanding the Long-Run Decline in Interstate Migration*, 58 INT'L ECON. REV. 57 (2017); Michael S. Dahl & Olav Sorenson, *The Social Attachment to Place*, 89 SOC. FORCES 633 (2010); Patrick Coate & Kyle Mangum, *Fast Locations and Slowing Labor Mobility* (Fed. Rsrv. Bank of Phila., Working Paper No. WP 19–49, 2021), https://perma.cc/3LBH-5B9X.

[116] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) (finding that the "economic and virtual contacts" the out-of-state vendor has with South Dakota satisfies substantial nexus, establishing the requirement to establish due process to substantial nexus); Eric C. Miller, *Answering the Call:* South Dakota v. Wayfair, Inc. *and A Challenge to the Physical Presence Rule*, 64 S.D. L. Rev. 94, 117 (2019) ("By sustaining South Dakota's definition of what constitutes the threshold for sellers to avail themselves, the Court correctly related the Commerce Clause and Due Process 'nexus' requirements back together.").

[117] Jesse H. Choper & Tung Yin, *State Taxation and the Dormant Commerce Clause: The Object-Measure Approach*, 1998 SUP. CT. REV. 193, 214 (1998). The third non-

telecommuters are subject to the same tax regime as their in-state coworkers under the Convenience Rule, the Massachusetts tax rule is not discriminatory. The fourth prong of *Complete Auto* requires that the tax be "fairly related to services provided by the taxing state."[118] This prong, however, is dead law since it has been delegated to the legislature rather than being a justiciable issue.[119]

C. *Wayfair* Applied to Income

New Hampshire places undue weight on the physical presence of the telecommuter, a method which is losing its value as a shorthand for economic presence in a digital economy. A physical presence rule had been rejected in *Wayfair* in the sales tax context under both the Due Process Clause and the Commerce Clause on the grounds that such a rule is "removed from economic reality."[120] *Wayfair* based its rejection of *Quill's* physical presence rule on three main factors: the fact that physical presence was not necessary to create a nexus with a state, the market distortions which the physical presence regime created, and the arbitrary formalism of the physical presence rule.[121] These rationales, though used in a sales tax context, apply just as well in an income tax context. And if the Convenience Rule is found to be unconstitutional, the same concerns expressed in *Wayfair* would play out.

First, the "substantial nexus" prong of *Complete Auto* should not require physical presence when taxing income, just as physical presence is not required to establish minimum contacts for due process.[122] Second, striking down the Convenience Rule would create rather than resolve market distortions by allowing interstate telecommuting to serve as a tax shelter. Employees who telecommute would be subject to a different tax regime than their coworkers who physically commute. Third, a physical presence rule for taxing income is an "arbitrary, formalistic distinction" that does not properly allocate taxing power to the benefit-providing state. *Wayfair* instead called for a "sensitive, case-by-case

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discrimination prong also overlaps significantly with the second prong's internal consistency test. *See* Armco Inc. v. Hardesty, 467 U.S. 638, 644 (1984) (applying the internal consistency test to determine if a tax is discriminatory).

118 Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

119 Commonwealth Edison Co. v. Montana, 453 U.S. 609, 627 (1981) (holding that "the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution.").

120 *Wayfair*, 138 S. Ct. at 2092.

121 *Id.* at 2018.

122 *Id.*

analysis of purposes and effects"[123] which can be accomplished through an economic presence test. By focusing exclusively and formalistically on physical presence, courts overlook real economic presence and create tax planning opportunities.

Wayfair also expressed a concern for administrative compliance costs.[124] Under a Convenience Rule, businesses would only have to deal with the state tax authority that they have an economic connection to, not the state in which telecommuter is physically located. Administrative costs would increase if businesses had to comply with the tax regimes of every state from which employees telecommuted. Businesses who have not purposefully directed their activities towards the taxing state, nor have received any benefits from the state, would still risk being subject to taxation by that state. While this form of taxation has been held to be constitutional, it would not likely pass muster under an economic presence analysis.[125] States have created explicit rules exempting corporations from their states' corporate income tax despite the physical presence of a telecommuter in the state.[126] However, without a recognition of economic presence, corporations would be at greater risk to extraterritorial taxation.

Commentators who argue that *Wayfair* should not be "pushed"[127] to apply to the Convenience Rule should explain how it is that *Wayfair* is being pushed rather than being consistently applied.[128] Similarly, in the *Zelinsky* case, the Court based its decision on the opportunities for tax avoidance that striking down the Convenience Rule would create.[129] An employee need only claim to be working remotely from a low-tax or no-tax jurisdiction to avoid tax liability. The Court in *Zelinsky* also relied on *Quill* to show that a substantial nexus exists.[130] The Court's concerns in *Wayfair* are as valid for state income taxes as they were for state sales taxes, as shown by the overlapping reasoning with *Wayfair*

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123 *Id.* at 2085 (citing W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 201 (1994)).

124 *Id.* at 2093.

125 Telebright Corp. v. Dir., N.J. Div. of Tax'n, 424 N.J. Super. 384, 390 (N.J. Super. Ct. App. Div. 2012) (holding that a Delaware corporation who had single employee who telecommuted from New Jersey was doing business in New Jersey and was therefore subject to New Jersey's Corporation Business Tax Act).

126 *See State Guidance Related to COVID-19: Telecommuting Issues,* HODGSON RUSS (June 9, 2021), https://perma.cc/MTP3-TKP5 (presenting a 50-state survey on the state income tax implications for telecommuting).

127 Zelinsky, *supra* note 49, at 3.

128 *Id.*

129 *Id.*

130 Zelinsky v. Tax Appeals Tribunal, 1 N.Y.3d 85 (2003).

and *Zelinsky*. It would therefore be appropriate to apply *Wayfair* to uphold the Convenience Rule.

D. Convenience Test Safe Harbor

There may be instances where an economic presence rule may allow a "place-of-performance" source rule to prevent tax avoidance. This could be achieved by establishing a sham physical office in a low-tax state while relying on remote labor. Here, a physical office would create only the illusion of economic presence. If a telecommuter's work is done entirely remotely, then part of the telecommuter's property is used as a principal place of business, and the state of performance may tax the telecommuter's labor. This safe harbor is consistent with current practice. States that use destination-based source rules for sales taxes might still use place-of-performance rules where the destination state is uncertain.[131]

This would serve as a safe harbor when the work is sufficiently localized so that a local property tax does not sufficiently account for the commercial value of the property where the labor is performed. Providing a safe harbor may help prevent tax avoidance. Courts would need to consider practical concerns, just as the Court did in *Wayfair*.[132] This may require the Convenience Rule to import a form of the home office deduction test,[133] wherein the source state would be the state where the service is performed if the test is met.

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[131] *See* ARTHUR ROSEN & JACK TRACHTENBERG, 1310-3RD T.M., SALES AND USE TAXES: SERVICES (BL) § 5(B) (last visited Apr. 15, 2022) (reviewing the SSUTA's hierarchy of sourcing rules, known as "cascading sourcing rules," when there is insufficient information to source the transaction where the customer receives the product or service); *see* STREAMLINED SALES AND USE TAX AGREEMENT § 309 (Streamlined Sales Tax Governing Bd., Inc., 2019), https://perma.cc/F3BM-T2GV.

[132] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099–100 (2018) ("First, the Act applies a safe harbor to those who transact only limited business in South Dakota. Second, the Act ensures that no obligation to remit the sales tax may be applied retroactively. Third, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs.") (citation omitted).

[133] *See* 26 U.S.C. § 280A(c)(1) (home office deduction requirements for the federal income tax). *See generally* 83 A.L.R FED. 691 (reviewing the application of the federal home office deduction).

E. Commentary Against the Convenience Rule

Post-*Zelinsky* commentary has relied on the overturned *Quill* case and is outdated.[134] Yet three recent papers have argued that the Massachusetts Convenience Rule violates both the Due Process Clause and Commerce Clause.[135] Zelinsky argued that New Hampshire is the principal provider of services to telecommuters physically within the state since the state provides "police and fire personnel among other services."[136] However, these services only protect telecommuters' *access* to the benefits ultimately provided by Massachusetts. The state provisions associated with physically commuting (physical infrastructure) should be viewed no differently than those associated with telecommuting (network infrastructure and emergency services). While New Hampshire finances the roads and protects the automobiles used for a New Hampshire resident's commute into Massachusetts, these benefits do not entitle New Hampshire to tax *all* of a physical commuter's income. Providing police and fire protection does not affect Massachusetts's market wages, although they affect access to Massachusetts's market wages.

Zelinsky relies heavily on the case of *Central Greyhound.* There, the Court properly struck down a New York tax which attempted to tax all income from a motor bus carrier where "nearly 43% of the mileage lay in New Jersey and Pennsylvania."[137] The Court apportioned the tax proportional to the mileage within the state. However, *Central Greyhound* is compatible with an economic presence approach, and apportionment in that case was appropriate. Since 43 percent of the carrier's mileage was through Pennsylvania and New Jersey, the tax was apportioned based on mileage among the three states. The carrier and its customers were directly relying on the fiscal and legal institutions provided by the state they had driven through. The carrier generated its profits through the market developed by the states, which made driving within their borders and servicing their residents a

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134 *See* Meredith A. Bentley, *Recent Development,* Huckaby v. New York State Division of Tax Appeals*: In Upholding the Current Tax Treatment of Telecommuters, the Court of Appeals Demonstrates the Need for Legislative Action*, 80 ST. JOHN'S L. REV. 1147 (2006); Michael Kraich, *The Chilling Realities of the Telecommuting Tax: Adapting Twentieth Century Policies for Twenty-First Century Technologies*, 15 U. PITT. J. TECH. L. POL'Y 224 (2015).

135 *See* Young Ran (Christine) Kim, *Taxing Teleworkers*, 55 U.C. DAVIS L. REV. 1149 (2021); Pomp, *supra* note 93; Zelinsky, *supra* note 49.

136 Zelinsky, *supra* note 49, at 25.

137 Cent. Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 660 (1948).

profitable enterprise. A change in Pennsylvania's or New Jersey's policies could conceivably affect the carrier's income.

This ruling should be contrasted with *Jefferson Lines*, which upheld an Oklahoma tax on the full value of a bus ticket which travelled through several states based on the "economic justification for the State's claim upon the value taxed."[138] Admittedly, *Jefferson Lines* dealt with a sales tax rather than an income tax, and the Court would have ruled differently had the challenged tax been the latter.[139] However, the Court's concern with an income tax was that apportionment would be required when interstate business led to there being "several States in which the taxpayer's activities contributed to taxable income."[140] Yet when income generated from telecommuting is sourced within only one state, telecommuting is not interstate business. A Massachusetts employee no more engages in New Hampshire's marketplace or institutions when she telecommutes into her office than when she physically commutes from her residency in New Hampshire.

Professor Shanske, meanwhile, argues that the Massachusetts tax rule abides by the Due Process Clause and Commerce Clause based on the *Wayfair* decision.[141] Yet, Shanske still argues that some form of apportionment should be applied.[142] But applying apportionment to interstate telecommuters is far more dubious than applying it to the bus in *Central Greyhound*. A state apportionment method cannot be "intrinsically arbitrary,"[143] and New Hampshire would have to justify any apportionment formula.[144] Interstate telecommuting does not lend itself to a clear, non-arbitrary percentage. Moreover, New Hampshire's fiscal and legal institutions lack a rational relationship to the income of a Massachusetts employee who telecommutes to work.[145] There is

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138 Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 175–76 (1995).

139 *Id.* at 190.

140 *Id.* at 176.

141 Darien Shanske, *Agglomeration and State Personal Income Taxes: Time to Apportion (With Critical Commentary on New Hampshire's Complaint Against Massachusetts)*, 48 FORDHAM URB. L.J. 949 (2021).

142 *Id.* (proposing the application of "apportionment by formula").

143 Hans Rees' Sons v. North Carolina ex rel. Maxwell, 283 U.S. 123, 133 (1931).

144 Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) (citing Hans Rees' Sons v. North Carolina ex rel. Maxwell, 283 U.S. 123, 135 (1931)) ("[W]e will strike down the application of an apportionment formula if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State'").

145 *See* Exxon Corp. v. Wis. Dep't of Revenue, 447 U.S. 207, 219–20 (1980) (quoting Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 436 (1980)) (requiring a tax based on interstate activities to have "a rational relationship between the income attributed to the State and the intrastate values of the enterprise.").

no relationship either gained or lost based on an out-of-state employee's decision to commute virtually or physically, as these actions are equivalent from an economic perspective. Since these actions are economically equivalent, they should be subject to the same tax treatment.

The reasons why parties choose to contract in one state and not another should also be examined. Both the employee and the employer purposefully direct their activities of the state of employment for commercial activity due to the marketplace and institutions of that state. Meanwhile, a telecommuter's decision to telecommute from a certain state would more likely be based on non-economic factors, such as being the telecommuter's residency or the state the telecommuter is vacationing in. Under an economic presence analysis, New Hampshire and Massachusetts would have the same right to tax an interstate telecommuter both before and after the COVID-19 related restrictions, meaning telework would create no need for apportionment. And an unapportioned tax would still abide by external consistency, as has been held in *Jefferson Lines* and several other cases.[146]

Shanske also justifies the Massachusetts rule based on telecommuters' "substantial virtual presence" within the state.[147] Yet virtual presence, like physical presence, is not based on state benefits, which would reveal the telecommuter's economic presence. For instance, a corporation may be virtually present in a state where one of its telecommuters' lives. Yet the corporation's virtual presence does not necessarily equate to having an economic presence, or receiving benefits from that state. A virtual presence rule risks creating the same arbitrary formalism that was rejected in *Wayfair*.[148]

Commentators have placed undue weight on the role of "residence" when analyzing the Convenience Rule.[149] Yet the source of a telecommuters' income is irrelevant to their residence. The income generated by an interstate telecommuter is through the marketplace and institutions provided by the source state.

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[146] *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185–94 (1995); Gen. Motors Corp. v. Washington, 377 U.S. 436 (1964); Standard Pressed Steel Co. v. Dep't of Revenue, 419 U.S. 560 (1975); Tyler Pipe Indus., Inc. v. Wash. Dep't of Revenue, 483 U.S. 232 (1987).

[147] Shanske, *supra* note 141, at 961.

[148] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2094 (2018).

[149] *See generally* Pomp, *supra* note 93; Kim, *supra* note 135, at 1202 (arguing for a "residence-based taxation system" on income from teleworking); Zelinsky, *supra* note 49, at 17 ("The state of the telecommuter's residence is the jurisdiction in which she lives, works and receives her primary public services.").

Meanwhile, Professor Pomp argues in opposition to the Massachusetts tax rule based on the importance of representation as a justification for taxation.[150] Pomp argues that the Convenience Rule unjustly burdens unrepresented nonresidents while benefiting politically connected residents.[151] Zelinsky had made a similar argument previously.[152] However, the argument that political power should be considered when applying the Dormant Commerce Clause relies on dicta that was repudiated in *Wynne*.[153] Importantly, commuters (especially telecommuters) have no need for a voice when they have the power of exit and may choose to subject themselves to a different tax regime by directing their activities to another jurisdiction.

A New Hampshire resident who works in Massachusetts has no right to vote in Massachusetts elections, since that resident can exit and work in New Hampshire or Maine in response to an unfavorable change. Meanwhile, the Massachusetts resident remains far more bound to the state for reasons stated above. Whether a taxpayer may vote in the state that is exercising taxing authority it not a concern for the Dormant Commerce Clause and should not be a concern for an economic presence analysis.[154] It is the fact that residents are more tightly bound to their state of residency, which can extract residence rents, that justifies their stronger voice in the form of voting rights. A state like New Hampshire would have less incentive to increase value within its market if it can simply tax the benefits which its residents receive from Massachusetts**.**

Professor Kim, another critic of the Convenience Rule, recognizes that physical presence is "outdated in the digitalized economy."[155] However, Kim argues that source-based taxation should be used only for businesses, while the physical presence regime should be maintained for individuals.[156] This is because a company's physical presence is more dubious and fungible than that

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150 Pomp, *supra* note 93, at 20 ("[P]olitical safeguards are . . . missing when Massachusetts asserts the right to tax nonresidents whose interests are not being protected by Massachusetts voters.").

151 *Id.*

152 Zelinsky, *supra* note 76, at 54–56.

153 Comptroller of the Treasury of Md. v. Wynne, 575 U.S. 542, 555 (2015).

154 *See* W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 215 (1994) (Rehnquist, J., dissenting) ("Analysis of interest group participation in the political process may serve many useful purposes, but serving as a basis for interpreting the dormant Commerce Clause is not one of them.").

155 Kim, *supra* note 135, at 1208.

156 *Id.* at 1208–09.

of a flesh-and-blood human being.[157] Yet this is an administrative concern, not a constitutional one. If an interstate teleworker were to be characterized as a sole proprietorship rather than an individual, the relative benefits it receives from the source state and residence state would not change. Neither should its tax treatment.

To summarize, the Convenience Test's constitutionality rests on three premises. First, a state's taxing authority is based on the value that the state adds to the taxed transaction. Second, a telecommuter's income is determined by the institutions and marketplace of the state of employment. Third, a telecommuter's income is not shaped by the institutions or marketplace of the state where the telecommuter physically performs in. The fiscal and legal institutions of the residence state may affect *access* to income in the state where the employer resides (such as maintaining roads for physical commuters and network services for telecommuters). Yet the actual income generated is affected by the source state, or the state of the employer. Whereas the fiscal and legal effects of the residence states would affect the telecommuter's property value, local property taxes would be the best method for a state to be reimbursed for the benefit of interstate access. Where institutional changes would affect a telecommuter's income, as is the case with the source state, an income tax would be justified.

Under an economic presence analysis, a New Hampshire tax on a state resident who is telecommuting into Massachusetts would likely be deemed a residence rent, since New Hampshire is extracting value from a transaction rather than adding value to it. Residents may be in New Hampshire due to the factors mentioned that limit physical mobility (social ties, occupational licensing, housing regulations, etc.) and New Hampshire should not be able to extract the income generated from Massachusetts solely because of these factors. Telecommuters especially have a unique ability to vote with their virtual presence and subject themselves to employment within a state based on the state's fiscal and legal regime. Residence-based taxes on telecommuting would undermine workers' modernized power to choose.

Ideally, New Hampshire should have no more of a claim to tax income generated by a telecommuter who works in Massachusetts (and who may have moved to Massachusetts if not for mobility barriers) than a former New Hampshire resident who both lives and works in Massachusetts. However, it is well established

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[157] *Id.*

that a state can tax a resident on all their income from all sources.[158] Still, this raises the question of which state, if any, has the duty to provide the taxpayer with a tax credit for taxes paid elsewhere when source rules are in conflict. I will turn to this question in the next part.

IV. STATES SHOULD PROVIDE A CREDIT FOR TAXES PAID UNDER THE CONVENIENCE RULE

New Hampshire's complaint argues that the Massachusetts Convenience Rules violates the Dormant Commerce Clause by creating the possibility of discriminatory double taxation.[159] While I concur that double taxation does discriminate against interstate commerce, New Hampshire wrongly applies this concern when challenging the Convenience Rule. As argued above, the Convenience Rule appropriately allows the state where a telecommuter generates income to exercise taxing authority. Even if the New Hampshire regime is internally consistent, it is not externally consistent, as it seeks to tax value which it plays no role in generating. While New Hampshire has no income tax, if it did (as I will assume for the sake of this analysis), this Comment will argue that it would have to provide a credit for taxes paid under a Convenience Rule. This Comment will apply both the internal and external consistency tests to show that failure to provide a credit would violate the second "fair apportionment" prong of *Complete Auto*.

A. Internal Inconsistency of the Physical Presence Regime

Under the internal consistency test, a court would examine whether interstate commerce would be discriminated against if every state were to apply the challenged rule.[160] If every state were to tax telecommuters based on physical presence, there would be no double taxation, and interstate commerce would have the same tax consequences as intrastate commerce. Yet to the extent the Convenience Rule is justified, failure to respect the rule by providing a credit, as many states have,[161] for taxes paid under it may discourage interstate telecommuting.

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158 Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 462–63 (1995) (recognizing "a well-established principle of interstate and international taxation—namely, that a jurisdiction . . . may tax *all* the income of its residents, even income earned outside the taxing jurisdiction").

159 New Hampshire's Complaint, *supra* note 80, at 27.

160 Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 175 (1995).

161 *See* HODGSON RUSS, *supra* note 126.

The Court used the internal consistency test in *Wynne* to strike down Maryland's tax regime.[162] However, New Hampshire's tax regime differs from Maryland's in *Wynne*. Professors Michael S. Knoll and Ruth Mason maintain that the internally inconsistent Maryland tax in *Wynne* had "simultaneously both *encourage[d]* Maryland residents to earn income in Maryland and *discourage[d]* Maryland nonresidents from earning income in Maryland."[163] It was these simultaneous effects on residents and nonresidents that was at the heart of Maryland's internally inconsistent tax regime in *Wynne*. Meanwhile, in *New Hampshire*, since New Hampshire does not impose an income tax, nonresidents are not discouraged from earning income in the state by the state's income tax scheme.

The Court in *Wynne* had distinguished "(1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes."[164] The case asserted that the first type is unconstitutional while the second is not. States have the freedom to maintain their own tax regimes. Even though their lack of coordination may lead to double taxation, this by itself does not make a tax regime unconstitutional.[165] In *Zelinsky*, the potential for double taxation created by the source state and resident state taxing the same income was deemed an "accidental incident" rather than a "structural evil."[166]

While New Hampshire's tax regime differs importantly from the regime in *Wynne*, it may still be internally inconsistent. If states tax the value of telecommuting beyond what is fairly attributed to their own states, these overlapping claims would disadvantage interstate telecommuting and may therefore be internally inconsistent.[167] But even if New Hampshire's failure to

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[162] Comptroller of Treasury of Md. v. Wynne, 575 U.S. 542, 551 (2015).

[163] Michael S. Knoll & Ruth Mason, *Dual Residents: A Sur-Reply to Zelinsky*, 87 STATE TAX NOTES 269, 270 (2018).

[164] *Wynne*, 575 U.S. at 562.

[165] *See* Guar. Trust Co. v. Virginia, 305 U.S. 19, 22–23 (1938) (holding that Due Process does not prohibit multiple taxation); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 267 (1978) (holding that the Commerce Clause does not prohibit multiple taxation).

[166] Zelinsky v. Tax Appeals Tribunal, 1 N.Y.3d 85, 96 (2003) (quoting Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 192 (1995)).

[167] *See* Kim, *supra* note 135, at 1191 ("[T]he internal consistency test . . . should consider the impact of each state unconstitutionally extending its sourcing rule, and thus taxing right, and the impact that would have on interstate commerce.").

provide a credit is internally consistent on its face, it is still externally inconsistent and violates the second "fair apportionment" prong.

B. External Inconsistency of the Physical Presence Regime

The external consistency test requires that the factors used in the apportionment formula reflect a reasonable sense of how income is generated.[168] New Hampshire must show how any claim to apportionment is reasonably related to the income generated by the interstate telecommuter. New Hampshire telecommuters who generate their income within Massachusetts generally have their incomes determined by Massachusetts labor market conditions, as argued in Part III. Therefore New Hampshire should not have a claim to this income under source rules unless the State can show that its institutions affect telecommuters' incomes.

It might be argued that New Hampshire provides emergency services to telecommuters who are physically present in New Hampshire, and therefore the state should have the right to be compensated for these services through an income tax. However, taxing telecommuters based on their physical presence would create a risk of burdensome double taxation on telecommuters, as argued in Part III regarding the legitimacy of the Massachusetts Convenience Rule. For state taxation to be justified where another state already has a right to tax that same amount, the benefits provided by that state must not be *de minimis* but rather substantive and related to the value which it seeks to tax. This would exclude network infrastructure and emergency services provided to telecommuters as a basis to tax income, since these services affect property values, not income. Otherwise, granting taxing authority which is already held by another state would risk burdensome double taxation that discriminates against interstate commerce.

This case is analogous to *Northwood Construction Co. v. Township of Upper Moreland,*[169] which found that a township's business privilege tax on one hundred percent of a business taxpayer's income was unfairly apportioned despite the taxpayer maintaining their principal place of business within the township.[170] Because the business privilege tax did not even attempt

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[168] *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) (stating that for a tax to be externally consistent "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.").

[169] 579 Pa. 463, 489 (2004).

[170] *Id.* at 489.

to allocate within-state and out-of-state income, despite the fact that the business generated income from other states, the tax did not pass the external consistency test.[171] Similarly in *New Hampshire*, despite the physical presence of the taxpayer in the state, New Hampshire would have to allocate income based on the value added by Massachusetts.

In other domains, New Hampshire is well-aware of the economic value provided by states where a taxpayer has an economic presence, rather than a physical one. Strikingly, New Hampshire imposes its own market-based source rules on business profits by attributing the source of a service sale to the state where it is received rather than where the service is performed.[172] This means that if a New Hampshire business provided remote services to a Massachusetts business, New Hampshire would attribute the sale to Massachusetts. However, if that New Hampshire business was instead a telecommuting employee of a Massachusetts business and provided that same remote service while physically in New Hampshire, New Hampshire attributes that income to itself. Moreover, businesses operating outside of New Hampshire are taxed by New Hampshire for providing services to beneficiaries within the state, despite physically performing the service outside the state. New Hampshire demands Massachusetts use a place-of-performance rule for taxing telecommuters, despite replacing its own place-of-performance rule for one based on destination for taxing businesses. Under New Hampshire's own arguments against Massachusetts, New Hampshire's tax on business income is extraterritorial and unconstitutional.

This tax scheme is an affront to principle-based taxation. New Hampshire recognizes that out-of-state businesses are profiting from the benefits provided by the state and taxes these businesses accordingly. However, New Hampshire challenges this exact principle when another state applies it. Importantly, this showcases that without an underlying principle of taxation, like economic presence, states can adopt strategic tax policy that seeks to maximize revenue to the detriment of interstate commerce.

This Comment does not argue that New Hampshire has no right to impose an income tax on its residents, since states may

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[171] *Id.* This ruling was cited to strike down the application of a similar tax in *KMS Financial Services, Inc. v. City of Seattle*, 135 Wash. App. 489 (Wash. Ct. App. 2006*)*, *rev. denied*, 161 Wash. 2d 1011 (2007).

[172] Rick Najjar, *New Hampshire Adopts Market-Based Sourcing for 2021 & Beyond*, BKD (Apr. 6, 2021), https://perma.cc/LA7Y-K7T3.

tax their own residents on income from any source.[173] Since an economic presence test would help determine the true economic source of income, New Hampshire would still be able to exercise taxing authority based on residency. But, generally, a tax on residence gives way to a tax based on source by providing a tax credit.[174] New Hampshire should be required to credit its resident telecommuters on the taxes they have already paid under a states' Convenience Rule. Some may argue that judges invalidating tax regimes would threaten state sovereignty.[175] However, courts are best positioned to ensure that state taxation is based on principle and not a desire for extraction.

C. A Case for Judicial Coordination

If states use differing, yet internally consistent source rules, with one state adopting a market-based rule while the other uses an origin-based one, this would create double taxation.[176] For instance, if all states used a physical presence regime through adopting origin-based source rules, then there would be no discriminatory double taxation since source rules are uniform. Still, that does not mean that a physical presence regime would allow the state that adds value to the transaction through the benefits it provides to be compensated through taxation. However, if courts were to formally adopt an economic presence test, then this test would help ensure that tax regimes are both non-discriminatory and based on the benefits provided by the state.

Courts, however, have been hesitant in crafting and imposing uniform tax rules.[177] Yet the alternative to courts taking a passive role would be states using internally consistent yet revenue-maximizing rules that may be divorced from benefits provided. States should continue to be free to determine their own tax rates and bases. However, when states apply conflicting source rules and

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[173] *See* Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 462–63 (1995).

[174] *See* HELLERSTEIN ET AL., *supra* note 46, at ¶ 6.04 ("[I]nsofar as the Constitution does prohibit double taxation of income when there is a conflict between the state of residence and the state of source, it permits the latter rather than the former to tax the income.") (first citing Walter Hellerstein, *State Taxation of Corporate Income From Intangibles: Allied-Signal and Beyond*, 48 TAX L. REV. 739, 744 n.11, 804–05 (1993); and then citing John Swain & Walter Hellerstein, *State Jurisdiction to Tax 'Nowhere' Activity*, 33 VA. TAX REV. 209, 222–24 (2013)).

[175] *See* Charles E. McLure, Jr., *The Difficulty of Getting Serious About State Corporate Tax Reform*, 67 WASH. & LEE L. REV. 327, 337 (2010).

[176] *See* Adam B. Thimmesch, *The Unified Dormant Commerce Clause*, 92 TEMP. L. REV. 331, 365 (2020) (maintaining that double taxation resulting from "nonharmonized laws, not discrimination. . . . would survive the internal consistency test.").

[177] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978).

fail to provide a credit for taxes paid to other states, this creates de facto discrimination against interstate commerce. Courts should scrutinize tax regimes that lead to double taxation by ensuring that there is at least some economic justification for a state's tax authority. This conflict can be resolved through an economic presence test, where taxing authority is based on benefits provided. So long as each state exercises taxing authority that is at least roughly related to economic presence, the resulting double taxation can be seen as an "accidental incident of interstate commerce"[178] and would be best resolved through interstate agreements or Congress.

New Hampshire's internally contradictory tax regime can show the harm of this unresolved conflict. While New Hampshire has argued for the supreme importance of requiring physical presence when seeking to invalidate the Massachusetts Convenience Rule, it clearly recognizes economic presence when taxing out-of-state businesses.[179]

Courts try to protect states' differing tax regimes based on the states' unique circumstances.[180] Yet with judicial neutrality to source rules, states have greater freedom to impose strategic yet unprincipled source rules that are aimed at extracting revenue and detached from the benefits provided. A state's decision to use an economic or physical presence rule would not necessarily rest on legal or economic principles, but rather on how much a state can extract without regard to harmful effects on interstate commerce.[181] While this places courts in the uncomfortable position of policy maker, this is a necessary and not unfamiliar role. This is true not just for telecommuting, but conflicting source rules for services generally.

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178 Zelinsky v. Tax Appeals Tribunal of State, 1 N.Y.3d 85, 96 (2003).

179 Dan Chadwick et al., *New Hampshire Adopts Market-Based Sourcing*, RSM (Oct. 15, 2019), https://perma.cc/4ZQM-A7BU.

180 *Moorman*, 437 U.S. at 279 (stating that "[t]he Constitution, however, is neutral with respect to the content of any uniform rule" and decisions of state tax policy are based on each states' unique factors and independent considerations).

181 *See generally* Brian L. Hazen, *Rethinking the Dormant Commerce Clause: The Supreme Court as a Catalyst for Spurring Legislative Gridlock in State Income Tax Reform*, 2013 BYU L. REV. 1021, 1024 (2014) ("[T]he Constitution has granted Congress the final say on laws touching interstate commerce, the Supreme Court is free (until Congress acts) to utilize the dormant Commerce Clause to prevent states from unduly burdening interstate commerce.").

V. ADOPTING AN ECONOMIC PRESENCE RULE

An economic presence rule should not be limited only to interstate telecommuting. There have been several cases where taxation was justified based on economic presence despite the absence of physical presence.[182] These include instances where the out-of-state entity located intangible property within the state,[183] received income from a partnership located within the state,[184] and solicited customers in the state.[185] While these cases have not been granted certiorari, if a similar case is heard by the Supreme Court, an economic presence test should, finally, be formally adopted. Here, courts should ask what value, if any, is provided by the states involved and if these services are *de minimis* or substantively related to the value being taxed. For instance, if a taxpayer chooses to locate physical or non-physical property in a state due to the states' favorable marketplace or institutions, that state should have some proportionate taxing authority.

Courts are rightfully wary of striking down tax regimes that are internally consistent in pursuit of national uniformity.[186] Justice Stevens stated in the *Moorman Manufacturing* decision that the Constitution "is neutral with respect to the content of any uniform rule."[187] Yet courts should still ensure that state taxes are reasonably related to the value that states are adding, rather than the value added by another state. It might be argued that courts are not equipped to understand the underlying economics of a taxable activity to determine which state it has an economic presence in. However, courts have developed this ability through the substance-over-form doctrine.

A. The Economic Substance Doctrine Applied to Economic Presence

An economic presence doctrine would conform with tax law's current requirement that for the tax benefits of a transaction to be respected, it must have economic substance.[188] Revenue agencies use this doctrine to challenge transactions whose purposes,

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182 *See* Thimmesch, *supra* note 50.

183 KFC Corp. v. Iowa Dep't of Rev., 792 N.W.2d 308 (Iowa 2010).

184 Borden Chems. & Plastics, L.P. v. Zehnder, 726 N.E.2d 73 (Ill. App. Ct. 2000).

185 MBNA Am. Bank, N.A. v. Ind. Dep't of State Rev., 895 N.E.2d 140 (Ind. T.C. 2008).

186 Armco v. Hardesty, 467 U.S. 638, 645–46 (1984) (holding that a nondiscriminatory and internally consistent tax regime is not unconstitutional).

187 Moorman Mfg. Co. v. Bair, 437 U.S. 267, 279 (1992).

188 *See generally* Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5 (2000) (providing a general overview of the economic substance doctrine).

according to the agency, lack a non-tax business purpose.[189] The 1935 case of *Gregory v. Helvering*[190] established the general principle of substance-over-form in tax law, which was formally codified in 2010.[191] Decades of case law developed by courts seeking to discover the underlying economics of a transaction leaves judges well-equipped to use an economic presence test when determining state tax jurisdiction. Just as the economic substance doctrine asks if the transactions add non-tax economic value, courts should be able to ask if states provide value (including tax benefits) that would allow the state tax regime to be externally consistent. Applying the economic substance doctrine to an economic presence test would lead to physical presence serving only as a factor in this analysis rather than a determinative shorthand.

A judge-designed tax regime would still lack the nuance that could be provided by the legislature.[192] Still, a court should not focus on crafting comprehensive tax rules but rather on determining the taxing authority that a state holds based on the value that the state provides to the transaction relative to other states. With the well-developed substance-over-form doctrine, judges are sufficiently equipped to determine which states are providing substantive benefits to the taxpayer and to scrutinize the arbitrary formalism stressed by revenue-seeking states.

B. Economic Presence Applied to Other Source Rule Conflicts

As mentioned, states' use of different source rules exposes taxpayers to potential double taxation. Judges should look to whether state tax regimes make a sufficiently reasonable claim on a taxpayer's income-generating *activity* to justify taxation. Judges may be guided by asking how the economics of a transaction would be affected by a change in the state's fiscal and legal institutions. If there is no significant economic presence to justify taxation by the state, the tax should be deemed to be externally inconsistent. Economic presence may be considered a rough principle that should guide courts to permit an approximate range of

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189 ACM P'ship v. Comm'r of Internal Revenue, 157 F.3d 231, 247 (3d Cir. 1998) (citing Casebeer v. Comm'r of Internal Revenue, 909 F.2d 1360, 1363 (9th Cir. 1990)) ("The inquiry into whether the taxpayer's transactions [have] sufficient economic substance to be respected for tax purposes turns on both the 'objective economic substance of the transactions' and the 'subjective business motivation' behind them.").

190 293 U.S. 465 (1935).

191 26 U.S.C. § 7701(o).

192 McLure, *supra* note 175, at 1376–78 (2004) (arguing that Congress rather than courts should resolve the problem of conflicting tax rules, as legislative rules can be more nuanced).

taxation, while more precise apportionment formulas to avoid double taxation can be left to interstate agreements and Congress.[193] Additionally, courts may have the ability to use an economic presence rule when interpreting ambiguous legislation, particularly if the state revenue agency's interpretation of the source rule is disputed.[194]

Whether an activity has an economic presence in a state would rest on the facts of an activity. For non-physical services like cloud computing, states may tax these services either where the consumer receives the benefit or where the cloud computing server is physically located.[195] Yet courts should examine what supply-side factors are being provided or supported by the state in which the servers are located, as such factors may add value to the cloud transaction.[196] If there are none of significance, a "location of the user" source rule[197] must be used rather than one based on the "location of the server."[198] If the state where the servers are located does add value, then a court may justifiably uphold both taxes (so long that there is some attempt at reasonable apportionment) and leave the resulting double taxation to be resolved through interstate agreements or Congress.

In the international sphere, a "significant economic presence" rule has been proposed to determine taxing jurisdiction among countries.[199] Under this regime, "significant economic presence" considers a "basis of factors that evidence a purposeful and sustained interaction with the jurisdiction via digital technology and

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193 *See* David J. Shipley, *The Limits of Fair Apportionment: How Fair Is Fair Enough?*, 2007 STATE & LOC. TAX L. 93, 93 (2007) ("Any state tax apportionment formula will be inaccurate—either overstating or understating the portion of a corporation's income that should be subject to tax. As a result, every apportionment formula will, to some degree, be unfair. However, the U.S. Constitution does not protect against trivial unfairness in apportionment. Rather, the constitutional inquiry is how much unfairness is too much.").

194 *See* Hegar v. Sirius XM Radio, Inc., 604 S.W.3d 125, 132 (Tex. Ct. App. 2020) (adopting a market-based source rule based on statutory interpretation); *see also* Honigman Miller Schwartz & Cohn, LLP. v. City of Detroit, 505 Mich. 284 (2020) (adopting a place of performance-based source rule based on statutory interpretation).

195 Jennifer West Jensen, *How Does One Tax a Cloud?*, TAX ADVISER (Nov. 30, 2011), https://perma.cc/4GLX-QPHV.

196 *See generally* HELLERSTEIN ET AL., *supra* note 46 at ¶ 13.07[5] (reviewing the state source rules for cloud computing transactions).

197 *See id.* at ¶ 13.07[5][b] (citing state source rules that rely on the "location of the user").

198 *See id.* at ¶ 13.07[5][a] (citing state source rules that rely on the "location of the server").

199 Org. for Econ. Cooperation & Dev., *Addressing the Tax Challenges of the Digitalisation of the Economy: Public Consultation Document* (Feb. 13–Mar. 6, 2019), https://perma.cc/7E9Q-Z2CB.

other automated means."[200] As the digital economy unties physical from economic presence, tax source rules would need to better reflect this changing landscape for governments to receive their due compensation. With *Wayfair* leading to the end of a physical presence regime, tethering taxing jurisdiction to economic presence would provide states and businesses greater clarity over which sourcing rules should apply and help prevent discrimination against interstate commerce.

VI. CONCLUSION

The Convenience Rule does not violate either the Due Process Clause or the Dormant Commerce Clause. Due process is respected because telecommuters purposefully direct their activities toward the state they are employed in. And the Commerce Clause is respected because a telecommuter's income is determined by the marketplace and institutions in the state of the telecommuter's employer. The essence of the Dormant Commerce Clause as applied to taxation can be boiled down to the benefit principle. This principle seeks to ensure that taxes properly reflect the benefits provided by the state and prevent states from overreaching by taxing transactions with which they are not economically affiliated.[201]

The digital economy has untied physical presence from economic presence. An entity does not have to be within a jurisdiction to receive the benefits of that jurisdiction. But a state should maintain the right to tax an entity on an activity to which the state adds value. This principle has been recognized in *Wayfair* regarding sales taxes and should be recognized in *New Hampshire* regarding income taxes.

While economic presence would recognize the taxing power of some states, it should lead courts to question the exercised power of others. When states attempt to tax value generated beyond their borders that is properly taxed by another state, these overlapping claims create double taxation that disadvantages interstate commerce.

But without a foundation principle upon which taxing authority is grounded, states may continue to impose uncoordinated and strategic tax rules. States may base part of their tax regimes on physical presence and base another part on economic presence,

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[200] *Id.*

[201] *See, e.g.*, Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940) ("The simple but controlling question is whether the state has given anything for which it can ask return.").

leading to taxation beyond a state's fair apportionment. Several state courts have recognized an economic presence analysis, but it has not formally become a part of how courts apply the Dormant Commerce Clause. Legislatures are better positioned to craft nuanced tax rules. Nevertheless, courts still have a role in ensuring that tax rules are at least roughly based on the value added by the taxing state. The well-developed economic substance doctrine would assist courts with understanding the value being added by transactions, and therefore, which state or states are involved in producing that value.