# THE AMAZON TAX: COLLECTING THE USE TAX IN THE AFTERMATH OF THE NEW YORK APPELLATE COURT'S RECENT HOLDING

## I. INTRODUCTION

In light of the recent economic recession, many states have turned to creative methods in order to increase revenues.[1] One such method, as exemplified in the State of New York, consisted of an aggressive attempt to tax out of state online retailers through what has become notoriously known as the "Amazon tax."[2] This comment examines the environment leading up to the enactment and the aftermath experienced by New York, other states, and online retailers affected by the law.

First, a brief overview of general state tax and, more specifically, sales and use tax is provided and is followed by a review of important cases relevant to the subject matter. Second, state challenges leading to the enactment of the "Amazon tax" are examined, and the tax's constitutionality (including arguments for and against) is also considered. Third, in light of the questionable constitutionality of the "Amazon tax," its unlikely success due to retailer's reactions, and the mixed results experienced by various states that have enacted similar laws,[3] this comment discusses possible alternatives to successful tax collection. These options include congressional action, projects like the Streamlined Sales Tax Project, and other more creative and perhaps more successful alternatives.

## II. BACKGROUND

### A. *Brief Overview of State Taxation*

One of the first inquiries in deciding whether a corporation can be taxed is determining where the specific corporation has a "nexus."[4] If a corporation has a nexus with a state, the "state has the jurisdiction to tax" that corporation.[5] Usually, if a corporation has property in a state or carries out business in a state, the corporation will have nexus with that state.[6] There are, however,

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1. *See* GEORGE B. DELTA & JEFFREY H. MATSUURA, LAW OF THE INTERNET §15.07 15-94 (3d ed. 2012).

2. *See* NY Tax Law § 1101(b)(8)(vi) (McKinney 2008); DAVID E. HARDESTY, ELECTRONIC COM.: TAX'N & PLAN. ¶ 14.03[5][b][vi], ¶ 1 (1999), *available at* 1999 WL 1336736.

3. HARDESTY, *supra* note 2, at ¶ 14.03[5][b][vi], ¶ 1-2.

4. Ethan D. Millar, *Overview of State and Local Taxation*, *in* TAX LAW & PRACTICE 2011, at 20-1, 20-8 to -12 (PLI Tax Law & Estate Planning, Course Handbook Ser. No. 928, 2010).

5. *Id.* at 20-8.

6. *See id.*

significant constitutional limits on a state's general ability to tax.[7]

Both the Due Process Clause and the Commerce Clause present noteworthy limits in a state's ability to tax corporations.[8] In *Quill Corp v. North Dakota*, the Supreme Court first set out the rule that before a state could tax an out-of-state corporation, there should be a "definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[9] This "minimum contacts" test under the Due Process Clause has further been clarified to require that a retailer's activities in-state be more than merely casual: they must be "continuous" and "systematic."[10]

The Court has also found the Commerce Clause imposes limits on state taxing power.[11] In *Complete Auto Transit, Inc. v. Brady*, for example, the Court held state taxes are valid only if they are "applied to an activity [or taxpayer] with a 'substantial nexus' with the taxing State."[12] In *Quill*, the Court noted that although the substantial nexus test is a way to limit the burden states can place on interstate commerce, it is not a "proxy for notice."[13] Therefore, even though the Due Process prong may be satisfied by a corporation's contacts with a state, those activities will not necessarily satisfy the substantial nexus test under the Commerce Clause.[14] In short, physical presence in a state is necessary to satisfy the latter.[15]

Furthermore, the Supreme Court held in *Tyler Pipe Indus., Inc. v. Washington* that "a taxpayer may have nexus in a state based on the activities performed by another person on behalf of the taxpayer, if such activities are 'significantly associated with the taxpayer's ability to establish and maintain a market in the state' for its products."[16]

Generally, this type of nexus occurs when out-of-state retailers have a nexus based on activities of contractors,

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7. *See id.* at 20-12.
8. *See id.* at 20-12 to -13.
9. *Id.* at 20-12 (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992)).
10. Millar, *supra* note 4, at 20-12.
11. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).
12. *Id.*
13. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992).
14. Millar, *supra* note 4, at 20-13.
15. *See id.* The physical presence is necessary to meet Commerce Clause requirements with regards to sales and use taxes only, a topic, which will be further elaborated below. *Id.*
16. Millar, *supra* note 4, at 20-15 (quoting Tyler Pipe Indus., Inc. v. Washington State Dep't. of Revenue, 483 U.S. 232, 250 (1987)).

employees, or affiliate entities.[17] With regards to affiliate entities, a corporation may have a nexus where a corporation with a "brick-and-mortar" location in-state also conducts business through an internet or mail-order affiliate located out-of-state.[18]

Courts are currently split in determining whether an "agency relationship" is necessary to establish the nexus of one entity to another.[19] For jurisdictions where such a relationship is necessary to establish a nexus, the relationship must meet certain requirements.[20] First, the "agent must have the authority to act for the principal," and second, "the agent must act on the principal's behalf and be subject to the principal's control."[21] On the other hand, other courts have held this type of "agency relationship" is not necessary to establish a nexus.[22] Instead, these courts "have continued to expand the situations under which attributable nexus may apply."[23] At the heart of these decisions is the New York Supreme Court's ruling in *Amazon.com, LLC v. N.Y. Dep't of Tax and Finance*, which is one of the most recent examples of such expansion.[24] In that case, the court held Amazon.com established a sufficient nexus with the state even though the corporation did not have an "agency relationship" with New York or any of its residents.[25] The New York trial court found Amazon.com established a nexus based on the relationship created by an affiliate program where New York residents referred customers online.[26]

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17. *See id.* It must be noted, however, that although the Supreme Court's holding in *Scripto, Inc. v. Carson* specifically found a contractor's activities could "be attributed to the corporation, if performed on the corporation's behalf," states have decided to differentiate between actual employees and contractors. *Id.* at 20-14. Therefore, the laws in different states may vary with regards to fulfilling the required nexus. *See id.*

18. *See id.* at 20-14.

19. *See id.* at 20-14.

20. *See id.*; *see also* Pledger v. Troll Book Clubs, Inc., 871 S.W.2d 389, 392 (Ark. 1994).

21. Millar, *supra* note 4, at 20-14.

22. *Id.*

23. *Id.*

24. *Id.* The "Amazon tax" was challenged in the New York court by Amazon.com. The tax provision in question "provide that an internet retailer has attributable nexus with [New York] if they (1) enter into 'affiliate' agreements with one or more [New York residents] in which residents earn a commission for referring potential customers to the internet retailer using a link on a website or by other means; and (2) have at least $10,000 in annual sales to customers in New York as a result of such referrals." *Id.* This topic will be further discussed below.

25. *See id.*

26. *See id.*

B. *Overview of Sales and Use Taxes*

As a supplement to state sales taxes, the use tax serves to "fill[] a gap when sales tax does not apply."[27] For example, a taxable transaction occurs when a buyer in Virginia buys a coat through a catalogue from L.L. Bean in Maine.[28] However, the tax liability is not incurred in Maine.[29] The buyer is instead liable for the use tax to Virginia under the reasoning that the coat will be "used" in Virginia.[30] Although the use tax concept is simple, difficulties arise because consumers are not usually aware of the requirement to pay a use tax on these items and state governments are often unable to track out-of-state purchases and are thus unable to collect such taxes.[31]

This problem is not as evident on larger purchases such as vehicles.[32] Larger purchases are easier to track, and due to the larger revenues, governments usually implement more "practical" and definite means to enforce the tax.[33] In contrast, a smaller out-of-state purchase (including items sold over the internet or by catalogues) is more difficult to track, and the tax will ordinarily not be collected by the state where the item will be used.[34] A growing e-commerce exponentially adds to the problem because more consumers are purchasing from remote retailers.[35] These remote retailers are often incorporated in one or two states, with inventory in only a few states.[36] Consequently, the retailer will likely not have the required nexus or connection with a state and will have "no obligation to collect and remit the state's sales or use tax."[37]

C. *Significance of Quill Corp v. North Dakota*

In *Quill Corp. v. North Dakota*, the Supreme Court set a bright-line standard when it held the Commerce Clause required that businesses have an in-state physical presence sufficient to

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27. George B. Delta & Jeffrey H. Matsuura, *State Taxation of Electronic Commerce*, L. Internet 15.06 at 15-63.

28. *See id.*

29. *See id.*

30. *Id.*

31. *See Id.*

32. Delta & Matsuura, *supra* note 27, at 15-63.

33. *See id.* When it comes to out-of-state vehicle purchases, for example, state governments force consumers to pay a use tax when the consumer registers the vehicle. *See id.*

34. *See id.*

35. *See id.*

36. *See id.* at 15-64, 15-65.

37. *Id.* at 15-63.

meet the "substantial nexus" test before a state could tax that business.[38] Today, if a retailer does not fulfill the "substantial nexus," the retailer is not required to collect either sales or use taxes.[39] The *Quill* decision was particularly revealing because the Court indicated the nexus analysis under the Due Process Clause and under the Commerce Clause were different.[40] According to the Court, Due Process did not require physical presence, but instead required an inquiry as to whether an out-of-state vendor "purposefully avail[ed] itself of the benefits of an economic market in the forum State. . . ."[41] The minimum contacts requirement[42] means that today, in order to tax an out-of-state vendor, a vendor must have a minimum physical presence in the state.[43] On the other hand, the Court also concluded the Dormant Commerce Clause should be examined under a four part test outlined in *Complete Auto Transit, Inc. v. Brady*.[44] Under *Brady*, a tax on an out-of-state vendor is constitutional if: (1) the tax is applied to an activity with a substantial nexus with the taxing State, (2) it is fairly apportioned, (3) it does not discriminate against interstate commerce, and (4) it is fairly related to the services provided by the State.[45]

A state today can thus impose a sale or use tax on out-of-state vendors only if the "substantial nexus" is established through physical presence.[46] The exact requirement for physical presence is uncertain, but the Court in *Quill* provided some guidance by finding the "slightest presence" did not create a substantial nexus.[47] The Court concluded that even though the Quill Corporation, the out-of-state retailer, sold a small number

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38. Quill Corp. v. North Dakota, 504 U.S. 298, 317-18 (1992). This case concerned a sales tax imposed by North Dakota on Quill, an out-of-state mail-order vendor with no employees or offices in the state. *Id.* at 302.The Quill Corporation solicited business in North Dakota through mail-order catalogs, flyers, ads in newspapers, and telemarketing. *Id.* Most courts have applied *Quill's* physical presence requirement to both internet retailers and "traditional mail-order companies" presumably because the only difference between the two methods of business is that one company obtains orders through the internet and the other through phone or mail. HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 9.

39. HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 1.

40. *See* Quill, 504 U.S. at 305. The significance of this distinction will be discussed below.

41. *Id.* at 307.

42. *See id.* at 306.

43. *See* HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 6.

44. *See* Quill, 504 U.S.at 311; Complete Auto Transit Inc. v. Brady, 430 U.S. 274, 279 (1977).

45. *See* Brady, 430 U.S. at 279.

46. Daniel T. Cowan, *New York's Unconstitutional Tax on the Internet: Amazon.com v. New York State Department of Taxation & Finance and the Dormant Commerce Clause*, 88 N.C. L. REV. 1423, 1424 (2010).

47. HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 15.

of computer software programs to in-state residents (which could arguably amount to a "physical presence" in the state), those few items alone were not enough to fulfill the nexus requirement.[48] Consequently, although an extensive presence is probably not necessary, the physical presence requirement can likely be met if there is more than a "slightest presence" in the state.[49] Additionally, in 1960 the Supreme Court held Florida could require out-of-state retailers to collect taxes if the orders were placed and solicited through out-of-state representatives.[50]

D. *Challenging Quill Corp.*

The "substantial nexus" requirement under *Quill* posed a distinct obstacle to states intending to tax out-of-state internet retailers with physical presence in only one or two states.[51] Nonetheless, because a sizeable amount of sales taxes are not collected when in-state residents buy from out-of-state retailers, states have become increasingly "creative" in finding ways to force the retailers to collect taxes.[52]

New York was one of the first states to challenge *Quill's* physical presence requirement through a unique state law.[53] The new "Amazon tax" amendment was designed to establish a "substantial nexus" through Amazon.com's in-state advertisers.[54] More specifically, amendment section 1101(b)(8)(vi) required all on-line vendors to collect taxes if items were purchased by New York residents.[55] Despite challenges by Amazon.com, and Governor Spitzer's initial reluctance to sign the bill, the "Amazon tax" became effective in 2008.[56]

One of the most distinctive aspects of the new tax was the broader definition of "vendor."[57] Under the new definition, the relationship between in-state advertising affiliates and out-of-

48. *Id.*

49. *Id.*

50. *See* Delta & Matsuura, *supra* note 27, at *6.

51. *See* Cowan, *supra* note 46, at 1427.

52. HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 8.

53. Cowan, *supra* note 46, at 1426.

54. *Id.* at 1427.

55. *See* Amazon.com v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 132 (N.Y. App. Div. 2010).

56. *See* Cowan, *supra* note 46, at 1426.

57. *See* Cowan, *supra* note 46, at 1426. Before enacting the new law, New York law allegedly conformed to Commerce Clause requirements because tax collection obligations were imposed on retailers that solicited only through "employees, independent contractors, agents, or other representatives." *See* Amazon's Mem. in Supp. of Cross-Mot. Summ. J. in Opp'n to the State's Mot. Dismiss at 1, *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 003), 2008 WL 5592585.

state online companies like Amazon.com purportedly created a nexus sufficient to satisfy the physical presence required under *Quill*.[58] According to the opinion in *Amazon v. New York*, the amended statute:

> created a presumption that an out-of-state seller was 'soliciting business [in New York] through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller, if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller, is in excess of ten thousand dollars during the preceding four quarterly periods ending on the last day of February, May, August, and November.'[59]

The new law effectively shifted the responsibility of collecting the tax from the consumer to the retailer, as long as the affiliates or in-state contractors affirmatively participated in soliciting customers.[60] This presumption could be rebutted by showing proof that in-state affiliates did not participate in such solicitation.[61]

### E. *Amazon v. New York and Subsequent Appeal*

After New York passed the "Amazon tax," Amazon.com responded in two ways.[62] First, the company filed suit in state court challenging the constitutionality of the new law.[63] Second, and perhaps more effectively, Amazon.com broke off relationships with all in-state affiliates of New York.[64] To the retailer's dismay, in 2009 the New York Supreme Court ruled against Amazon.com, holding the new tax law provision: (a) did not facially violate the Commerce Clause, (b) did not violate the

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58. *Id.* at 1429.

59. Amazon.com v. New York State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 133 (N.Y. App. Div. 2010) (quoting N.Y. Tax Law § 1101(b)(8)(iv) (McKinney 2012)).

60. *See id.*

61. *See id.*

62. *See* Sam Zaprzalka, *New York's Amazon Tax Not Out of the Forest Yet: The Battle Over Affiliate Nexus*, 33 SEATTLE U. L. REV. 527, 527-28(2010).

63. *See id.* at 528.

64. *See id.* at 539.

Commerce Clause as applied, (c) did not violate Due Process, and (d) did not specifically target Amazon.com or Overstock.com.[65] The company subsequently appealed.

The first part of this section will consider the constitutionality of the law, concluding that, despite the recent opinion in New York, it will likely not be upheld.[66] The second part of this section contemplates that even if upheld as constitutional, the "Amazon tax" is ineffective in light of Amazon.com's other response.[67]

## III. IN SUPPORT OF AMAZON.COM: THE "AMAZON TAX" IS UNCONSTITUTIONAL

### A. *Amazon.com's Argument*

Amazon.com is incorporated in Delaware, while Amazon Services is incorporated in Nevada.[68] Overstock.com, the second party in the suit, is also incorporated in Delaware with its principal place of business in the state of Utah.[69] Throughout the course of their business, both Amazon.com and Overstock.com contract with independent parties that advertise through the independent parties' websites.[70] These advertisements are usually banners located in the independent contractor's website where a potential customer can "click-through" and subsequently navigate into the Amazon or Overstock website.[71]

In the suit, Amazon.com's core arguments against the new tax were that the statute violated the Due Process Clause, the Commerce Clause, and the Equal Protection Clause of the Constitution, while Overstock.com claimed the statute violated the Due Process Clause and the Commerce Clause.[72] Specifically, on appeal Amazon.com argued: (a) the statute violated the Commerce Clause because the company did not have a required "substantial nexus" with the state of New York, (b) the statue violated the Due Process Clause because it created an "irrational and irrebuttable presumption, and [was] also vague," and (c) the

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65. *See*Amazon.com v. New York State Dep't of Taxation & Fin., 877 N.Y.S.2d 842, 848-51 (N.Y. Sup. Ct. 2009).

66. *See* Zaprzalka, *supra* note 62, at 544.

67. *See* Zaprzalka, *supra* note 62, at 556.

68. Amazon.com v. New York State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 133 (N.Y. App. Div. 2010).

69. *Id.* at 134.

70. *Id.*

71. *Id.*

72. *Id.*

statute violated the Equal Protection clause because it specifically and in bad faith targeted Amazon.com.[73]

Both Amazon.com and Overstock.com facially challenged the constitutionality of the state, arguing it was vague.[74] The plaintiffs claimed the statute "impose[d] tax collection obligations based on activities that are insufficient to create a substantial nexus under the dormant Commerce Clause."[75] They also challenged the statute's apparent applicability to mere in-state advertisements, which had previously been considered insufficient to qualify as a nexus.[76] One commentator suggested the statute was so broad it could arguably apply to radio and television ads.[77]

Amazon.com and Overstock.com also opposed the statute as-applied.[78] The retailers argued the statute was unconstitutional as it applied to them for three reasons.[79] First, neither Amazon.com nor Overstock.com had a physical presence in the state of New York in the form of brick-and-mortar locations, contractors, or employees.[80] In fact, the only activities that could be linked to either party were the activities of affiliates who resided in New York but were only advertising for the companies online.[81] Second, the online retailers also argued, if "affiliates were involved in solicitation, it had not been authorized by the plaintiffs and should not have been the basis for substantial nexus."[82] Finally, the activities of New York affiliates could not be "significantly associated with [the plaintiff's] ability to establish and maintain a market for sales in New York."[83]

Although several arguments can be made against the constitutionality of New York's new statute, the substantial nexus test under the Commerce Clause seems especially

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73. *Id.* at 136 (Overstock.com did not join in this last argument, but makes similar arguments with regards to the Commerce Clause and the Due Process Clause).

74. *See* Zaprzalka, *supra* note 62, at 548.

75. *Id.*

76. *Id.*

77. *See id.* at 549.

78. *Id.* at 550.

79. *See id.*

80. *See id.*

81. *See id.*

82. *Id.* at 550-51.

83. *Id.* at 551 (quoting Amazon.com v. N.Y State Dep't of Taxation & Fin., 877 N.Y.S.2d at 849). *See also* Amazon's Mem. in Supp. of Cross-Mot. Summ. J. in Opp'n to the State's Mot. Dismiss at 27, *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 601247/08) [hereinafter Amazon's Memo].

compelling.[84] In fact, despite the court's initial dismissal of the suit when it granted summary judgment against Amazon.com in 2009, many still maintain the court erred when it based its decision on the activities of in-state affiliates.[85] One claim is:

> [w]hile the activities of an in-state contractor or salesperson are sufficient to create a taxable nexus, traditional advertising is considered insufficient in this regard. Because the affiliates' activities more closely resemble traditional advertising than the activities of an in-state contractor or salesperson, the Statute is in violation of the Commerce Clause.[86]

In mid-2011, the appellate court concluded the statute did not facially violate the Commerce Clause because the retailer's obligation to collect a tax was necessary *only* where: (1) the retailer contracted with a New York State resident in a "business-referral agreement," and (2) the resident was paid a commission on the specific sale.[87] The court's conclusion turned on two important points.[88] First, the business agreement between the affiliate and the retailer required some form of solicitation and was not considered to be merely "passive advertising."[89] Second, although the New York law created a presumption that affiliates do solicit business, it presented an "escape hatch or safe harbor" for the retailer as long as the applicable contract prohibited any form of solicitation.[90] The court further concluded Amazon.com's program required in-state affiliates to "clearly" solicit customers.[91] Thus, unless the retailer provided evidence that affiliates did "not engage[] in solicitation, the facial challenge based upon the Commerce Clause . . . fail[ed]."[92]

The appellate court rejected Due Process arguments that the law created an irrebuttable presumption or that it was

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84. *See* Zaprzalka, *supra* note 62, at 529. The Due Process minimum contacts requirement, for example, is often thought to be satisfied in this specific situation because Amazon.com "purposefully directed their activities toward New York." *Id.*

85. *See id.*

86. *Id.*

87. *See* Amazon.com v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 138-39 (N.Y. App. Div. 2010).

88. *See id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. Amazon.com v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 139 (N.Y. App. Div. 2010).

unconstitutionally vague.[93] The New York law creates a presumption "that in-state solicitation occurs when an in-state representative is paid a commission on a per sale basis, after a New York purchaser accesses its Web site and 'clicks' through to make a purchase at the out-of-state vendors' Web site."[94] This, according to the Court, was not an irrebuttable presumption because affiliates could present evidence and prove they did not actually solicit customers.[95] The court also rejected the Equal Protection claim because Amazon.com simply could not "claim that it [was] being exclusively targeted since it [was] being treated exactly the same as Overstock."[96] Additionally, the retailer could not argue it was treated differently from other retailers that are not similarly situated particularly because other retailers used different advertising methods.[97] Finally, the court remanded the "as-applied" arguments with regards to the Commerce Clause and the Due Process Clause.[98] The court was not able to conclude the affiliates were conducting "sufficiently meaningful activit[ies] so as to implicate the State's taxing powers."[99] Instead, the court remanded to allow the retailers to gather and provide evidence that in-state affiliates were only advertising and not soliciting business in New York.[100]

In his concurrence, Justice Cattersons agreed with the majority but recognized that "[h]ad the challenge been based on the tax as applied to the plaintiff's actual activities in New York, supported by a complete record of those activities as well as how the tax was apportioned, the plaintiffs may have had a valid challenge."[101]

### B. *The Performance Marketing Industry*

"The Performance Marketing [Association] ("the PMA") is a non-profit trade association that represents the interests of the performance marketing industry."[102] In an amicus brief filed

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93. *Id.* at 140-41.

94. *Id.* at 140.

95. *Id.* at 140.

96. *Id.* at 145.

97. *Id.* at 145.

98. Amazon.com v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 143 (N.Y. App. Div. 2010).

99. *Id.*

100. *Id.*

101. *Id.* at 146-47 (Catterson, J., concurring).

102. *See* Brief for Performance Marketing Alliance as Amicus Curiae Supporting Appellants; Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534), 2009 WL 7868637 at *1.

when Amazon.com appealed the New York decision, PMA argued the statute was unconstitutional because "a retailer's mere publication of electronic advertisements on New York-based websites does not constitute a constitutionally sufficient 'physical presence' in the State to permit New York to impose an obligation on the retailer to collect its sales or use tax."[103] Specifically, PMA argued New York's decision (a) restricted interstate commerce and discriminated against a specific marketing model, and (b) harmed small business owners because revenues from their internet advertisements would be lost.[104] In fact, many have found PMA's latter argument persuasive.[105]

### C. *The Tax Foundation*

In addition to PMA, the Tax Foundation also filed an amicus brief.[106] "The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy."[107] In support of Amazon.com, the Foundation argued that absent physical presence in the form of "employees, offices, or retail outlets," an out-of-state vendor must "maintain[] arrangements with independent persons physically present in the state who are engaged in local solicitation or sales support vital to the establishment and operation of the company's in-state market."[108] The Foundation emphasized that instead of focusing on the significance of Amazon.com's activities, the lower court merely concluded Amazon.com benefitted and the benefit was

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103. Brief for Performance Marketing Alliance, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

104. *See* Brief for Performance Marketing Alliance, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

105. Kathryn Buschman Vasel, *Proposed Online Sales Tax Gaining Momentum and Foes*, FOX BUSINESS ¶ 14 (July 24, 2012), http://www.foxbusiness.com/personal-finance/2012/07/24/friend-or-foe-online-sales-tax.

106. *See* Brief for Tax Foundation as Amicus Curiae Supporting Appellants, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534), 2009 WL 7868636.

107. *See* Brief for Tax Foundation, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

108. *See* Brief for Tax Foundation as Amicus Curiae Supporting Appellants, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

enough.[109] The Foundation also pointed out the conclusion was contrary to precedent.[110]

## IV. THE "AMAZON TAX" IS CONSTITUTIONAL

Many do not believe the "Amazon tax" and other similar provisions are unconstitutional, and argue it is not only constitutional but is actually part of a larger and growing trend.[111] Similar to other analysis, Michael R. Gordon notes the development of this trend started after online retailers began to find means to "avoid collecting sales and use taxes in order to make their prices appear lower."[112] One such tactic was to create two separate legal entities, where one entity would sell online and the other entity would legally own the brick-and-mortar location.[113]

One of the first cases regarding this corporate tactic was *Borders Online, LLC v. State Bd. of Equalization*, where "the requirement to collect California sales tax was stretched to its limit."[114] In *Borders Online*, the court held if a brick-and-mortar store accepted the return of items purchased online the store would essentially be acting as the retailer's "agent," which was enough to constitute a presence and enough to impose a collection of the use tax.[115] The practical effect of this holding was that "companies with online divisions that [did] not wish to collect sales taxes for online orders must create a corporate structure where the online division is completely distinct from the 'brick-and-mortar' division."[116]

More litigation followed, often with contradictory results.[117] Although the litigation led to "numerous gray areas," corporations continued to follow various tactics to avoid collection

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109. *See* Brief for Tax Foundation as Amicus Curiae Supporting Appellants, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

110. *See* Brief for Tax Foundation as Amicus Curiae Supporting Appellants, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 1534).

111. *See* Michael R. Gordon, Recent Development, *Up the Amazon Without a Paddle: Examining Sales Tax, Entity Isolation, and the "Affiliate Tax"*, 11 N.C.J.L. & TECH. 299, 311 (2010).

112. *Id.* at 304.

113. *See id.* (citing Borders Online, LLC v. State Bd. of Equalization, 29 Cal. Rptr. 3d 176, 178-79 (2005)).

114. *Id.*

115. *See id.*

116. *Id.* at 305 (emphasis added).

117. *See id.*

of sales tax and structured legal entities with the specific purpose of achieving that result.[118]

While online retailers were finding ways to stay competitive in the marketplace, states were losing sizeable revenues in taxes.[119] Some studies estimate the total amount lost by states in sales and use taxes is as high as $7.7 billion.[120] In North Carolina alone, the total loss incurred was $145 million.[121] It did not take long before states began to fight back, and in 2008 New York passed the "Amazon tax."[122] North Carolina also passed a very similar provision in 2009, with provisions specifically targeting affiliate programs used by retailers like Amazon.com.[123]

In response, the online retailer filed suit and argued the New York law and other similar provisions were unconstitutional.[124] However, recent decisions suggest otherwise.[125] In the first *Amazon.com* case, the court decided the law did not violate the Dormant Commerce Clause and dismissed the case.[126] A second seminal case was *Dell Catalog Sales L.P. v. Taxation Revenue Dep't.*[127]

Interestingly, the argument could be made that the issue in the "Amazon tax" provision should not be one of constitutionality.[128] Instead, it is argued this is, or at least should be, an issue of state law.[129] Despite the decision in *Dell Catalog*, for example, two completely different results were reached in Kansas and in Connecticut.[130]

The varying results indicate court decisions often turn on a state's definition of "agency."[131] Clearly, a state is limited by precedent in that it cannot define the term so broadly it would be

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118. *See id.* at 305-07.

119. Gordon, *supra* note 111, at 299-30.

120. *See id.* at 300.

121. *Id.* at 301.

122. *See id.* at 309.

123. *See id.* at 309-10.

124. Complaint, Amazon.com v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842, (N.Y. Sup. Ct. 2008) (No. 08601247) 2008 WL 5592584.

125. Gordon, *supra* note 111, at 311-12.

126. *See id.* at 311.

127. *Id.* at 311-12.

128. *See id.* at 312.

129. *See id.* at 312-13.

130. Gordon, *supra* note 111, at 312. In Connecticut, for example, the court concluded teachers who received sales training and other incentives for the sales of goods could not be considered agents of Scholastic Book Clubs. *Id.* In contrast, a Kansas court held teachers who received similar training and similar incentives were in effect agents of the club. *Id.*

131. *See* Scholastic Book Clubs, 2009 WL 1175675, at *5–6; In re Appeal of Scholastic, 920 P.2d at 955–56.

blatantly unconstitutional.[132] The more important point, however, is that nuances and variations in state law can make critical differences in how the law is applied.[133]

Even if the "Amazon tax" is held to be constitutional, there are powerful responses against Amazon.com's arguments in refusing to collect taxes.[134] Amazon.com has argued that it is simply too difficult to collect taxes from all 50 states due to the different tax laws.[135] A response to such argument is that the company "already collects tax for most U.S. jurisdictions when it acts as the sole online retailer for the department store Macy's or the superstore Target."[136]

Additionally, there is evidence that other online retailers have been collecting taxes from various states without major difficulties.[137] Netflix, for example, is able to collect sales taxes in practically every state for its DVD rentals.[138] By using a company that "specializes in sales tax collection to comply with the laws of each state," Netflix is able to easily and cheaply collect taxes.[139] Another company that also collects taxes in various states is Apple's iTunes Store.[140] A noteworthy point is that Apple is able to collect taxes and still turn a profit on sales that are sometimes as low as 69 cents.[141]

## V. NEW YORK'S DECISION

Despite the various arguments for and against its constitutionality, the New York Supreme Court Appellate

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132. *See* Gordon, *supra* note 111, at 312–13. For instance, a state could not simply state all common carriers are "agents of the companies whose goods they deliver" because "the imposition on the seller of the duty to collect sales tax for the state solely for that reason would be unconstitutional." *Id.* (citing Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967)).

133. *See* Gordon, *supra* note 111, at 312.

134. *Id.* at 315 (citing MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, AMAZON'S ARGUMENTS AGAINST COLLECTING SALES TAXES DO NOT WITHSTAND SCRUTINY 4 (rev. 2010), *available at* http://www.cbpp.org/files/11-16-09sfp.pdf).

135. *Id.* (citing Randall Stross, *Sorry, Shoppers, but Why Can't Amazon Collect More Tax?*, N.Y.TIMES (Dec. 27, 2009), http://www.nytimes.com/2009/12/27/business/27digi.html?_r=0).

136. *Id.* (citing Mazerov, *supra* note 134).

137. *See id.* (citing Stross, *supra* note 135).

138. *See id.* (citing Netflix, Inc., *Frequently Asked Questions*, NETFLIX, http://www.netflix.com/Static?id=5157(last visited Mar. 25, 2010)).

139. *Id.* at 316 (citing Stross, *supra* note 1356).

140. *See id.* (citing Apple, Inc., *iTunes Store Terms & Conditions*, APPLE, http://www.apple.com/legal/itunes/us/terms.html (last visited Oct. 16, 2012)).

141. *See id.* (citing Rik Myslewski, *Apple iTunes Unwraps (Precious Few) 69 Cent Tracks*, THE REGISTER (Apr. 7, 2009), http://www.theregister.co.uk/2009/04/07/no_bargains_at_the_itunes_store/).

Division, First Department, ruled against Amazon.com.[142] On appeal, the court recently held: (a) the statue did not facially violate the Commerce Clause, (b) the statute did not violate equal protection rights with regards to the plaintiffs, but remanded because (c) further discovery was necessary with regards to the applied challenge.[143]

## VI. AMAZON.COM'S RESPONSE: SEVERING TIES WITH AFFILIATES

Even if the "Amazon tax" is ultimately upheld in court, it is unlikely to be successful in light of Amazon.com's response. California's experience with a similar tax is a telling example.[144] California is the most recent state to enact a statute requiring out-of-state vendors using in-state affiliates and with sales over $500,000 in the state to collect use taxes from their customers.[145] The key difference between the New York and the California statutes is that in the latter, the state (and not the retailer) bears the burden of proving in-state affiliate actions result in a nexus with the state.[146]

Under the new California law, out-of-state vendors should have begun collecting taxes in July of 2011.[147] After the law's enactment, and equipped with its experience in the state of New York, Amazon.com promptly notified all California advertising affiliates it would terminate its relationship with them.[148] As a direct result, all 25,000 California affiliates were expected to leave the state, taking with them $152,000 million in income taxes.[149]

Although California's law is unique in establishing the high threshold of $500,000 as an attempt to protect out-of-state vendors selling through eBay, California feared possible

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142. *See* Amazon.com v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 146 (1st Dep't 2010), *aff'd as modified*, 877 N.Y.S.2d 842 (Sup. Ct., N.Y. Cnty. 2009).

143. *See id.*

144. *See* Kelley C. Miller, *Goodbye, California? Will California's New 'Amazon Tax' Send E-Retailers Packing?*, E-COMMERCE L. REP., July 2011 (citing Mark Lifsher, *California Tells Online Retailers To Start Collecting Sales Taxes From Customers*, L.A. TIMES (June 30, 2011), http://articles.latimes.com/2011/jun/30/business/la-fi-amazon-tax-20110630) [hereinafter Miller].

145. *See id.*

146. *See* HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 1 &¶ 14.03[1], ¶ 1, 6.

147. *See* Miller, *supra* note 144 (citing Andrew S. Ross, *Internet Sellers Must Collect Tax, Like It Or Not*, S.F. CHRONICLE (June 30, 2011), http://www.sfgate.com/business/article/Internet-sellers-must-collect-tax-like-it-or-not-2366175.php).

148. *See id.*

149. *See id.* (citing Lifsher, *supra* note 144).

repercussions (including the possibility of 25,000 affiliates leaving the state) and repealed the law on September 23, 2011.[150]

The state of North Carolina initially imposed a similar tax provision and, unfortunately, endured the same disastrous consequences.[151] Like in California, Amazon.com quickly discontinued all future contracts with North Carolina affiliates after the state enacted a similar "Amazon law."[152] Thus, the law will probably have little, if any, effects on North Carolina's goal of increasing tax collection.[153] In fact, "in a striking example of unintended consequences, North Carolina's attempt to increase its use tax collection by enacting the Amazon law, in the end, may have cost the state tax dollars."[154]

This result is even more apparent when other losses are taken into consideration.[155] For instance, Amazon.com's termination of contracts with in-state affiliates also led to losses in "commission income" that would have also been taxed in North Carolina.[156] Therefore, the state ultimately did not reach its goal of increasing tax revenue, but actually ended up losing revenue in the form of income tax from the lost commissions of in-state affiliates.[157]

## VII. FOLLOWING NEW YORK'S LEAD

In addition to New York and California, a number of states have enacted similar statutes, and some have been forced to repeal them.[158] According to an estimate published in July, 2011, at least Texas, Colorado, Connecticut, Arkansas, Illinois, Hawaii, Rhode Island, North Carolina, and, of course, New York, have all passed laws imposing an obligation on internet out-of-state retailers to collect a use tax.[159]

Arkansas enacted a new statute in 2002 requiring "an out-of-state vendor with an affiliate that is physically present in the state to collect use tax if the out-of-state vendor [sold]

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150. *See id.*

151. *See* Scott W. Gaylord & Andrew J. Haile, Article, *Constitutional Threats in the E-Commerce Jungle: First Amendment and Dormant Commerce Clause Limits on Amazon Laws and Use Tax Reporting Statutes*, 89 N.C. L. REV. 2011, 2033 (2011).

152. *Id.*

153. *See id.*

154. *Id.*

155. *See id.*

156. Gaylord, *supra* note 151, at 2033.

157. *See id.*

158. *See Delta* & Matsuura, *supra* note 27, at 15-90.

159. *See* Miller, *supra* note 144, at *1.

substantially similar products as the affiliated Arkansas retailer."[160]

Rhode Island also enacted a similar statute in 2009, which presumed that a "retailer solicits business in the state if it compensates any in-state entity for referring customers to the retailer, directly or indirectly."[161] The new Rhode Island statute defined "retailers" to include people that sold property through a contractor or through a representative as long as the out-of-state retailer and the in-state resident entered an agreement where the resident received a commission for directly or indirectly referring customers.[162] Like the New York statute, the presumption could be rebutted through affirmative proof that the resident was not effectively "engag[ed] in any solicitation."[163]

Illinois also recently enacted a similar "Amazon tax."[164] On March 10, 2011, H.B. 2659 (a.k.a. the Public Act 96-1544) was adopted by Governor Patrick Quinn.[165] It became effective in July 1, 2011, and provided that retailers would be defined to "maintain a place of business in Illinois, and therefore expected to collect use tax on sales to Illinois purchasers" if the retailers met certain requirements.[166] First, retailers needed to enter a contract with an Illinois resident where a commission could be paid for direct or indirect referral of customers through the resident's website.[167] Alternatively, an out-of-state vendor could also fall within the definition if the vendor both: (a) contracted with an Illinois resident who sold "the same or substantially similar line of products as the person located in Illinois . . . using an identical or substantially similar name, trademark name, or trademark as the person located Illinois," and (b) paid a commission to the Illinois resident depending on sales.[168] Second, the Illinois law also required that the "cumulative gross receipts for sales of tangible personal property . . . exceed $10,000 during the preceding four quarterly periods."[169]

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160. Delta &Matsuura, *supra* note 27, at *10.

161. *Id.* at *12.

162. *Id.* at *12.

163. *Id.* at *11.

164. *See* Michael J. Wynne & Kelley C. Miller, *Illinois Adopts Click-Through Nexus Law*, 13 No. 4 E-COMMERCE L. REP. 13, at *1.

165. *Id.*

166. *Id.*

167. *See id.*

168. *Id.*

169. *Id.*

The effects of the Illinois law have been significant.[170] In response to the new law, Amazon.com again predictably notified all affiliates in Illinois that the company was terminating its contractual relationships.[171] The stark difference between this and prior retaliatory action by Amazon.com is the extensive Illinois affiliate program.[172] In fact, the Performance Marketing Association considers Illinois to have "one of the largest concentrations of affiliates and the country's largest concentration of 'super affiliates'- entities that generate their revenues through the creation of affiliate programs, such as coupon and e-rebate Web sites."[173]

For over forty years, Illinois has supported an "economic nexus" standard for "use tax collection."[174] Beginning with *National Bellas Hess*, continuing with Governor Thompson's support, and ending with the more recent law, the State and the Illinois Department of Revenue have persistently endorsed the economic standard.[175] Illinois has thus joined the number of states attempting to circumvent *Quill*.[176] Perhaps more importantly, Illinois' action does not reflect a divergence but represents an out-right challenge to *Quill*, with the ultimate goal of its reversal.[177]

Some states established even more aggressive laws to force out-of-state retailers to collect taxes.[178] Colorado, for example, passed H.B. 1193 in March of 2010, a law, which attempted to "circumvent the Supreme Court's cases on nexus."[179] Colorado's law differed from prior statutes in that it commands out-of-state retailers that fail to collect sales or use taxes to: (1) "notify each Colorado purchaser on its invoice that sales or use tax is due to the state and that Colorado law requires the customer to file a sale or use tax return," (2) mail an additional notice before January 31 every year notifying purchasers that Colorado law requires the payment of sales/use taxes, as well as providing detailed information required by the Colorado Department of

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170. *See id.* at *1.

171. *See id.* The e-mail notification stated Amazon.com "opposed [the] new . . . law because it [was] unconstitutional and counterproductive." *Id.* Amazon.com further noted similar laws in other states had resulted in "job and income losses." *Id.*

172. *See id.*

173. *Id.*

174. *Id.* at *3.

175. *See id.*

176. *See id.* at *1.

177. *Id.* at *3.

178. *See* Delta & Matsuura, *supra* note 27, at 15-72.

179. *Id.* at 15-78.

Revenue with regards to date, amounts, and categories of all purchases where taxes were not collected, and (3) "provide to the Colorado Department of Revenue, the names, addresses, and purchase amounts of all Colorado customers for whom tax was not collected by March 1 of each year."[180]

The Colorado law also provided for a detailed schedule of penalties if the out-of-state retailer failed to comply with a particular provision.[181] If a retailer failed to provide notice to the customer, for example, a $5 penalty applied to every violation.[182] If a retailer did not comply with the second requirement, a $10 penalty per violation applied each time that the invoice did not have the necessary notice.[183]

According to George B. Delta and Jeffrey H. Matsuura, authors of *Law of the Internet: State Taxation of Electronic Commerce*, Colorado's law is the "most ingenious effort by any state to circumvent Quill since the decision in 1992, and if it succeeds, the authors expect other states to copy it."[184]

## VIII. ALTERNATIVES

In light of the questionably constitutionality of the "Amazon tax" and its unlikely success due to Amazon.com's reaction, this section discusses possible alternatives to successful tax collection.

### A. *Congressional Action*

One alternative is for Congress to pass legislation allowing states to require out-of-state vendor's collection of taxes.[185] Among various important conclusions reached in *Quill*, the Supreme Court made a crucial distinction between the Commerce Clause and the Due Process Clause in connection to the physical presence requirement and taxing out-of-state vendors.[186] Prior to *Quill*, the controlling decision in *National Bellas Hess* meant that both under the Due Process Clause and the Commerce Clause, a requirement of a minimal physical presence was necessary before a state could tax out-of-state retailers.[187] Congress was "powerless to enact laws enabling states to compel out-of-state vendors to collect tax, where those

180. *Id.* at 15-78.
181. *See id.* at 15-78.
182. *See id.*
183. *See id.*
184. *Id.*
185. *See* Gaylord, *supra* note 151, at 2029-30.
186. *See* HARDESTY, *supra* note 2, at ¶ 14.03[1], ¶ 2.
187. *See Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 756-57 (1967).

vendors ha[d] no physical presence in a state" because Congress cannot authorize a violation of the Due Process Clause.[188]

As previously mentioned, the *Quill* Court held physical presence was *not* required under the Due Process Clause, even though it was required under the Commerce Clause.[189] The purpose of this differentiation was to indicate Congress had the power to pass legislation giving states power to require tax collection from out-of-state vendors.[190] In short, the Court "affirmed the power of Congress to grant to states the power to compel tax collection even when a seller does not have such a presence"[191] because "Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so."[192]

In *Quill*, the Court concluded that "[affirming the physical presence standard] 'is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve' [under the authority granted to it in the Commerce Clause]."[193] Therefore, Congress has express authority to decide what, if any, tax burdens can or should be placed on out-of-state online vendors by states.[194] Congress has yet to pass legislation on the matter.[195]

In the Journal of Multistate Taxation and Incentives, Scott M. Susko and Lucia Cucu encourage online retailers to consider legislation as a more viable alternative to litigation.[196] Although ongoing litigation can be a powerful tool it is also risky: "a single victory by a taxing authority can embolden other jurisdictions, and the response becomes something akin to trying to plug a leaking dam."[197] Instead, seeking a comprehensive federal legislative program would be more effective because Congress could potentially protect online retailers while at the same time

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188. HARDESTY, *supra* note 2, at ¶ 14.04[1], ¶ 3.

189. *See id.* at ¶ 14.03[1], ¶ 5.

190. *See id.* at ¶ 14.03[1], ¶ 5.

191. *Id.* at ¶ 14.03, ¶ 3.

192. Quill, 504 U.S. at 320.

193. Gaylord, *supra* note 151, at 2030 (alteration in original) (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992)).

194. *See id.*

195. *See id.* Although Congress has considered passing such legislation, it has been thwarted by a powerful opposition from vendors. *See id.* The legislation has thus failed to pass. *See id.*

196. *See* M. Susko & Lucia Cucu, *State and Local Governments Turn to Online Business for Tax Revenue in an Attempt to Remedy Budget Shortfalls*, 19 Sept J. MULTISTATE TAX'N 14, 17.

197. *See id.*

giving states some ability to tax them.[198] More specifically, "there may be room to negotiate with politicians and economic development agencies for solutions that keep online businesses growing in their respective jurisdictions, with the hope that these businesses benefit in-state companies."[199]

Another reason for using legislation as a solution is that it is superior to other possible solutions.[200] For example, if a state resorts to using a "reporting statute," it will not necessarily result in 100% use tax compliance.[201] Considering that the *Quill* decision is "antiquated" and that the results are not guaranteed, Congressional action is the better option.[202]

In fact, many acknowledged "[t]he *Quill* decision has created problems for courts throughout the country as they wrestle with what constitutes a substantial nexus."[203] The *Quill* decision created a "safe harbor" for many online retailers that did not have a physical presence in states.[204] Nonetheless, courts have applied the test inconsistently.[205]

The New York case *Orvis Company, Inc. v. Tax Appeals Tribunal of the State of New York* presents a telling example regarding a court's ambiguous application of *Quill*.[206] In *Orvis*, the New York court concluded that a substantial nexus "did not require a substantial physical presence in the state."[207] The court declined to "extend the physical presence standard to include the 'slightest presence,'" and, in doing so, the court established two justifications.[208] First, the physical presence standard was necessary in order to maintain the "bright-line test that clearly demarcates the vendors who qualify for safe harbor."[209] In other words, changing or modifying this test would undermine the clarity of this test and would eventually lead to a case-by-case analysis.[210] A second justification cited by the court was the test's

198. *See id.*
199. *Id.*
200. *See* Gaylord, *supra* note 151, at 2092-93.
201. *See id.*
202. *Id.; see also* Zaprzalka, *supra* note 62, at 558.
203. Zaprzalka, *supra* note 62, at 538.
204. *See id.* at 537-38.
205. *See id.* at 538-39.
206. *See id.*; *see also* Orvis Co. v. Tax App. Trib. of N.Y., 86 N.Y.2d 165 (1995) (holding that while a physical presence need not be substantial, it must constitute more than the "slightest presence").
207. Zaprzalka, *supra* note 62, at 538.
208. *Id.* at 538 (citing Orvis, 86 N.Y.2d at 175-76).
209. *Id.* at 538.
210. *See id.*

precedential importance and reliance.[211] As it stands, the test has "'engendered substantial reliance and has become part of a basic framework of a sizeable industry.'"[212] In *Orvis*, the court found that the *Quill* decision did not necessarily require a "substantial" physical presence in a state.[213] This court thus opens a dialogue as to exactly how much presence is necessary to meet a substantial nexus requirement.[214] However, its answer is not definitive and *Quill's* physical presence test continues to pose a problem in application.[215]

Furthermore, Congressional action would also "level the playing field between in-state and out-of-state retailers by allowing the states to require Amazon.com and other remote internet retailers to collect the use tax without implicating First Amendment or dormant Commerce Clause problems."[216]

In summary, the Congressional option would resolve many of the problems that various state strategies have encountered in attempting to raise tax revenue, as it would: (1) not raise constitutional issues similar to those litigated under the Amazon tax, (2) fix the gap in use tax collection under a "reporting statute" scheme, (3) clarify an old and "antiquated" standard that has led to inconsistencies in state implementation, and (4) result in a scheme that states and companies alike would be able to identify and follow.[217]

### B. *The Streamlined Sales Tax Project*

A measure taken by states in order to smooth the tax collection process is the Streamlined Sales Tax Project (hereinafter referred to as "SSTP").[218] David E. Hardesty believes that "[i]f, in a future case, states are able to demonstrate that nationwide sales tax compliance has been substantially simplified, they may very well win Court approval to compel remote sellers to collect tax."[219] This effort was an attempt to curtail *Quill's* requirements through the use of the Streamlined

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211. *See id.*
212. Zaprzalka, *supra* note 62, at 538 (quoting Orvis, 86 N.Y.2d at 176).
213. *Id.* at 538-39.
214. *See id.* at 539.
215. *See id.*
216. Gaylord, *supra* note 151, at 2093.
217. *See id.* at 2092-93.
218. *See* HARDESTY, *supra* note 2, at 3.
219. *Id.*

Sales and Use Tax Agreement (hereinafter referred to as "SSUTA").[220]

The SSUTA sought to remove the "undue burden" asserted under the *Quill* Court by "increas[ing] the uniformity of the sales and use tax laws around the country, thereby reducing the burden imposed on interstate commerce that might result from requiring remote retailers to collect and remit taxes."[221]

In addition to reducing the burden on interstate commerce, the SSUTA also provides a more consistent set of rules.[222] For example, one clear rule under the SSUTA is that items are taxed "where they are sourced."[223] This means that if a business has a brick-and-mortar location, items bought from that location will be taxed in that state.[224] Other purchases, including online business, will be "sourced and taxed based on the location of the purchaser, indicated either by location of receipt, the purchaser's designated address, or the purchaser's address obtained for payment purposes."[225] If a purchaser with a New York residence buys an item from Amazon.com and that item is delivered to that residence, the company would then have to collect a tax from that resident.[226] This consistent set of rules would "maintain a physical presence requirement for sellers with brick-and-mortar businesses and remove any guesswork about substantial nexus for out-of-state sales; instead, the location of the purchaser (and more generally the market for an out-of-state seller's goods or services) is scrutinized for tax purposes."[227]

Many believe that SSUTA implementation is the best approach to solve the growing inconsistencies in state tax law and court decisions.[228] First, the SSUTA simplifies a complex set of tax rules while also clarifying an inconsistent set of recent state court decisions.[229] Second, the SSUTA is not only appropriate but has been strongly encouraged by the Supreme Court.[230] Specifically, in *Quill*, the Supreme Court emphasized that the physical presence standard is not perfectly suited to deal

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220. *See* Gaylord, *supra* note 151, at 2029.

221. *Id.* at 2028.

222. Zelda Ferguson, *Is the Tax Holiday Over for Online Sales?*, 63 TAX LAW.1279, 1295 (2010).

223. *Id.*

224. *Id.*

225. *Id.* at 1295-96.

226. *Id.* at 1296.

227. *Id.*

228. *See* Ferguson, *supra* note 222, at 1295-96.

229. *See id.* at 1296.

230. *See id.*

with the issues at hand and that "tax matters are best addressed by legislatures and not courts."[231]

Finally, the SSUTA is superior to a state's individual tax enactment as evidenced by the fact that even though the recent New York decision "may have produced a desirable outcome for New York State," the result was gained "at the cost of clarity and *Quill's* bright-line physical presence rule."[232] In addition, New York's and other similar statutes also "attempt[] to stretch attributable nexus to cover online solicitation" but they often go "too far to also cover passive advertising."[233] Zelda Ferguson notes the discrepancy in the application of such statutes:

> An instate Amazon Associate who favorably mentions an Amazon product in the actual website content is arguably actively soliciting customers, while an Associate that simply puts up a click-through link is only advertising. Yet under the Amazon law's solicitation presumption, contrary to Supreme Court precedent, the reverse is true. Furthermore, the statue's monetary threshold and process for rebutting the presumption of solicitation are insufficient safe harbors.[234]

In light of the holdings discussed above, this overreach often undermines the validity of the statute and ends up on "shaky constitutional" grounds.[235]

As of 2010, 22 states have actually "implemented most or all of the SSUTA provision by passing legislation implementing the agreement's simplification measures."[236] If this number continues to grow, a more consistent scheme would result for both states and online retailers to operate.

### C. *The North Carolina Approach*

North Carolina was the third state to follow New York's "Amazon" tax law.[237] After finding that the state probably lost more than $160 million in unpaid taxes for 2010, and that since 2003 North Carolina residents "engaged in more than fifty million transactions with Amazon" alone, North Carolina's

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231. *Id.*
232. *Id.*
233. *Id.* at 1297.
234. Ferguson, *supra* note 222, at 1297.
235. *See id.*
236. *Id.* at 1295.
237. Gaylord, *supra* note 151, at 2031.

Department of Revenue ("DOR") sought to collect the "use tax" that many North Carolina residents failed to pay when buying items out-of-state from internet retailers.[238] Pundits estimate that compliance with the use tax in the state currently stands at around four percent.[239]

North Carolina, like many other states including New York, first attempted to increase tax revenues by requiring the out-of-state internet vendors to collect use taxes.[240] However, the uncertainty of prior attempts by other states prompted North Carolina to follow a more creative method of use tax collection.[241] The state re-focused its efforts "toward improving use tax compliance by increasing enforcement against individual consumers."[242] North Carolina's new goal was to educate consumers about specific tax obligations when purchasing items from out-of-state vendors.[243] One way to achieve this goal was to include a "tax reporting line" on income tax forms.[244] Two separate "worksheets" gave individuals the option of reporting a use tax from purchases made out-of-state with or without the use of a receipt.[245]

The results were not favorable to the state. Perhaps not surprisingly, North Carolina did not see an increase in use tax collections after changes were made to state tax forms.[246] In a drastic move, North Carolina's DOR then issued an "audit request" requiring Amazon.com to provide a list containing: (1) the name of North Carolina residents who had purchased from Amazon.com, and (2) the specific items consumers purchased.[247] Even less surprising was that Amazon.com filed suit against North Carolina to retaliate.[248]

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238. Gaylord, *supra* note 151, at 2016-17. Gaylord notes consumers are not aware of the requirement to pay a "use tax" when buying from out-of-state online vendors. *See Id.* at 2017. Additionally, Gaylord hints that even if they do know of the requirement to pay this tax, it is easy to "ignore" due to the state's difficulty in tracking consumer's out-of-state expenditures. *Id.* at 2017, 2055. Estimates reveal compliance with the use tax is at less than four percent. *Id.* at 2017.

239. *Id.* at 2017.

240. *See id.* at 2026.

241. *See id.*

242. *Id.*

243. *See id.* at 2025.

244. *Id.* at 2027.

245. *Id.* Gaylord concludes these options presumably made it easier for taxpayers to report a "use tax" if they had not kept all the receipts for purchases made in the prior year. *See id.*

246. *See id.* at 2031.

247. *Id.* at 2017.

248. *Id.*

The online retailer filed suit against the North Carolina Department of Revenue in the Western Division of Washington and won.[249] The district court held that the DOR's request had violated Amazon.com's First Amendment rights.[250] In essence, the decision meant that the state of North Carolina would have to come up with even more creative solutions that "conform[ed] to the requirements of the First Amendment and the Commerce Clause" but that still allowed "the state to significantly increase its use tax collections."[251]

## IX. ADVICE TO ONLINE RETAILERS

Scott M. Susko and Lucia Cucu of the Journal of Multistate Taxation and Incentives, predict the trend of "expanding taxes to online transactions" is likely to endure.[252] The authors note the turmoil in the U.S. economy and expect that increased "budget shortfalls" will continue to lead to a creative "search for tax revenue by tax authorities and legislatures alike."[253] For online retailers, the trend not only signifies a risk of owing back-taxes and perhaps even interest, but also losing their "competitive advantage against their brick-and-mortar competitors."[254]

In light of the current rules, online retailers should be aware of how different forms of presence in a state can fulfill the nexus requirement.[255] For instance, it is evident that the presence of any employees, agents (such as solicitors), or a business premise in a state will create a physical presence.[256] Moreover, the requirement will likely be fulfilled if a retailer's property is used in-state to "earn income" or if there is a considerable amount of equipment in a state.[257]

It is still unclear whether the affiliate relationship creates a substantial nexus.[258] Some states argue that both the physical presence of affiliates in a state and that affiliates solicit business and generate revenue for online retailers is enough to fulfill the nexus requirement.[259] Online retailers, on the other hand, argue

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249. *Id.* at 2017-18.
250. *Id.*
251. *Id.* at 2018.
252. Susko, *supra* note 196, at 17.
253. *Id.* at 14.
254. *Id.*
255. *See* HARDESTY, *supra* note 2, at 4.
256. *See id.* at 4-5.
257. *Id.* at 10-11.
258. *See id.* at 42.
259. *See id.*

that affiliates are mere advertisers and not actual representatives.[260]

As states continue to explore independent and creative options to force collection of taxes for online sales, the legal significance of this relationship varies by state.[261] For states that have not yet adopted an "Amazon tax," it is advisable that retailers creating affiliate relationships take measures to: (1) prevent control of the affiliate, and (2) prevent the formalization of that relationship in order to avoid a nexus with that state.[262] Hardesty notes that "[a]t the very least, the vendor should avoid adopting tighter controls on the affiliates than are necessary."[263]

Online retailers are also finding creative methods to avoid nexus with specific states.[264] One such method consists of creating "clicks-and-mortar" relationship between independent businesses.[265] Amazon.com recently entered into an agreement with Borders.com where Amazon.com agreed to "develop and operate a Web site utilizing the Borders.com URL (the 'Mirror Site')."[266] While Amazon.com retains responsibility to record sales, determine prices, and deliver the product under the agreement, Borders.com is entitled to a commission or a referral fee if an item is purchased through the "Mirror Site."[267] Generally if an item is picked up in store, the sales tax will be collected by the brick-and-mortar store (in this case Borders), but the sales tax is "ordinarily not collected on this sale."[268] This type of business agreement, however, creates a structure similar to an affiliate relationship and its effect on the nexus requirement is still uncertain.[269]

## X. CONCLUSION

Despite the various hurdles imposed by constitutional limitations, as well as the problems posed by the unintended consequences experienced in states like California and North

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260. *See id.*

261. *See id.* (discussing, Geoffrey, Inc. v. S. Carolina Tax Commn., 437 S.E.2d 13, 18 (S.C. 1993); Kmart Props., Inc. v. Taxation & Revenue Dep't, 131 P3d 22 (NM S. Ct. 2005), aff'g in part and rev'g in part Kmart Props., Inc. v. Taxation & Revenue Dep't of State of NM, 131 P3d 27 (NM Ct. App. 2001)).

262. *Id.*

263. *Id.*

264. *See id.* at 83.

265. *Id.* at 84.

266. *Id.*

267. *Id.*

268. HARDESTY, *supra* note 2, at 83.

269. *See id.* at 84.

Carolina, states should continue to find other means of increasing tax revenues.[270]

The fact that the national economy continues to weaken and that states are losing a significant amount of revenue both support this conclusion.[271] Plus, the state's past "limited success" does not necessarily mean all options have been exhausted.[272] The Washington district court in North Carolina, for example, presented one option that the state could attempt.[273] Another strategy to consider would be to enact a reporting statute similar to the one used in Colorado.[274] This second option would give a state's DOR the ability to identify in-state consumers that made purchases online, and would also provide the total for all purchases.[275] With that information, a state would be able to easily identify a state resident's total use tax liability.[276]

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270. *See* Gaylord, *supra* note 151, at 2028.

271. *See id.*

272. *Id.* at 2091.

273. *See id.* at 2091-92. As mentioned above, the court suggested using a strategy where the state could "audit a remote retailer and request the names and general product information of consumers as part of that audit." *Id.* at 2091. However, there are possible constitutional issues raised by the strategy. *Id.* at 2091-92. The critical question would be whether the First Amendment would limit "the state's ability to gather information about use tax compliance when the consumer purchases expressive materials." *Id.* at 2091. Perhaps because the constitutionality of the strategy is questionable, other less problematic options should be considered. *Id.*

274. *See id.* at 2062. *See also* Colo. Rev. Stat. Ann. § 39-21-112 (West 2012).

275. *See* Gaylord, *supra* note 151, at 2063-64.

276. *See id.*