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In this edition of Eyes on E-Commerce, the authors explore the significant federal constitutional limitations under the commerce and due process clauses on the power of the states to "situs" IT and cloud services for both sales and gross receipts taxes based on the claimed "receipt of the benefit of the service" in the taxing state.

In 2016 we wrote an article, "Where's Waldo: Sourcing IT and Cloud Services."[1] This article picks up where that article left off. Here, we explore the significant federal constitutional limitations under the commerce and due process clauses on the power of the states to "situs" information technology and cloud services for both sales and gross receipts taxes based on the claimed "receipt of the benefit of the service" in the taxing state. In light of those constitutional tests, we also analyze the Streamlined Sales and Use Tax Agreement's sourcing waterfall approach, which applies an identical situs test for services as is used for the sale of tangible personal property.

As we explain, states simply cannot justify sourcing services based solely on the location of the purported "benefit of the service," as an attempt to replicate the rules for sourcing the sale of tangible personal property. Services require a sourcing rule tailored to the nature of services, so as to be able to satisfy the applicable constitutional requirements. Those requirements apply even if the seller has a physical presence in the taxing state and would be liable for taxes on the sales of tangible personal property delivered there. The "substantial nexus with the transaction" and "fair apportionment" requirements of the four-part commerce clause test, as well as the nexus requirement of the due process clause, dictate something more, because of critical differences between the sale of tangible personal property and the sale of services.

Background

There are few U.S. Supreme Court decisions that concern the constitutional limits on a state's power to tax the sale of services. That is likely because although 45 states and the District of Columbia impose a sales tax on the retail sale or use of tangible personal property, far fewer states impose such taxes on services. Similarly, only a few states, such as Ohio, Tennessee, and

[1] Martin I. Eisenstein and Michael E. Carey, "Where's Waldo: Sourcing IT and Cloud Services," *State Tax Notes*, Aug. 8, 2016, p. 429.

Washington, impose gross receipts taxes on providers of services in general, although gross receipts taxes on transportation and telecommunications carriers are more common. Thus, the cases that have addressed the states' power to tax services have generally been in the area of taxation of interstate transportation or telecommunications.

A trio of U.S. Supreme Court cases apply the modern-day test under the commerce clause, as set forth in *Complete Auto Transit Inc. v. Brady*,[2] to taxation of interstate transportation and telecommunications services, but the lessons they teach have applicability to services generally. The unique problems that arise, common to the taxation of all services, generally revolve around difficulties in determining where the services are "performed" (which may be in no one geographic location, for example, for cloud-based transactions) and where they are "delivered" (which can be in one or many different geographic locations other than where the service is performed). Interstate transportation and telecommunications services (other than cellular services or voice over internet protocol) may present the easiest cases of all, as, in most instances, there is a fixed point of origination and receipt that may be readily determined from the location of the buyer and seller. For data processing, storage, and cloud computing services, the actual "services" are not provided or delivered to a location of the customer. It is the customer that accesses the provider's place of business, where the service is performed, and the customer often is responsible for making the connection to the provider's place of business. Moreover, the seller of the services may not know the location or locations from which the customers access the service. Compounding the issue is that access may be by mobile device, and there may be many persons authorized to access the service and do so from several different — and often mobile — locations.

We now turn to the three informative U.S. Supreme Court cases.

First, *Central Greyhound Lines Inc. v. Mealey*,[3] although decided before *Complete Auto Transit*, used a similar analysis in deciding that an unapportioned New York tax on gross receipts for interstate transportation from points within New York and over routes that went through New Jersey and Pennsylvania was unconstitutional. In what seems today a truly unremarkable proposition, the Supreme Court stated that New York was not prohibited from taxing the transportation simply because it was interstate, but must limit its taxes to the portion of the trip that took place within New York. According to the Court, the tax must be "fairly apportioned . . . to the business done within the state."[4] On that basis, the Court struck down the tax because it was not limited to the portion of the services that took place in New York. The Court upheld the vitality of the *Central Greyhound* decision most recently in *Comptroller of the Treasury of Maryland v. Wynne*.[5] State courts have continued to follow the *Central Greyhound* requirement that a carrier's revenue must be apportioned to travel within the state.[6]

Second, in *Oklahoma Tax Commission v. Jefferson Lines Inc.*,[7] the Supreme Court limited the apportionment principle of *Central Greyhound Lines* to a gross receipts tax imposed on the provider, finding that an Oklahoma sales tax on the purchaser of an interstate trip, in contrast, did not need to be limited to the portion of the trip that occurred in Oklahoma. The vice of the New York unapportioned gross receipts tax on the provider in *Central Greyhound Lines* was that the provider was exposed to a similar tax on the same gross receipts, thus encumbering interstate commerce with multiple, overlapping tax

[2]The four-part *Complete Auto* test requires that "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 U.S. 274, 279 (1977).

[3]334 U.S. 653 (1948).

[4]334 U.S. at 664, quoting *Western Livestock v. Bureau of Revenue*, 303 U.S. 250, 255 (1938).

[5]135 S. Ct. 1787, 1799, 191 L. Ed. 2d 813 (2015).

[6]*See, e.g.*, *South Pacific Transportation Co. v. State Department of Revenue*, 202 Ariz. 326, 331, 44 P.3d 1006, 1011 (Ct. App. 2002) (rejecting the revenue department's claim that "no apportionment is required because the passage of Southern Pacific's route through New Mexico was a 'necessary deviation,' and formed a much smaller portion of the total route than did the taxpayer's non-New York mileage in *Central Greyhound*"); and *Green v. Western Union Telegraph Co*. (Fla.Sup.1960), 123 So.2d 712 (applying *Central Greyhound* and finding that telegraph messages between two parties located in the same state, which travel outside the state for transmission purposes only, are subject to a state gross receipts taxes on all charges except for those regarding use of the out-of-state transmission facilities).

[7]514 U.S. 175, 190-191 (1995).

burdens.[8] In contrast, the taxpayer in *Jefferson Lines* — the buyer of the services — was not subject to double taxation because the taxable event was the "agreement, payment, and delivery of some of the services in the taxing State. No other State could claim to be the site of the same combination."[9] The Court noted that the "economic activity represented by the receipt of the ticket for 'consumption' in the form of commencement and partial provision of the transportation thus closely resembles" the delivery of goods within the state.

Other courts have followed the *Jefferson Lines* test for substantial nexus and fair apportionment, sourcing the sale of services to the place of sale. In *Mayor & City Council of Baltimore v. Priceline.com Inc.*,[10] the district court found that the "retail rental of a hotel room, whether facilitated online using interstate or international computer servers or in person at the hotel reception desk, is most sensibly viewed as a discrete event facilitated by the laws and amenities of the place of the hotel."[11]

Third, in *Goldberg v. Sweet*,[12] the U.S. Supreme Court for the first time applied the *Complete Auto* test to determine the constitutionality of a tax on services. In that case, the Illinois telecommunications excise tax at issue was imposed on purchases of interstate telephone calls that originated or terminated in Illinois and were charged to an Illinois service address. The tax was, in effect, a sales tax due from the purchaser of the telecommunications services. As to the requirement under *Complete Auto* that there be "substantial nexus with the transaction," the *Goldberg* Court noted that "we also doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. *See National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967) (receipt of mail provides insufficient nexus)." In analyzing the external consistency test of the fair apportionment prong, the Court pointed out that only two states could tax the call: (1) the state where the call originates or terminates and where the service address is located; and (2) the state where the call originates or terminates and where the billing address is located.[13] Thus, the Court noted that there was a reduced risk of duplicative taxation. Pointing out that the Illinois statute provided for a credit for taxes paid to other states, and there was no practical way to apportion the tax to the different jurisdictions in which the call was transmitted, the Court sustained the tax under the fair apportionment prong, even though the tax was imposed on the entire charge for service. The Court stated that "the external consistency test is essentially a practical inquiry." In light of "insurmountable administrative and technological barriers," the Court found the Illinois statute to pass the external consistency test.[14]

In *Mayor & City Council of Baltimore v. Vonage America Inc.*,[15] a federal district court wrestled with the application of a transactional tax on interstate communications for which the point of origination and termination is unknowable, concluding that *Goldberg*'s nexus rule should not apply in such circumstances. Because it was impossible for the court to determine the points of origination and termination of the service at issue, VoIP, the court held that the substantial nexus requirement was satisfied by the billing address without requiring proof that the VoIP call originated or terminated in Maryland.[16] The district court stated that if the origination or termination of the service were required as well, no state or local jurisdiction would be able to tax

[8] *Id*. at 190.

[9] *Id*. at 191.

[10] *Id*. at 191. No. CIV.A. MJG-08-3319, 2012 WL 3043062, at *6 (D. Md. July 24, 2012).

[11] *See also Travelscape LLC v. South Carolina Department of Revenue*, 391 S.C. 89, 107, 705 S.E.2d 28, 38 (2011) ("The Supreme Court has consistently approved the taxation of sales without any division of the tax base among different states, finding such taxes properly measurable by the gross charge for the purchase regardless of any activity occurring outside the taxing jurisdiction that might have preceded the sale or might occur in the future. *Oklahoma Tax Commission v. Jefferson Lines Inc.*, 514 U.S. 175, 186, 115 S.Ct. 1331, 1339, 131 L.Ed.2d 261 (1995). '[A]n internally consistent, conventional sales tax has long been held to be externally consistent as well.' *Id*. at 188, 115 S. Ct. at 1340").

[12] 488 U.S. 252 (1989).

[13] *Id*. at 263.

[14] *Id*. at 264-265.

[15] 569 F. Supp.2d 535, 538 (D. Md. 2008) ("Accordingly, under the *Goldberg* test, no state or local government would be permitted to tax Vonage for the sale of its telecommunications services. I do not believe that the Supreme Court intended the nexus requirements it set forth in *Goldberg* to apply to a technology, such as Vonage's nomadic VoIP, that differs so extensively from the wired telecommunications it considered in 1989").

[16] *Id*. at 538-539.

Vonage.[17] We believe that *Council of Baltimore* can best be viewed as an anomaly. No other court has followed the lead of the Maryland district court, although one case cited it with approval in a VoIP case in 2009,[18] in eliminating the requirement that the service originate or terminate in the state imposing the tax. In other words, the service must be performed partly in a state for the state to impose the tax on the service.[19] The provider performs its services, in part, both at the point of origination and termination.

The Sourcing of IT Services

As we wrote in our prior article, sourcing of IT services and cloud services turns in large part on the nature of the services. It is our position that we believe the constitutionality of the tax must also be driven by the nature of the services, particularly regarding the substantial nexus and fair apportionment prongs of the *Complete Auto* test.

We now address the constitutional limitations on a state's sourcing of each of three types of IT services based on the location of the benefit of the service, but when the service is performed in a different state. In each case, we assume that the provider itself has substantial nexus under the commerce clause test with the state where the benefit of the service is realized. The fact that the service provider has nexus with the state does not necessarily satisfy the requirement that there be substantial nexus with the transaction. As the Supreme Court stated in *Allied-Signal Inc. v. Director*, "for a tax on an activity, there must be a connection to the activity itself, rather than only a connection to the actor the State seeks to tax."[20] That is because the "constitutional question in a case such as *Quill Corp*. is whether the state has the authority to tax the corporation at all," while the substantial nexus with the transaction requirement "focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax."[21]

The first service we consider is remote installation, alteration, and repair (including patches) to software housed on computers located in other states. Most states tax the service based on where the software is located. The second type of services we discuss are the cloud services of software as a service (SaaS), in which users in several states access software located on servers in other states, and infrastructure as a service (IaaS), when the customers access the provider's servers for storage and processing functions. States commonly source such cloud services to the state where the beneficiary of the service is located. Finally, we consider the states that impose sales and use tax on data processing services: Connecticut, the District of Columbia, Hawaii, Ohio, and Texas, which impose their taxes based on the location of the beneficiary of the service.

The common feature of these three hypotheticals is that a state *other than* the state where the provider actually performs the service seeks to impose sales or use tax collection on the retail sale of taxable services or a gross receipts tax on the revenue derived from services in the states in which the customer is located.[22] There is little doubt that the substantial nexus prong of the commerce clause and due process clause is satisfied for a tax imposed by the state where the service is performed.[23]

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[17] *Id.*

[18] *See also Vonage America Inc. v. City of Seattle*, 152 Wash. App. 12, 27, 216 P.3d 1029, 1037 (2009) (citing the mayor and city council of Baltimore with approval for the proposition that "the presence of a billing address in the taxing locality is sufficient to constitute a 'substantial nexus'").

[19] In *In the Matter of General Electric Co.*, DTA No. 800844 (N.Y. Tax App. Trib. 1992), the New York Tax Appeals Tribunal held that the substantial nexus test was satisfied for a tax on disposal of refuse in Arkansas because the tax was on the charge for an "integrated service" of pickup of the waste in New York and subsequent disposal of the waste, which occurred solely in Arkansas. It was because the service was conducted partly in New York that the tax did not violate the substantial nexus prong. However, the characterization of the tax as being on an integrated service, such that Arkansas could tax the same service, led the tribunal to conclude that the tax did not satisfy the fair apportionment prong of *Complete Auto*.

[20] 504 U.S. 768, 778 (1992).

[21] *Id.*

[22] *See* Ohio Rev. Code 5751.033(l) (sourcing gross receipts for purposes of the Ohio commercial activity tax to the location of the receipt of the benefit).

[23] *See Jefferson Lines Inc.*, 514 U.S. at 189-190, holding that services performed within a state are taxable in the state, even though some value from the transaction arises from interstate shipments, citing *Department of Treasury of Indiana v. Ingram Richardson Manufacturing Co. of Indiana*, 313 U.S. 252 (1941) (Indiana tax on receipts from services performed on tangible personal property delivered to another state are proper under the commerce clause).

Example One: Sourcing of Remote Installation and Repairs of Software

Providers of IT services often enter into contracts to provide continuing monitoring of performance of the IT systems of their business customers from the provider's central location. Those contracts frequently include the requirement to fix, make changes to, and patch software located on servers, desktops, printers, laptops, and mobile devices. Also, such contracts customarily provide for installation of software on the computers and other devices of the customer, wherever located. While the software is often located in multiple jurisdictions, the provider of the service typically distributes services from a central location. From that location, the service is provided over the internet or other network connections to customers' devices, wherever they may be located.

It is arguable that in that situation, the provider is partly providing for the service in the state where its customer's software is located. The service may be analogous to the interstate telephone call in *Goldberg*, where the origination and termination of the service occurs in the state of the benefit, although the charge to the customer is not for the connection between the provider's place of business and the customer's location. Nevertheless, *Goldberg* required not only the origination or termination of the service in a state, but also that the billing address or service address for charging service be in that state. Similarly, *Jefferson Lines* sustained the sales tax on the passenger ticket because agreement and payment occurred in the state, in addition to the performance of the service.

What if the service provider does not know the locations of the software (the so-called service addresses in *Goldberg* and the location of payment in *Jefferson Lines*) and the billing address of the customer is not in the state that seeks to tax the service? In that situation, we think that the service provider would have a sound argument that the substantial nexus with the transaction requirement of the commerce clause would not be satisfied.

Likewise, a provider of the service likely has an argument that it is not subject to the tax based on the due process clause nexus requirement, since the provider does not know that the service is to be used in the state.[24] In *Nicastro*, which discussed the requirements of the due process clause for purposes of court jurisdiction, the U.S. Supreme Court cast doubt on whether the requirements of the clause are met where the defendant has not knowingly engaged in the "transmission of goods" to the forum state; "it is not enough," the Court observed, "that the defendant might have predicted that its goods will reach the forum state."[25] The Court thus grounded its due process analysis on the questions of fairness and foreseeability, under which the placing of a product into the stream of commerce, without more, is an insufficient connection to the state that might ultimately receive it.[26] Similarly, in *Miller Bros. v. Maryland*, the Court invalidated under the due process clause a Maryland use tax assessed against a Delaware retailer based on purchases at its Delaware store, because the retailer had no knowledge of where the customer would use the goods.[27]

The thornier question is whether the provider has a duty to determine the location of the software for which he provided a service. Although pricing for software services often is based on the number of users or locations, does the provider have a duty to ask its customers where the software is located? Certainly, under *Miller Bros.*, even though the retail store owner knew that the advertisements were circulated in Maryland so that Maryland customers would shop at the store, the Court did not find that the retailer had a duty to determine the home address of the customer. On the other hand, for performing service on software, the provider performs, in part, the service in the state of the user.

[24] *See also J. McIntyre Machinery Ltd. v. Nicastro*, 564 U.S. 873 (2011).

[25] 564 U.S. at 882.

[26] 564 U.S. at 883.

[27] 347 U.S. 964 (1954). As the Court held in *Miller Bros.*, there must be "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." *Id.* at 344-345; quoted with approval in *Allied-Signal Inc. v. Director*, 504 U.S. at 767.

Also, even if there had been substantial nexus with the transaction, a provider of services would also have a strong argument that it is not liable for the gross receipts tax, and possibly sales taxes as well, on the *entire* charge for remote installation and repairs to software. As was true in *Central Greyhounds Lines*, failure to apportion the charges based on the number of computers and other devices located in the state would violate the external consistency test of the fair apportionment prong of *Complete Auto*. Unlike *Goldberg*, in which it was impractical to apportion based on the extent to which the telecommunications service was used in a state, there is a relatively easy and practical way to determine local use based on the percentage of the computers and other devices located in the state of the total serviced by the provider.[28]

Example Two: Cloud Services Sourced to Location of Users

Although several states impose sales taxes on SaaS based on the location of the users,[29] there are no reported decisions challenging the imposition of such taxes on constitutional grounds. Fewer states tax IaaS, but those that do generally base the tax on the location of the users as well.[30] Even though a provider of SaaS may have nexus with a state from which the user accesses the SaaS or IaaS, we think that this is only the starting point of the constitutional inquiry. That view flows from *Allied-Signal*'s admonition that "for a tax on an activity, there must be a connection to the activity itself, rather than only a connection to the actor the State seeks to tax."[31]

We question whether the first prong of the *Complete Auto* test — substantial nexus with the transaction — can be satisfied based on the location of users. In *Goldberg*, the Court stated that it doubted whether the mere termination of an interstate call, in which the provider was responsible for furnishing the interstate connection, would create nexus. For the SaaS transaction, in which a provider houses software on a server located in another state that is accessible by its customers using the internet or other network connections, the transaction has no connection of the same nature as the interstate call's origination or termination in the state of the customer. Similarly, for IaaS the customer has access to the computing power, hardware, and software of the provider to store data on the provider's servers and or to process data using the provider's servers. Those cloud services occur solely within the state where the server is located. Also, at least one of the three components that caused the *Jefferson Lines* Court to sustain the sales tax on the charges for a bus ticket sold in Oklahoma — delivery of service — would not be satisfied.

It is also likely that a cloud services provider would have a similar due process and substantial nexus argument (as does a provider of remote installation and repair of software) if the cloud services provider does not know the location of the users.

Example Three: Sourcing of Data Processing Services

In the typical situation, a service provider operates a data center in which it has several servers and software both to store and process data provided by its customers. The provider typically employs on-site personnel to manage and operate the data center. Employees and other authorized users of the customers transmit data to the data center and retrieve the stored data from the data center. Authorized users are responsible for the transmission of data that the provider processes and transmits back to them into a final product for subsequent use by the customer.

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[28] For this reason, many providers ask that their customers provide a certificate attesting to the number of users by state.

[29] *See, e.g., New York Department of Taxation and Finance*, TSB-A-11(17)S, June 1, 2011 ("We conclude that the hosted marketing service constitutes the sale of prewritten software and its charges for that service are subject to sales and use tax. . . . If the client's employees who use the software are located both in and outside of New York State, Petitioner should collect tax based on the portion of the receipt attributable to the client's employee users located in New York"); and Pennsylvania Department of Revenue, SUT-12-001 Cloud Computing, May 31, 2012 ("Accessing taxable canned software is taxable when the user is located in Pennsylvania."). *Id.* ("In the case of taxable canned software accessed remotely that is sold to Taxpayer's customers, Taxpayer is required to collect sales tax from customers when the user is located in Pennsylvania.").

[30] New Mexico Taxation and Revenue Department, Ruling 401-13-2 (June 26, 2013) (Both IaaS and SaaS taxed on the basis of the location of the users).

[31] 504 U.S. at 778.

States that tax data processing argue that the benefit of the storage and processing services is realized where the users are located.[32] For a number of data processing services, it is doubtful that the states from which users transmit or receive information is the "location of the benefit" for sourcing purposes. For example, a company's accounts payable, accounts receivable, and general accounting functions could be in India, while the company's headquarters are in New York. If the output from the service provider is financial statements, is the true benefit of the service in India or New York?

Also, a service provider could argue that for a sales tax or service tax, sourcing to the states where authorized users operate does not provide an adequate connection to the state to satisfy the substantial nexus requirement. The transaction is the storage of information as well as the processing of information, all of which occurs where the data center is located. Unlike remote installation and repairs of software located outside the state of the provider's central office, the storage and data processing service does not involve any services provided on equipment or software located in the states of the users. Although storage and processing may not be useful to the customer without retrieval and access by authorized users of the customer, the transaction subject to tax is complete at the provider's data center. In contrast to the VoIP cases discussed above, there is a state where the service is performed — the state of the data center.

Furthermore, as discussed above, a taxing state would be required to show that the billing address or service address of the data processing service lies within its geographic boundaries. But pricing for storage services is usually not based on the number of authorized users or the number of requests for services made by authorized users.

Finally, if a state can overcome the substantial nexus argument, it still must satisfy the fair apportionment test. In a sense, what is "good for the goose is good for the gander." Thus, if a state could justify the substantial nexus transaction requirement based on the presence of in-state users, then that should be the basis to apportion the charges to the state, so that the entire charge should not be subject to either sales tax or gross receipts taxes. To similar effect is the New York Tax Tribunal's decision in *In the Matter of General Electric Co.*, in which the tribunal found that while the substantial nexus prong was satisfied, the tax in question did not provide for fair apportionment because the tax was based on the entire charge, rather than the portion of the charge attributable to the service performed in New York.

The Problems With the SSUTA Test For Sourcing Services

Section 310 of the SSUTA[33] provides the same test for sourcing all services, except telecommunications services, as used for the sale of tangible personal property. Section 310 has a waterfall of five tiers or levels. Sourcing is based on working through the tiers until the requirements of the applicable tier are satisfied.

The first level is the vendor's place of business if the first use of the service is received at the vendor's place of business. Arguably, that could apply to data processing services and cloud services, although the tax agencies in two SSUTA states — Ohio and Washington — have already ruled that cloud services are not received where the servers are located.[34] If the first tier did apply, we see no significant issues under either the commerce clause or due process clause for any of the three types of services discussed above.

The second tier of section 310 is the location of receipt where that place is "known" to the vendor. That is like the "place of benefit" rule in other states. Unlike the place of benefit rule, however, this tier is satisfied only if the vendor is aware of the location. While that potentially satisfies the

[32] Connecticut, the District of Columbia, Hawaii, Ohio, and Texas source services to the state of benefit. Connecticut Department of Revenue Services, Policy Statement No. 2006(8); D.C. Mun. Regs. tit. 9, section 474; Haw. Rev. Stat. Ann. section 237-13(6); Ohio Rev. Code Ann. section 5739.033; and 34 Texas Admin. Code section 3.330. *See also* Chicago Department of Finance's sourcing of the personal property lease transaction tax. Department of Finance, Personal Property Lease Transaction Tax Ruling No. 12.

[33] Streamlined Sales and Use Tax Agreement.

[34] *See Opinion of the Ohio Tax Commissioner* (Feb. 4, 2014) ("However, the service is sourced to Ohio only if the benefit of the service is received in Ohio (*i.e.*, customer is in Ohio and accesses the service from a location in Ohio"); Wash. Rev. Code section 82.12.010(6)(f) ("With respect to a service defined as a retail sale in RCW 82.04.050(6)(b), [use means] the first act within this state by which the taxpayer, as a consumer, accesses the prewritten computer software").

substantial nexus prong for remote installation and repair of software, it simply does not cure the issues regarding cloud services and data processing services, because no part of the service is performed in the state of receipt. Moreover, there is a question whether the *Goldberg* requirement of a service address or billing address in the state would be satisfied. Finally, there are real questions whether the due process minimum connection requirement is satisfied if the only connection is that users of the service are in the state.

The third and fourth tiers rely on the address of the customer known from the vendor's business records and the address given in the transaction, respectively. Use of those tests to source any of the IT services and cloud services described above probably would not pass muster under the requirement of a substantial nexus with the transaction. The customer's address from the provider's business records does not show any connection to the transaction being taxed, whether the analysis is under the two-pronged test of *Goldberg* or the due process requirements of a connection to the transaction being taxed. As to the fourth tier of an address given in the transaction, it might be argued that that address should be a sufficient connection, based on the VoIP line of cases. But there is a significant difference. For VoIP, it is impossible to determine where the service is performed, in whole or in part, since the court could not determine where the call originates or terminates. The location of cloud computing and data processing services, however, is easily determinable based on where the provider has its facilities.

The fifth tier is the location from where the service is provided. Sourcing on that basis would likely satisfy the substantial nexus test, even if the billing address were elsewhere.

Conclusion

The application of sales and use and gross receipts taxes to the sale of IT and cloud computing services has resulted in a virtual "Wild West" of sourcing rules and principles not connected to the underlying strictures of the commerce clause and due process clause. The uncoordinated efforts by the states to apply principles derived from the sale of tangible personal property to services — which are not "delivered" to a state in the same way as tangible personal property — has led to a patchwork of rules that are more akin to grasping at straws to justify taxing transactions rather than developing common-sense, consistent, and predictable situs rules that bear some relationship to transactional realities consistent with constitutional principles.

The only place to which taxpayers can turn to bring order to that chaos, as well as manage their tax responsibilities in a reasonable fashion, are the limits on state tax inconsistencies and extraterritorial adventures imposed by the U.S. Constitution. Those rules, as spelled out in a handful of governing cases, create a principled framework for taxing services that bears some connection to where those services take place and how they are provided to and received by customers. Although one federal court in Maryland decided simply to throw out the U.S. Supreme Court's rules as outmoded and outdated, it took that simplistic route because of the unique circumstances of that case. It did so by ignoring the problem of expanding the nexus rules of *Goldberg* to allow the taxation of services in places they are neither provided nor delivered. Use of the logic of that case is not justified for IT and cloud services. Sourcing of IT and cloud services must be based on the tests the U.S. Supreme Court has developed for services. A state may tax only those activities for which it has provided "protection, opportunities and benefits"[35] in order to avoid duplicative and inconsistent burdens on commerce across the country. ■

[35] *See Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).