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The Gap Created by E-Commerce: How States Can Preserve Their Sales and Use Tax Revenue in the Digital Age

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THE GAP CREATED BY E-COMMERCE: HOW STATES CAN PRESERVE THEIR SALES AND USE TAX REVENUE IN THE DIGITAL AGE

I. Introduction

Since its inception in 1932, the state sales tax has become an increasingly important source of revenue for most states, including Oklahoma.[1] Today, forty-five states and the District of Columbia impose a general sales tax.[2] Nationally, these taxes resulted in $224.5 billion of revenue in 2010, which, at 31.9% of total state tax collections, represents the second greatest source of state revenue.[3] Oklahoma collected $5,164,499,000 in revenue in 2010.[4] Of that total, approximately 38%, or $1,968,309,000, came from general sales taxes.[5] States that do not impose a state income tax—such as Florida, Nevada, Texas, and Washington—rely even more heavily on sales tax dollars, with sales taxes generating a majority of their tax revenues.[6]

Retail sales taxes, or simply "sales taxes," are a levy on the sale of tangible, personal property, imposed on a transaction-by-transaction basis, measured by the "sales price" or "gross

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[1] *The Growth of State and Local Sales Taxation, in* WALTER HELLERSTEIN, HELLERSTEIN & HELLERSTEIN: STATE TAXATION ¶ 12.02 (3d. ed. 2011), *available at* 1999 WL 1398963, at *1 [hereinafter *Growth of Sales Taxation*].
[2] Only Alaska, Delaware, Montana, New Hampshire, and Oregon have no general sales tax. MELISSA BRAYBROOKS ET AL., U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2010, at 3 (Mar. 2011), *available at* http://www2.census.gov/govs/statetax/2010stcreport.pdf [hereinafter 2010 SUMMARY REPORT].
[3] General sales taxes were second only to revenue from individual income taxes, which accounted for 33.5% of total tax revenue. *Id.* at 3 fig. 1.
[4] *Id.* at app. tbl. A-1.
[5] *Id.*
[6] *Growth of Sales Taxation*, *supra* note 1, ¶ 12.02, *available* at 1999 WL 1398963, at *1.

proceeds" of the sale.[7] Generally, although the consumer bears the economic incidence of the tax, the vendor, or seller, collects and remits the appropriate amount of sales tax to the state.[8] Because states only have jurisdiction to impose sales taxes on transactions occurring within their borders, states impose a complementary tax known as the "use tax" to prevent tax evasion.[9] The use tax is a levy upon "the use, storage, or other consumption in the state of tangible personal property that has not been subjected to a sales tax," generally measured by the "cost price," "purchase price," or "fair market value" of the property brought into the state.[10] The sales tax and use tax work together to ensure that all purchases of tangible personal property, whether transacted within or outside of the state, are subject to a uniform tax burden.[11] This diminishes the possibility of tax avoidance through out-of-state purchases and protects local businesses from out-of-state competitors that can offer lower prices because of lower or nonexistent sales tax burdens.[12]

Although the use tax imposes a tax on purchases of the same items at the same rate as the state sales tax, use taxes differ in an important way—unlike sales taxes, where the vendor collects and remits the tax due, individual purchasers are often responsible for reporting and remitting any use tax due to their state taxing authority.[13] This individual burden stems from the Supreme Court's decision in *Quill Corp. v. North Dakota*, in which the Court held that states are constitutionally prevented from requiring out-of-state sellers to collect and remit sales tax when

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[7] *Introduction to the American Retail Sales Tax, in* HELLERSTEIN, *supra* note 1, ¶ 12.01, *available at* 1999 WL 1398962, at *2 [hereinafter *American Retail Sales Tax*]; *Introduction to Chapter 16 – Use Taxes, in* HELLERSTEIN, *supra* note 1, ¶ 16.01, *available at* 1999 WL 1399001, at *4 [hereinafter *Introduction*].
[8] *American Retail Sales Tax, supra* note 7, ¶ 12.01, *available at* 1999 WL 1398962, at *2.
[9] *Introduction, supra* note 7, ¶ 16.01, *available at* 1999 WL 1399001, at *2.
[10] *Id.*
[11] 67B AM. JUR. 2D *Sales and Use Taxes* § 1.
[12] *Id.* § 134.
[13] Zelda Ferguson, *Is the Tax Holiday Over for Online Sales?*, 63 TAX LAW. 1279, 1281 (2010).

those vendors do not have a substantial nexus with—or physicial presence within—the taxing state.[14] Use tax reliance on individual self-reporting can lead to major revenue losses for states. Not only are many individuals unaware that they are required to remit use tax, others knowingly fail to remit use taxes because it is almost impossible for states to enforce use tax payment.[15]

Given the high dependence of state budgets on sales and use tax revenues, use tax evasion represents a serious problem, which is only heightened by the incredible growth of e-commerce. Internet purchases are often examples of remote commerce, or transactions that involve an in-state buyer and an out-of-state seller, making such purchases subject to use tax, rather than sales tax. Many Internet retailers maintain a nationwide virtual presence but have a physical presence in only one or two states. Because these sellers frequently do not have the required nexus with the state where the purchaser resides, they do not have to collect and remit the use tax imposed by that state on the transaction. Given the low use tax compliance rates by individual purchasers, the more transactions that take place over the Internet in interstate commerce, the less revenue states collect.

E-commerce represented 7% of total retail and food sales in 2010 and is predicted to reach $248.7 billion in revenue by 2014.[16] Some have forecasted an e-commerce sales growth rate of 9% each year through 2012 despite the recession.[17] The National Conference of State Legislatures predicts that states will lose an estimated $23.3 billion in 2012 because they are

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[14] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

[15] Ferguson, *supra* note 13, at 1281.

[16] *Online Retail Sales*, NAT'L RETAIL FED'N, tbls. 1 & 2, http://www.nrf.com/modules.php?name=Pages&sp_id=1240 (last visited Nov. 6, 2011).

[17] Donald Bruce, William Fox & LeAnn Luna, *State and Local Sales Tax Revenue Losses from E-Commerce*, 52 STATE TAX NOTES 537, 537 (2009).

prohibited from requiring online or catalog vendors to collect and remit sales and use taxes.[18] Others have estimated that there will be annual state and local tax losses from e-commerce of $11.4-12.65 billion by 2012 for a six-year total loss of $52-56.3 billion.[19] This number increases by $6.8 billion if losses from sales by other remote vendors, such as mail-order sales, are included.[20] These revenue losses are particularly troubling because of the major fiscal challenges states continue to face, despite the beginning of a slow economic recovery this year.[21] Given the grim fiscal circumstances of the states, the poisonous nature of tax rate increases in the current political climate, and the major loss of revenue from the failure of individuals to remit use tax, it is not surprising that states are seeking to circumvent, overturn, or re-interpret the *Quill* decision in order to require remote vendors to collect and remit use tax.

Part II of this paper examines the current constitutional restrictions on state taxing authority as set out in the Supreme Court's 1992 *Quill* decision. The next section, Part III, introduces the Streamlined Sales and Use Tax Agreement (the "SSUTA") and the federal bills that seek to implement a national solution to the problem created by *Quill*. Part IV discusses the different approaches that individual states have taken in attempting to circumvent the restrictions set out in *Quill* in the absence of a federal solution. Part V analyzes a new approach, not yet taken by any state, one that advocates interpreting *Quill*'s constitutional restrictions to be inapplicable if states compensate remote vendors for the cost of collecting and remitting use

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[18] *Collecting E-Commerce Taxes: An Interactive Map*, NAT'L CONF. OF ST. LEGISLATURES, http://www.ncsl.org/default.aspx?tabid=20274 (last visited Nov. 6, 2011).
[19] Bruce, Fox & Luna, *supra* note 17, at 537.
[20] *Id.*
[21] Elizabeth McNichol, Phil Oliff & Nicholas Johnson, *States Continue to Feel Recession's Impact*, CENTER ON BUDGET AND POL'Y PRIORITIES (June 17, 2011), http://www.cbpp.org/cms/index.cfm?fa=view&id=711.

taxes. Part VI concludes this note with a brief summary and analysis of the different approaches states can take in response to *Quill*.

II. Current Law - *Quill Corp. v. North Dakota*

A. Setting the Stage for *Quill*

When the Court decided *Quill Corp. v. North Dakota* in 1992, it specifically noted that it was not resolving the case on a blank slate, and that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today."[22] Because the Court's *Quill* opinion emphasized "adherence to settled precedent" and focused on harmonizing the holdings of *National Bellas Hess, Inc. v. Department of Revenue of Illinois* and *Complete Auto Transit, Inc. v. Brady*,[23] knowledge of the facts and holdings of those cases is essential to understanding the Court's subsequent decision in *Quill*.

1. *National Bellas Hess, Inc. v. Department of Revenue of Illinois*

National Bellas Hess, Inc. v. Department of Revenue of Illinois, arose when the State of Illinois obtained a judgment from the Illinois Supreme Court that required National Bellas Hess ("National"), a mail order house incorporated in Delaware with its principal place of business in Missouri, to collect and remit use taxes imposed by Illinois.[24] National had no physical operations or property in Illinois, no employees or sales representatives in Illinois, and did not advertize by newspaper, billboards, radio, or television in Illinois.[25] The only contacts that National had with Illinois were through United States mail or common carrier, as twice a year it mailed catalogues to all of its active and recent customers—including customers in Illinois—in

[22] Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992).
[23] *Id.* at 309-18.
[24] Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 753-54 (1967).
[25] *Id.* at 754.

addition to mailing out occasional advertising flyers.[26] Customers would then mail orders for merchandise back to National's Missouri plant, with the ordered goods sent back to the customers by mail or common carrier.[27]

Illinois law required all retailers "maintaining a place of business" in Illinois to collect and remit use tax.[28] The state's tax code defined a "retailer maintaining a place of business" in Illinois as one "[e]ngaging in soliciting orders within this state from users by means of catalogues or other advertising, whether such orders are received and accepted within or without this State."[29] Under this definition, the Illinois Supreme Court found National's mail order operations sufficient to classify National as a "retailer maintaining a place of business" in Illinois, and therefore required National to collect and remit Illinois use tax.[30] National challenged the Illinois statute as a violation of the Fourteenth Amendment Due Process Clause and the Dormant Commerce Clause.[31] The United States Supreme Court agreed with National on both grounds and reversed the Illinois Supreme Court, finding the Illinois law unconstitutional.[32]

The Court began by affirming the close relationship of Due Process claims and claims of an unconstitutional burden on interstate commerce.[33] The Court noted that for states to constitutionally "impose the burdens of collecting use taxes upon interstate sales," there must be "some definite link, some minimum connection, between a state and the person, property, or

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[26] *Id.*
[27] *Id.* at 754-55.
[28] *Id.* at 755.
[29] *Id.*
[30] *Id.* at 753-55.
[31] *Id.* at 756.
[32] *Id.* at 756-60.
[33] *Id.* at 756.

transaction it seeks to tax."[34] The Court then proceeded to list three separate instances in which it had upheld the power of states to impose collection and remittance liability on out-of-state sellers: where the sales were arranged by local agents in the taxing state, where the mail order seller maintained local retail stores, and where the out-of-state seller had independent contractor salespersons conducting continuous local solicitation in the taxing state.[35]

However, the Court emphasized that it "ha[d] never held that a State may impose the duty of use tax collection and payment upon a seller whose *only connection* with customers in the State is by common carrier or the United States mail,"[36] and had in fact ruled that a state could not constitutionally impose a use tax obligation upon an out-of-state seller whose only contacts with the taxing state were in-state advertisements and merchandise deliveries.[37] The Court refused to obliterate the distinction between out-of-state sellers with property, retail outlets, or solicitors within a state and remote vendors who lack a physical presence within the taxing state and communicate with customers only through mail or common carrier.[38] The Court feared that the many political subdivisions authorized to impose use tax and "[t]he many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements" would "entangle [] interstate business[es] in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government.'"[39] As such, the imposition of use tax collection and remittance obligations on out-

[34] *Id.* (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954)).
[35] *Id.* at 757-58.
[36] *Id.* at 758 (emphasis added).
[37] *Id.* (citing *Miller Bros.*, 347 U.S. 340).
[38] *Id.*
[39] *Id.* at 759-60.

of-state retailers without a physical presence in the state was an unconstitutional burden on interstate commerce and violated the Due Process Clause of the Fourteenth Amendment.[40]

2. *Complete Auto Transit, Inc. v. Brady*

The issue in *Complete Auto Transit, Inc. v. Brady*, decided ten years after *Bellas Hess,* was whether a Mississippi tax on "'the privilege of … doing business' within the State," as applied to the taxpayer's interstate commerce activities, unconstitutionally burdened interstate commerce.[41] The taxpayer in *Complete Auto* was a Michigan corporation that transported General Motors Corporation vehicles by truck from a Mississippi railway station to Mississippi dealerships.[42] The taxpayer claimed that because "its transportation was but one part of an interstate movement," the "taxes assessed and paid were unconstitutional as applied to operations in interstate commerce."[43] However, the Mississippi Supreme Court sustained the tax, relying on the taxpayer's large business operation in Mississippi that was "dependent on the State for police protection and other State services the same as other citizens."[44] The state court believed that the taxpayer should have to "pay its fair share of taxes so long, but only so long, as the tax does not discriminate against interstate commerce and there is no danger of interstate commerce being smothered by cumulative taxes of several states."[45]

On appeal, the taxpayer relied solely on the "*Spector* rule," which prohibited states from applying a state business privilege tax to an activity that was part of interstate commerce.[46] Conversely, Mississippi cited language from earlier Supreme Court cases that looked to the

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[40] *Id.* at 760.
[41] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 274 (1977).
[42] *Id.* at 276.
[43] *Id.* at 277.
[44] *Id.* (quoting Complete Auto Transit, Inc. v. Brady, 330 So.2d 268, 272 (Miss. 1976)).
[45] *Id.* (quoting *Brady*, 330 So.2d at 272).
[46] *Id.* at 278 (citing Spector Motor Serv. v. O'Connor, 340 U.S. 602 (1951)).

practical effect of a tax statute rather than just its formal language and had held that "[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business."[47]

Finding the *Spector* rule merely "a trap for the unwary draftsman,"[48] the Court in *Complete Auto* chose to expressly overrule the *Spector* rule.[49] Noting that it had previously rebutted the proposition that interstate commerce is immune from state taxation, the majority further rejected the formalism of the *Spector* rule and chose to adopt a rule with practical significance and economic consequence.[50] The Court then held that states can constitutionally impose taxes on interstate commerce, so long as the tax (1) is applied to an interstate activity with a substantial nexus with the taxing state (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state.[51]

B. *Quill Corp. v. North Dakota*

1. Facts

The facts of *Quill Corp. v. North Dakota* are similar to those that gave rise to *Bellas Hess* over twenty years before.[52] Both cases involved state attempts to require an out-of-state mail-order business to collect and remit use tax on goods purchased by state residents for use within the state.[53] In both cases, the taxpayers solicited business in the taxing state through catalogues and flyers but did not have any tangible property or personnel in the taxing state.[54] Additionally,

[47] *Id.* at 279 (quoting W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).
[48] *Id.*
[49] *Id.* at 288-89.
[50] *Id.*
[51] *Id.* at 279, 287.
[52] Quill Corp. v. North Dakota, 504 U.S. 298, 301 (1992).
[53] *Id.*
[54] *See Quill*, 504 U.S. at 302; Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 754-55 (1967).

in both *Bellas Hess* and *Quill*, the state statute required retailers "maintaining a place of business in" the state to collect and remit the state's use tax and defined "retailer" to include mail-order companies without a physical presence if they solicited business within the state through catalogues and flyers.[55] More specifically, in *Quill*, the North Dakota statute's definition of "retailer" included "every person who engages in regular or systematic solicitation of a consumer market in th[e] state," meaning anyone who advertised in North Dakota three or more times within a 12-month period.[56]

On these facts, the trial court ruled for Quill, the taxpayer, because it found no "nexus to allow the state to define retailer in the manner it chose," making this case virtually indistinguishable from *Bellas Hess*.[57] However, the North Dakota Supreme Court reversed, holding *Bellas Hess* constituted an "obsolescent precedent," and that blindly following it would result in "ignor[ing] the tremendous social, economic, commercial, and legal innovations [that have occurred] since 1967."[58] Factually, the North Dakota Supreme Court highlighted the incredible growth of the mail order industry, from "a relatively inconsequential market niche into a goliath" worth $183.3 billion, or 15% of total national retail sales, and the transformative impact of modern technology on the method of operating a mail-order direct marketing business.[59] Moreover, the North Dakota court also emphasized changes that had occurred in the "legal landscape" following the Court's decision in *Bellas Hess*.[60] The court noted that under the four-pronged test set out in *Complete Auto Transit, Inc. v. Brady,* as applied in subsequent cases, the Commerce Clause no longer required the physical-presence nexus standard established in

[55] *Quill*, 504 U.S. at 302-03; *Bellas Hess*, 386 U.S. at 755.
[56] *Quill*, 504 U.S. at 302-03.
[57] *Id.* at 303.
[58] North Dakota v. Quill Corp., 470 N.W.2d 203, 208 (N.D. 1991).
[59] *Id.* at 208-09.
[60] *Id.* at 209.

Bellas Hess, but looked more broadly at "the relationship between the out-of-state seller's contacts with the state and its establishment and maintenance of sales within the state."[61] Additionally, under the Supreme Court's more recent Due Process cases, the "minimum contacts" and "fair warning" requirements of the Due Process Clause were found satisfied in personal jurisdiction cases when an out-of-state defendant "'purposefully directed' his activities at residents of the forum" state.[62] Because Quill "'purposefully directed' its activities at North Dakota residents," North Dakota "could, consistent with Due Process" require Quill to collect and remit use tax.[63] The Supreme Court disagreed, and reversed the decision of the North Dakota Supreme Court.[64]

2. Opinion

Despite its claim in *Bellas Hess* that the tests for the Commerce Clause and the Due Process Clause were "closely related" and "similar," the Court began its analysis in *Quill* by stating that "[t]he two constitutional requirements differ fundamentally in several ways," as they "reflect different constitutional concerns" and are therefore "analytically distinct."[65] Therefore, it explained, "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."[66] The Court then proceeded to overrule *Bellas Hess*'s due process holding but affirm the bright-line physical-presence nexus requirement of *Bellas Hess* on Commerce Clause grounds.[67]

a) Due Process Analysis

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[61] *Id.* at 210-12.
[62] *Id.* at 212.
[63] *Id.*
[64] Quill Corp. v. North Dakota, 504 U.S. 298, 319 (1992).
[65] *Id.* at 305.
[66] *Id.*
[67] *Id.* at 308, 317-18.

According to the Court, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax.'"[68] Similarly, for the purpose of judicial jurisdiction, due process requires that a potential defendant's minimum contacts be "such that the maintenance of the suit [against him] does not offend 'traditional notions of fair play and substantial justice.'"[69] Although the Court conceded that in *Bellas Hess* it had "suggested" that physical presence within the state was necessary in order to satisfy the minimum contacts test,[70] it emphasized that the *Bellas Hess* decision preceded the subsequent, substantial evolution of its due process jurisprudence in the realm of judicial jurisdiction.[71]

The most significant due process development that the *Quill* Court cited was the recognition, in *Burger King Corp. v. Rudzewicz*,[72] that "jurisdiction … may not be avoided merely because the defendant did not *physically* enter the forum state."[73] In fact, the Court in *Burger King* found that "the notion that an absence of physical contacts can defeat jurisdiction" has been "consistently rejected."[74] Instead, a court has jurisdiction "[s]o long as a commercial actor's efforts are '*purposefully directed*' toward residents of [the forum] State."[75] In rejecting the physical presence requirement for jurisdictional due process purposes, the *Burger King* opinion specifically noted: "it is an inescapable fact of modern commercial life that a substantial

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[68] *Id.* at 306 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954)).
[69] *Id.* at 307 (quoting Int'l Shoe Co. v. Washington, 326 U.S. 310, 316 (1945)).
[70] *Id.* at 306-07.
[71] *Id.* at 307.
[72] 471 U.S. 462 (1985).
[73] *Quill*, 504 U.S. at 307-08 (quoting *Burger King*, 471 U.S. at 476).
[74] *Id.* at 308 (quoting *Burger King*, 471 U.S. at 476).
[75] *Id.* (quoting *Burger King*, 471 U.S. at 476) (emphasis added).

amount of business is transacted solely by mail and wire communication across state lines, thus obviating the need for physical presence within a State in which business is conducted."[76]

The Court in *Quill* found this logic also justified "the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State" and affirmatively held that "[t]he requirements of due process are met *irrespective* of a corporation's lack of physical presence in the taxing State," thus overruling *Bellas Hess*'s due process holding.[77] Because Quill "purposefully directed" its business activities at North Dakota and the extent of its contacts with North Dakota residents satisfied the minimum contacts due process standard, the Due Process Clause did not prevent the imposition and enforcement of use tax obligations against Quill.[78]

b) Commerce Clause Analysis

The Court began its analysis of Quill's Commerce Clause challenge by explaining that the Commerce Clause, in addition to *expressly* providing Congress with regulatory authority over interstate commerce, also *implicitly* prohibits states from taking certain actions that interfere with or burden interstate commerce.[79] This is known as the "negative" or "dormant" Commerce Clause.[80] The rule from early dormant Commerce Clause cases was simple: "no State has the right to lay a tax on interstate commerce in any form."[81] Later cases narrowed this rule and found some burdens on interstate commerce constitutional, but vacillated on the appropriate standard.[82] In 1977, in *Complete Auto Transit, Inc. v. Brady*, the Supreme Court ultimately

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[76] *Id.* (quoting *Burger King*, 471 U.S. at 746).
[77] *Id.* (emphasis added).
[78] *Id.*
[79] *Id.* at 309.
[80] *Id.*
[81] *Id.* (quoting Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888)).
[82] *Id.* at 309-10.

rejected its earlier formalistic approaches and instead adopted a four-part test that examines the "practical effect" of a state tax statute.[83]

The four-part test established in *Complete Auto* requires the Court to "sustain a tax against a Commerce Clause challenge so long as the 'tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.'"[84] The Court rejected the North Dakota Supreme Court's finding that *Complete Auto*'s four-part test "rendered *Bellas Hess* 'obsolete'" for two reasons.[85] First, although *Bellas Hess* was decided in 1967, "in the middle of [the] latest rally between formalism and pragmatism," the Court found that *Bellas Hess* was distinguishable from its earlier formalistic cases because the holding of *Bellas Hess* did not rely on the mere "draftsmanship" or "labeling" of state taxes.[86] Additionally, the Court found that *Bellas Hess* and *Complete Auto* can be read in harmony: *Bellas Hess* merely defines the "substantial nexus" required under *Complete Auto*'s first prong.[87] The Court found support for this proposition in *National Geographic Society v. California Bd. of Equalization*,[88] decided just three weeks after *Complete Auto*.[89] The Court claimed that *National Geographic* "affirmed the continuing vitality of *Bellas Hess*" and its "sharp distinction … between mail-order sellers [with a physical presence in the taxing] State and those … who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business."[90]

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[83] *Id.* at 310.
[84] *Id.* at 311 (quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).
[85] *Id.* at 310-12.
[86] *Id.* at 310-11.
[87] *Id.* at 311.
[88] 430 U.S. 551 (1977).
[89] *Quill*, 504 U.S. at 311 (citing Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551 (1977)).
[90] *Id.* (citing *Nat'l Geographic*, 430 U.S. at 559).

The Court in *Quill* also rejected the North Dakota Supreme Court's assertion that "the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent," finding that unique constitutional concerns and policies underlie and support the two different standards.[91] For example, the due process nexus analysis requires "notice" or "fair warning," because the Due Process Clause ensures that governmental activity is "fundamental[ly] fair[]" and "legitimate."[92] In contrast, the nexus requirement of the Commerce Clause serves to protect the national economy from the any negative structural effects stemming from state regulation of interstate commerce.[93] Accordingly, the first and fourth prongs of the *Complete Auto* test serve as an important check on state power to impose taxes that unduly burden interstate commerce by requiring a substantial nexus and relationship between the tax and state-provided services.[94] Therefore, "contrary to the State's suggestion, a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with the State as required by the Commerce Clause."[95]

Finally, the Court explained why the bright-line physical-presence test of *Bellas Hess* is still good law, despite the Court's recent trend away from formalistic tests and toward "a more flexible substantive approach."[96] The Court concluded that modern Commerce Clause jurisprudence "favor[ing] more flexible balancing analyses" does not automatically overrule all established "bright-line" tests, particularly those that effectively prevent states from unduly burdening interstate commerce.[97] Unlike earlier formalistic bright-line rules that distinguished

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[91] *Id.* at 312.
[92] *Id.*
[93] *Id.*
[94] *Id.* at 313.
[95] *Id.*
[96] *Id.* at 314.
[97] *Id.*

merely between the statutory draftsman's choice of language, the Court concluded that the physical-presence rule of *Bellas Hess* actually furthers the ends of the Commerce Clause by creating a "safe harbor" for remote vendors.[98] While the rule might "appear[] artificial at its edges," that is not dispositive, as the rule's "artificiality… is more than offset by the benefits of a clear rule," particularly in the realm of state taxation where various precedents often create a "quagmire."[99]

Because the *Bellas Hess* rule "ha[d] engendered substantial reliance," the Court found there was "continuing value" in having a bright-line rule.[100] Based on that continuing validity and principles of *stare decisis*, the Court held that the Commerce Clause ruling of *Bellas Hess* remains good law.[101] Because the Court clarified that only the Commerce Clause, and not the Due Process Clause, requires a physical presence, the Court explicitly invited Congress to use its regulatory authority under the Commerce Clause and consider "whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[102]

3. Implications

The holding of *Quill* is clear: the dormant Commerce Clause—but not the Due Process Clause—prohibits states from requiring out-of-state vendors without a substantial nexus with the taxing state to collect and remit the state's use tax. Under *Quill* and *Bellas Hess*, the substantial nexus requirement is only met by satisfaction of the bright-line physical presence rule. Unfortunately, today, with the emergence of e-commerce, *Quill* applies to an incredible number of remote vendors, as its holding extends beyond its facts to any interstate vendor without a

[98] *Id.* at 314-15.
[99] *Id.* at 315.
[100] *Id.* at 317.
[101] *Id.*
[102] *Id.* at 318-19.

physical presence in the taxing state, not just mail-order businesses. However, two aspects of *Quill* should give even its greatest critics hope: (1) its due process holding and (2) the Court's rationale for upholding the physical presence requirement of *Bellas Hess*.

One of the most important aspects of the *Quill* opinion, often glossed over by its critics, is its due process holding. In *Quill*, the Court expressly rejected the idea that the Due Process Clause prevents states from imposing use tax obligations on remote sellers, merely because those vendors lack physical presence within the taxing state. By requiring only that the vendors satisfy the much lower "purposeful direction" standard, the Court practically eliminated any due process concerns from consideration. Even more importantly, as acknowledged in its opinion, by "putting [the due process] problem to rest," "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[103] While Congress does not have the authority to permit states to infringe the due process rights of interstate actors, Congress can constitutionally regulate interstate commerce, which includes the power to expressly authorize the states to burden interstate commerce in certain ways. The *Quill* decision, as opposed to *Bellas Hess*, is accordingly much less constitutionally restrictive and gives states the opportunity to either lobby Congress or seek to undermine the "burden" rationale of the Court's Commerce Clause analysis.

The Court's two rationales for upholding the physical-presence requirement of *Bellas Hess* were "the continuing value of a bright-line rule" and *stare decisis*. This means that states can undermine the *Quill* decision by attacking the weaknesses of either or both of these rationales. The Court found that the benefits of the bright-line rule outweighed its artificiality. Those benefits centered on encouraging settled expectations and the fact that the rule had

[103] *Id.*

engendered substantial reliance. However, given the massive amounts of lost revenue stemming from *Quill*'s prohibition, the incredible growth and strength of the e-commerce industry, and the burden and inequality confronting Main Street retailers, who must collect and remit the tax, the Court might find that the benefits of the bright-line rule might no longer outweigh its artificial edges, were the question to come before the Court again. The Court's other rationale is also susceptible to attack. Although *stare decisis* is an important principal, it only makes sense to uphold an earlier rule that is still relevant and controlling today. While the Court in *Quill* rejected the North Dakota Supreme Court's argument that the technology and industry of 1992 were sufficiently different from *Bellas Hess* to warrant overruling it, the time might be ripe today in the face of the e-commerce industry. Regardless, states can also seek to avoid *stare decisis* in a more indirect way—by undermining the rationale provided in *Bellas Hess*, states also weaken *Quill*'s reliance on *Bellas Hess*.

III. Overturn *Quill* - The Federal Approach

A senator first requested Congress accept the Supreme Court's invitation and provide a national solution to the states' remote vendor problem only two years after the Court's *Quill* decision.[104] On February 3, 1994, Senator Dale Bumpers introduced Senate Bill 1825, known as the Tax Fairness for Main Street Business Act of 1994.[105] The bill was read twice and referred to the Committee on Finance where it died.[106] The bill never made it back to the Senate floor for a vote.[107] Over the years, Congress has continuously failed to act on the issue despite the

[104] *S. 1825: Tax Fairness for Main Street Business Act of 1994*, GOVTRACK.US., http://www.govtrack.us/congress/bill.xpd?bill=s103-1825 (last visited Nov. 6, 2011).
[105] *Id.*
[106] *Id.*
[107] *Id.*

introduction of relevant bills in the House or Senate almost annually.[108] This has resulted in Congress upholding a destructive public policy that disadvantages local businesses, undermines state and local governments by reducing their tax revenues, and makes a regressive tax even more regressive, as those who can take advantage of the internet retailers' tax exemption are only those with internet access, a credit card, and a home or workplace that allows them to accept daytime deliveries.

In 2011 alone, members of Congress have introduced four bills—Senate Bill 1832, House Bill 3179, Senate Bill 1452, House Bill 2701—that would remedy this flawed public policy and grant states the authority to require certain remote vendors, particularly e-retailers, to collect and remit sales or use tax to participating states.[109] All four of these bills have been referred to committee,[110] although it is doubtful whether any will make it past the committee and subcommittee stage, much less become law given the historical treatment of these types of proposals and the current anti-tax political climate. All four bills require states seeking to collect tax from remote sellers to implement a simplified system for the administration of their sales and

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[108] *See, e.g.*, Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (2003); Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (2003); Consumer and Main Street Protection Act, S. 1586, 105th Cong. (1998); Consumer and Main Street Protection Act, S. 545, 104th Cong. (1995).

[109] Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. (2011).

[110] *See S. 1832: Marketplace Fairness Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=s112-1832 (last visited Nov. 6, 2011); *H.R. 3179: Marketplace Equity Act of 2011*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=h112-3179 (last visited Nov. 6, 2011); *S. 1452: Main Street Fairness Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=s112-1452 (last visited Nov. 6, 2011); *H.R. 2701: Main Street Fairness Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=h112-2701 (last visited Nov. 6, 2011).

use tax collection.[111] Senate Bill 1452 and House Bill 2701 act by simply granting Congress's approval to a preexisting voluntary state agreement known as the Streamlined Sales and Use Tax Agreement, allowing the agreement to become binding.[112] In contrast, House Bill 3179 contains its own simplification requirements for states wishing to impose a collection obligation on remote vendors and does not require states to become member states of the State Sales and Use Tax Agreement.[113] S.B. 1832 is a hybrid of these two approaches: it grants authority for tax collection to Member States of the Streamlined Sales and Use Tax Agreement while simultaneously providing an alternative simplification procedure that non-member states can choose to instead implement.[114]

A. The Streamlined Sales and Use Tax Agreement

The Streamlined Sales and Use Tax Agreement (the "SSUTA") is the cooperative product of the Streamlined Sales Tax Project, a multistate effort organized by the National Governors Association and the National Council of State Legislatures to provide a simplified sales and use tax system that is neutral, efficient, certain and simple, effective and fair, and flexible.[115] Forty-four states joined in the creation of the SSUTA, which operates as "a sort of

[111] Marketplace Fairness Act, S. 1832, 112th Cong. § 3 (2011); Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. § 2 (2011); Main Street Fairness Act, S. 1452, 112th Cong. § 4 (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. § 4 (2011).
[112] Main Street Fairness Act, S. 1452, 112th Cong. § 4 (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. § 4 (2011).
[113] Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. § 2 (2011).
[114] Marketplace Fairness Act, S. 1832, 112th Cong. § 3 (2011).
[115] *See* Kathleen Hale & Ramona McNeal, *Technology, Politics, & E-commerce: Internet Sales Tax & Interstate Cooperation*, 28 GOV'T INFO. Q. 262, 263 (2011); Christopher G. Reddick & Jerrell D. Coggburn, *E-commerce & the Future of the State Sales Tax System: Critical Issues & Policy Recommendations*, 30 INT'L J. PUB. ADMIN. 1021, 1036-37 (2007).

model tax code" that adopting states can "adapt to reflect their individual choices."[116] Twenty-four states—including Oklahoma—have passed legislation conforming their state and use tax codes to the requirements of the SSUTA.[117] The SSUTA improves tax administration in three major ways: (1) code simplification; (2) more efficient administration procedures; and (3) the use of emerging technologies, such as databases and administrative software.[118]

Adoption of the SSUTA results in code simplification because the SSUTA requires "uniform tax definitions; uniform and simpler exemption administration; rate simplification; state-level administration of all sales taxes; uniform sourcing (where the sale is taxable); and state funding of the administrative cost."[119] Uniformity greatly benefits businesses operating in SSUTA member states by reducing administrative expenses and decreasing uncertainty.[120] It allows businesses to look to only one source for exemption definitions, limits the number of tax rates businesses must learn and apply, and permits business to file only a single tax return with each state in which it operates, which prevents business from having to deal with a multitude of state and local governments and all their differing requirements.[121] Administration is also made simpler through the use of technology.[122] For example, each member state must provide a database with the tax rate for each of its local jurisdictions, matched up with the nine-digit zip codes in each local jurisdiction to ensure that businesses are clear on what rates apply in each

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[116] Hale & McNeal, *supra* note 115, at 264; *Frequently Asked Questions*, STREAMLINED SALES TAX GOVERNING BOARD, INC., http://www.streamlinedsalestax.org/index.php?page=faqs (2011) [hereinafter *FAQ*].

[117] The twenty-four member states include Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rohde Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. *FAQ*, *supra* note 116.

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.*

[122] *Id.*

area.[123] Furthermore, SSUTA states partner with the one of six certified companies in the private sector to supply sales tax administration software that makes it simple to calculate the tax owed on each purchase in each jurisdiction.[124] The SSUTA states bear the cost of this service for any business without a physical presence in the state, in addition to compensating businesses for other reasonable expenses incurred in the collection of sales tax.[125]

The SSUTA is a voluntary agreement, both in the sense that states voluntarily choose to become full members by adopting compliance legislation and also that remote vendors with customers in member states volunteer to collect and remit tax.[126] Member states can provide vendors with incentives to collect the tax—both by diminishing the accompanying burden and by offering more direct advantages like amnesty on previously unremitted taxes—but they cannot force sellers to comply.[127] However, three of the bills pending before Congress would change that by ratifying the SSUTA, [128] which would transform the SSUTA into "an interstate compact with the force of federal law," enforceable against remote vendors.[129] For example, Senate Bill 1832 authorizes SSUTA member states "to *require* all sellers not qualifying for a small seller exception to collect and remit sales and use taxes with respect to remote sales sourced to that Member State pursuant to the provisions of the Streamlined Sales and Use Tax Agreement."[130]

Ratifying the SSUTA is a common tactic in relevant federal bills because of its simplicity—congressional representatives advocating for this method do not have to reinvent the

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[123] *Id.*
[124] *Id.*
[125] *Id.*
[126] Hale & McNeal, *supra* note 115, at 263.
[127] *Id.* at 264.
[128] Marketplace Fairness Act, S. 1832, 112th Cong. § 3 (2011); Main Street Fairness Act, S. 1452, 112th Cong. § 4 (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. § 4 (2011).
[129] Hale & McNeal, *supra* note 115, at 264.
[130] Marketplace Fairness Act, S. 1832, 112th Cong. § 3 (2011) (emphasis added).

wheel, but merely advocate for the ratification of an agreement that has existed for over a decade.[131] This approach has broad support. For example, the Marketplace Fairness Act, which would ratify the SSUTA, had bipartisan support in its sponsorship when it was introduced last November.[132] Additionally, the National Governors Association, the National Conference of State Legislatures, the Federation of Tax Administrators, the Multistate Tax Commission, and many large retailers support the SSUTA.[133] The Streamlined Sales Governing Board promotes the SSUTA as an equalizer for remote vendors and local "brick-and-mortar" stores. Others have endorsed the SSUTA as an alternative to the piecemeal, constitutionally questionable laws adopted by some states in response to frustration with the lack of another option.[134] Opponents, however, include state and local governments who fear that the cost of compensating for administrative expenses will exceed the corresponding increase in revenue.[135] Additionally, some have raised concerns about state sovereignty and self-determination of state tax policy, which the uniformity requirements of the SSUTA threaten.[136]

B. The Non-SSUTA Bill: The Marketplace Equity Act of 2011

Despite the popularity of the SSUTA ratification approach, one of the bills introduced this year approaches the problem of crafting a national solution slightly differently. Like the other bills, the Marketplace Equity Act of 2011 authorizes electing states to require remote vendors to collect and remit sales and use taxes with respect to their sales to customers within

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[131] *See FAQ*, *supra* note 116.
[132] Senator Michael Enzi (R-WY) sponsored the bill. The bill had nine consponsors: Lamar Alexander (R-TN), Roy Blunt (R-MO), John Boozman (R-AR), Bob Corker (R-TN), Richard Rubin (D-IL), Tim Johnson (D-SD), Mark Pryor (D-AR), John Reed (D-RI), and Sheldon Whitehouse (D-RI). *See S. 1832: Marketplace Fairness Act*, GOVTRACK.US. http://www.govtrack.us/congress/bill.xpd?bill=s112-1832 (last visited Nov. 6, 2011).
[133] Hale & McNeal, *supra* note 115, at 265.
[134] *See, e.g.*, Ferguson, *supra* note 15, at 1295-97.
[135] Hale & McNeal, *supra* note 115, at 265.
[136] *Id.*

those states.[137] However, to be an "electing state," states do not have to become members of the SSUTA; instead, they can act "individually or through an agreement with one or more of the several States, to satisfy the [simplification] requirements of subsection (b)."[138] This approach gives states a little more flexibility in deciding how exactly to proceed.

Section 2, subsection (b) sets out the simplification requirements electing states must satisfy and provides an exception for "small sellers." Specifically, "remote sellers with gross annual receipts in the preceding calendar year from remote sales of items, services, and other products in the United States not exceeding $1,000,000 (or such greater amount as determined by the State involved) or in the State not exceeding $100,000 (or such greater amount as determined by the State)" are exempt from the collection and remittance obligation imposed on other remote vendors by subsection (a).[139] The bill's simplification requirements include: (1) a single revenue authority to which remote sellers can submit a single tax return for all of its statewide liability; (2) a non-discriminatory, uniform tax base throughout the State; and (3) the use of one of three provided rate structures[140] that produces a non-discriminatory rate, or a rate that is not higher than the respective rate for sellers other than remote sellers.[141]

The simplification system of House Bill 3179 and the SSUTA share many characteristics. The most notable difference is merely that House Bill 3179 does not require states to join the interstate agreement to take advantage of the ability to require remote vendors to collect and

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[137] Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. § 2(a) (2011).
[138] *Id.*
[139] *Id.* § 2(b)(1).
[140] States can select from: (1) a single statewide blended rate that includes both the state rate and the applicable rates of the local taxing jurisdictions; (2) the maximum State rate, or the highest rate at which the State requires sellers to collect tax, exclusive of the tax imposed by local jurisdictions; or (3) the applicable destination rate, or the sum of the state rate and the applicable local jurisdiction rate. To select the destination rate, the State must provide remote sellers with software that eases the burden of computing destination rate liability. *Id.* § 2(b)(4).
[141] *Id.* § 2(b)(2)-(4).

remit tax. Whether through ratification of the SSUTA or adoption of a bill like House Bill 3179, there is significant reason for Congress to take action on this issue: the substantial loss of revenue confronting states, the necessity of avoiding piecemeal legislation, and the guarantee of constitutionality. However, given the number of bills already proposed and the current anti-tax climate, it is unlikely that any of the bills currently in committee will have a much greater chance of success than their predecessors. However, given that the "federal solution" remains the best one, and the recent support from companies like Amazon in response to state legislation,[142] Congress should seriously consider moving forward on the issue of state sales taxation and e-commerce.

IV. Current State Efforts to Challenge *Quill*

After waiting in vain for a federal solution, several states have taken steps on their own to challenge *Quill* and resolve the problem of Internet tax avoidance. Most states have sought to either attribute sufficient nexus to the remote vendors[143] or require the out-of-state seller to provide information to the consumer and the state regarding use tax liability for non-taxed purchases.[144] The effectiveness and probable constitutionality of the different laws vary.

A. Attributed Nexus

Quill and *Bellas Hess* require a vendor to have substantial nexus—meaning physical presence—with a taxing state before that state can require the vendor to collect and remit use tax.[145] However, an understanding of two other Supreme Court decisions are necessary to

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[142] Edward Zelinsky, *California's Once and Future 'Amazon' Law,* 62 STATE TAX NOTES 83, 96 (2011) [hereinafter *California's Amazon Law*].

[143] N.Y. TAX LAW §§ 1101(b)(8)(i)(C)(I), 1131(1) (McKinney); CAL. REV. & TAX. CODE § 6203(a), (c)(4) & (5) (eff. Sept. 15, 2012).

[144] COLO. REV. STAT. ANN. §§ 39-21-112(3.5), 39-26-102(3), (8).

[145] Quill Corp. v. North Dakota, 504 U.S. 298, 317 (1992) (upholding the physical-precense bright-line rule established in *Bellas Hess*).

complete the nexus framework: *Scripto, Inc. v. Carson*,[146] and *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*.[147] In both cases, the Court attributed nexus to the out-of-state seller based on actions of affiliated, soliciting third parties.

In *Scripto,* the Supreme Court rejected a dormant Commerce Clause argument and upheld the imposition of Florida use tax collection duties on Scripto, a Georgia corporation, even though the company did not have (1) an "office, distributing house, warehouse, or other place of business in Florida, or (2) have any regular employee or agent there."[148] The nexus between Scripto and Florida consisted of ten "advertising specialty brokers," or "wholesalers or jobbers," each of whom was a Florida resident "actively engaged in Florida as a representative 'of Scripto for the purpose of attracting, soliciting and obtaining Florida customers' for [Scripto's business]."[149] The Court found it irrelevant for nexus purposes that the "jobbers" were not regular employees of Scripto since they were "conducting continuous local solicitation" on Scripto's behalf.[150] Twenty-seven years later, relying on *Scripto*, the Court in *Tyler Pipe Industries* similarly held that a company could not defeat a showing of sufficient nexus by delineating its sales representatives "independent contractors" instead of "agents."[151] The Court concluded instead that the "crucial factor governing nexus is whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales."[152]

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[146] 362 U.S. 207 (1960).
[147] 483 U.S. 232 (1987).
[148] *Scripto*, 362 U.S. at 208-09.
[149] *Id.*
[150] *Id.* at 211.
[151] *Tyler Pipe Indus.*, 483 U.S. at 250.
[152] *Id.*

Based on *Scripto* and *Tyler Pipe Industries*, states have passed laws attempting to attribute nexus to an out-of-state or pure Internet seller, based on the presence and activities of affiliates located in the taxing state. States have attempted to attribute nexus to previously unreachable vendors either by using the vendor's in-state web affiliates (the "New York" approach) or in-state organizations in a commonly owned group with the vendor (the "California" approach).

1. Website Affiliates - The New York Approach

Some large Internet retailers like Amazon.com and Overstock.com have developed programs to allow independent third parties, known as "associates" or "affiliates," to advertise the retailer's website on the associates' own websites and to receive a commission for related purchases, pursuant to an agreement or contract between the retailer and associate.[153] Visitors to the third-party associates' websites can click on the link or banner advertising the Internet retailer, which will redirect the visitor to the retailer's own website.[154] If the visitor then makes a purchase from the retailer, the retailer pays the associate a commission.[155]

In 2008, New York sought to capitalize on these associate programs by using them to attribute nexus to previously unreachable pure Internet retailers. New York's tax code already required "every vendor of tangible personal property" to collect sales and use tax."[156] The term "vendor" included … [a] person who solicits business … by employees, independent contractors, agents, or other representatives… and by reason thereof makes sales to persons within the state

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[153] Amazon.com, L.L.C. v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 134 (N.Y. App. Div. 2010).
[154] *Id.*
[155] *Id.*
[156] N.Y. TAX LAW § 1131(1) (McKinney).

of tangible personal property or services, the use of which is taxed."[157] On April 23, 2008, New York amended its tax statutes "to reflect the reality that many sales of goods to New York residents are effected [sic] through the Internet."[158] The amendment created a rebuttable presumption that retailers using an associate program were "soliciting business [in New York] through an independent contractor or other representative,"[159] which under *Scripto* and *Tyler Pipe Industries* would constitute sufficient nexus, as the independent contractor's physical presence would be attributed to the retailer on whose behalf it solicited. More specifically, the amendment stated:

> [A] person making sales of tangible personal property or services taxable under this article ("seller") *shall be presumed* to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of [New York] 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 [New York] 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 … This presumption *may be rebutted* by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question.[160]

The amended New York statute thus has two key components: the solicitation presumption and the requirements for rebuttal.[161] The first component, the presumption, has a triggering mechanism. To incur use tax collection responsibility under section 1101(b)(8)(vi), the out-of-state Internet seller must first enter into an agreement with a resident of New York.[162]

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[157] *Id.* § 1101(b)(8)(i)(C)(I).
[158] *Amazon.com*, 913 N.Y.S.2d at 132.
[159] N.Y. TAX LAW § 1101(b)(8)(vi).
[160] *Id.* (emphasis added).
[161] *Id.*
[162] *Id.*

That agreement must be a commission-based referral agreement, rather than a flat-fee advertising contract.[163] Aggregated together, all such agreements entered into between the Internet seller and New York residents must have generated more than $10,000 of gross receipts during past four quarterly periods from sales to customers located in New York, that were referred to the seller by the New York associate.[164] If all of these requirements are met, the presumption will activate, and the Internet retailer will be obligated to collect and remit use taxes based on its use of in-state residents to solicit business from other New York residents, unless the seller can satisfy the rebuttal standard.[165]

Sellers can rebut the presumption of in-state solicitation by providing proof that during the four quarterly periods in question, the seller's New York associates "did not engage in any solicitation in [New York] on behalf of the seller that would satisfy the nexus requirement of the United States constitution."[166] Because the statute itself did not provide guidance to sellers on how to prove the lack of solicitation, a negative, the Department of Taxation and Finance issued a second memorandum on June 30, 2008,[167] which instituted a two-part "safe harbor" procedure for sellers.[168] First, to rebut the presumption, sellers must include a "no solicitation" clause in their agreements with each New York associate.[169] If each resident associate's contract stated that the representative was prohibited from "engaging in any solicitation activities in New York State that refer potential customers to the seller," the seller would have satisfied the first portion

[163] Technical Services Bureau Memorandum-TSB-M-08(3)S (May 8, 2008).
[164] N.Y. TAX LAW § 1101(b)(8)(vi).
[165] *Id.*; *see also* Amazon.com, L.L.C. v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 132-33 (N.Y. App. Div. 2010).
[166] N.Y. TAX LAW § 1101(b)(8)(vi).
[167] Technical Services Bureau Memorandum-TSB-M-08(3.1)S (June 30, 2008).
[168] *Amazon.com*, 913 N.Y.S.2d at 133.
[169] *Id.*

of the "safe harbor" procedure.[170] Second, to ensure rebuttal, the sellers would also have to require each in-state associate to submit a signed certification each year, stating that the associate had not engaged in any such prohibited solicitation during the preceding year.[171] If the seller satisfied both parts of the "safe harbor" procedure, the seller would be considered to have effectively rebutted the presumption of in-state solicitation, and thereby would remain free of any use tax obligations.[172]

Two days after the Governor signed New York's "Amazon Law," amending section 1101(b)(8) of the tax statutes, plaintiff Amazon.com, LLC[173] filed suit, alleging violations of the Commerce Clause and Due Process Clause of the United States Constitution, in addition to several other claims.[174] The trial court granted the State's motion to dismiss on January 13, 2009.[175] In rejecting Amazon's facial Commerce Clause challenge, the court focused on the careful crafting of the law: that the law targeted out-of-state sellers using in-state contractors, ensured there was sufficient nexus, and provided an "out" for sellers by allowing them to rebut the statutory presumption of vendor qualification.[176] Because Amazon did not rebut the statutory presumption by alleging "its New York Associates do not solicit business for it from New York customers," the court also dismissed Amazon's as-applied Commerce Clause challenge.[177] The

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170 *Id.*
171 *Id.*
172 *See id.*
173 Co-plaintiff Overstock.com filed suit independently on May 30, 2008. After the trial court, called the Supreme Court in New York, dismissed Overstock's suit "[f]or the reasons stated" in its Amazon decision, Overstock appealed. The Court of Appeals, New York's highest court, separately transferred the Amazon appeal and the Overstock appeal to New York's intermediary court, known as the Supreme Court, Appellative, which heard both appeals and issued a joint opinion. *Id.* at 134-36.
174 *Id.* at 134.
175 *Id.* at 135.
176 *Id.*
177 *Id.*

court found Amazon's Due Process Clause challenge to the presumption equally unconvincing, reasoning that "[t]here is a 'reasonably high degree of probability' that New York business people and entities desirous of raising money that are compensated for referring customers who ultimately make purchases will solicit business from those with whom they are familiar and encourage sales.[178] Amazon appealed.[179]

On appeal, the reviewing court whether New York's law violated the Commerce and Due Process Clauses facially and as-applied to Amazon and Overstock, another online retailer that had filed suit.[180] The court began by analyzing the parties' facial challenges in light of the high standard facing plaintiffs challenging the constitutionality of a statute.[181] After finding that the parties' Commerce Clause challenges implicated only the first prong of the *Brady* test[182]—the substantial nexus requirement—the court relied on *Matter of Orvis Co. v. Tax Appeals Tribunal of the State of New York*,[183] for the proposition that "while a physical presence of the vendor is required, it need not be substantial."[184] Thus, "the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf" may manifest the necessary physical presence.[185] Based on this approval of attributed nexus, the court concluded "that on its face, the statute does not violate the Commerce Clause" because "it imposes a tax collection obligation on

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[178] *Id.*
[179] *Id.* at 136.
[180] *Id.*
[181] The court set out four general principals applicable to facial challenges: (1) courts disfavor facial challenges; (2) to succeed, a plaintiff must prove "that the law is unconstitutional in all of its applications"; (3) statutes enjoy a "presumption of constitutionality," meaning challenging parties must "demonstrat[e] the statute's invalidity beyond a reasonably doubt"; and (4) if at all possible, courts avoid interpreting statutes in a manner that renders them unconstitutional. *Id.* at 136-37.
[182] *Id.* at 137.
[183] 654 N.E.2d 954 (1995).
[184] *Amazon.com*, 913 N.Y.S.2d at 137 (quoting *Orvis*, 654 N.E.2d at 960-61).
[185] *Id.* at 137 (*quoting Orvis*, 654 N.E.2d at 961).

an out-of-state vendor *only* where the vendor enters into a business-referral agreement with a New York State resident, and *only* where that resident receives a commission based on a sale in New York."[186] In upholding the law, the court specifically looked to three factors: (1) the requirement that the in-state presence must involve solicitation, not mere advertising; (2) that the law provided a "ready escape hatch" through the "safe harbor" rebuttal procedure; and (3) that New York had a "legitimate basis" for concluding that in-state representatives are likely to solicit business when paid on a sales commission basis. Because the court could recite "a set of circumstances under which the law would be valid"—when a seller's New York representative with sufficient in-state presence receives a commission for proactively soliciting sales—the facial Commerce Clause challenge failed.[187]

Both of the parties' facial Due Process Clause challenges—the "irrational and irrebuttable presumption" and "void for vagueness" arguments—also failed.[188] Citing *Quill*, the Appellate Division court distinguished the Commerce Clause and Due Process Clause nexus requirements and applied the less burdensome "minimum contacts" due process test.[189] The court then considered the claims of "irrebuttable presumption" and "vagueness" more specifically.[190]

Amazon and Overstock first argued that section 1101(b)(8)(vi) was unconstitutional because it contained an "irrational and irrebuttable" presumption. Section 1101(b)(8)(vi) of the New York Tax Law presumes that an in-state representative paid on commission is incentivized

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[186] *Id.* at 138 (emphasis added).
[187] *Id.* at 139.
[188] *Id.* at 139-41.
[189] *Id.* at 139-40.
[190] *Id.* at 140-41.

to proactively solicit sales in order to generate greater pay.[191] After conceding that the Supreme Court disfavors *irrebuttable* presumptions "as violative of due process," the court recognized that many rebuttable presumptions are frequently upheld, so long as there is "a *rational connection* between the basic facts proven and the ultimate fact presumed."[192] New York's Due Process Clause requires a presumption to satisfy the standard of a "reasonably high degree of probability that the presumed fact follows from those proved directly."[193] However, even under the higher standard, the court found the statutory presumption constitutional because "it is not irrational to presume that the [seller's] in-state representative will engage in various legal methods to enhance earnings," including solicitation.[194] Any representatives behaving in a contrary fashion can prove that they did not engage in solicitation, thus helping the seller avoid use tax collection obligations.[195] The parties also made a "void for vagueness" due process argument based on the words "or indirectly," "or other consideration," and "solicitation," which the court quickly dispensed with, noting that it found the parties' criticisms "perplexing" as the phrases presented no cause for confusion.[196]

Amazon and Overstock fared better on their as-applied challenges, as the Appellate Division found that the lack of discovery and undeveloped record precluded them from making a determination on both the Commerce Clause and Due Process Clause "presumption" claims.[197] For purposes of the Commerce Clause challenge, the court remanded for discovery, holding that it was unable "to conclude as a matter of law" that plaintiff's in-state representatives were

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[191] *Id.* at 140.
[192] *Id.*
[193] *Id.* (internal citations omitted).
[194] *Id.*
[195] *Id.*
[196] *Id.* at 140-41.
[197] *Id.* at 143-44.

actually "engaged in sufficiently meaningful activity"—solicitation, rather than merely advertising—and that those activities were "'significantly associated' with the out-of-state retailer's ability to do business in the state," as required by *Tyler Pipe Industries*.[198] Similarly, for due process purposes, the court remanded to allow Amazon and Overstock to challenge the validity of the statutory presumption by evidencing that "all their in-state representatives do is advertise on New York-based Web sites."[199]

No other court has yet reviewed the constitutionality of section 1101(b)(8)(vi); therefore, New York's law remains in-force for the time being. It is unclear if the Supreme Court will grant certiorari and review the New York courts' Commerce Clause and Due Process holdings. However, the Court's language in *Quill* inviting Congress to act is reason to believe that the Supreme Court might deny any petition for certiorari or at least delay in taking the case.[200] Until a higher court sanctions this type of "Amazon law," it might be wise for states to be wary of passing similar legislation. Although several other states have already passed or considered legislation styled on New York's law,[201] such a move can be risky and expensive. For example, the Tax Foundation warns that "Amazon Laws" can result in more costs than benefits because such laws often fail to generate revenue and actually result in losses as online retailers simply end their affiliate programs in those states, mire the state in expensive litigation, can be seen placing disproportionate collection burdens on Internet sellers, and create uncertainty and

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[198] *Id.*
[199] *Id.* at 144.
[200] *See* Quill Corp. v. North Dakota, 504 U.S. 298, 318-19 (1992).
[201] Twenty-one states have considered "Amazon" laws over the past three years, but only seven have enacted them: Arkansas, California, Connecticut, Illinois, New York, North Carolina, and Rhode Island. Joseph Henchman, *California Becomes Seventh State to Adopt "Amazon" Tax on Out-of-State Online Sellers*, TAX FOUNDATION (July 1, 2011), http://www.taxfoundation.org/news/show/27416.html.

increase compliance costs for businesses.[202] Based on the potential risks and the uncertainty surrounding a New-York-style Amazon Law, states should first consider other approaches before adopting similar legislation.

2. Common Ownership Nexus - The California Approach

When California enacted its "Amazon Law" in 2011,[203] it had the benefit of other states' experiences and was able to borrow ideas and incorporate them into its statute. In one section of its two-part statute, California adopted a modified form of the "New York" approach and amended its definition of "retailer engaged in business in this state" for the purpose of sales and use tax collection duties.[204] The new definition includes out-of-state retailers entering into commission-based agreements with California residents who refer potential customers with a link on their websites, so long as the remote vendor had $10,000 in cumulative referred sales of tangible property to California purchasers and $1,000,000 in total cumulative sales of tangible personal property to customers in California in the preceding year.[205] California expressly provided that section 6203(c)(5) is inapplicable to advertising-only agreements and requires solicitation to become operative; thus, it does not apply to those retailers who can demonstrate that their in-state affiliate did not engage in referrals in a manner that would satisfy the requirements of the Commerce Clause.[206] California defined "retailer" for the purpose of section 6203(c)(5) to include "an entity affiliated with a retailer within the meaning of Section 1504 of

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[202] JOSEPH HENCHMAN, TAX FOUNDATION, SPECIAL REPORT: "AMAZON TAX" LAWS SIGNAL BUSINESS UNFRIENDLINESS AND WILL WORSEN SHORT-TERM BUDGET PROBLEMS 1-8 (March 2010), *available at* www.taxfoundation.org/files/tax_foundation_sb_824_mar_2010.pdf.

[203] California enacted its Amazon law in June 2011. However, it agreed to a compromise: in exchange for Amazon halting its efforts to repeal the new law, the legislature agreed to retroactively reinstate the former law and delay the effective date of the new version until September 15, 2012. *California's Amazon Law*, *supra* note 142, at 83, 83 n.1.

[204] *See* CAL. REV. & TAX. CODE § 6203(c)(5); *California's Amazon Law*, *supra* note 142, at 83.

[205] CAL. REV. & TAX. CODE § 6203(c)(5).

[206] *Id.* § 6203(c)(5)(B), (C) & (E).

the Internal Revenue Code," meaning that it attacked the online affiliate programs of Internet retailers even more broadly than New York because it not only allowed in-state affiliates' solicitation activities to be attributed to the retailer they contract with, but also to any company affiliated with that retailer under Internal Revenue Code section 1504.[207]

In the second portion of its "Amazon Law," California chose to attack a different avoidance technique of Amazon's—entity isolation and the use of in-state subsidiaries. Amazon has a history of "aggressive" tax planning,[208] as evidenced by its decision to establish its headquarters in Seattle, rather than in Los Angeles.[209] Jeff Bezos, the founder of Amazon, explained that because companies "have to charge sales tax to customers who live in any state where [the companies] have a business presence," "[i]t made no sense for [Amazon] to be in California or New York," given the high populations and high sales potential of those states.[210] However, although Amazon itself does not have a physical presence in California, it does have several subsidiaries in the state: A2X Development Centers, with locations in Cupertino (dba Lab126), Orange County, San Francisco, and San Luis Obispo (dba ZME); A9.com, in Palo Alto; and Alexa, located in San Francisco.[211] California thus decided to attribute to Amazon the nexus of its subsidiaries, with those entities' operations in California thereby satisfying *Quill*'s physical presence requirement.[212]

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[207] *See id.* § 6203(c)(5)(D).
[208] MICHAEL MAZEROV, CENTER ON BUDGET AND POLICY PRIORITIES, AMAZON'S ARGUMENTS AGAINST COLLECTION SALES TAXES DO NOT WITHSTAND SCRUTINY 6 (2010), *available at* http://www.cbpp.org/cms/index.cfm?fa=view&id=2990.
[209] Rachel Metz, *Amazon Wants California Voters to Decide on Sales-Tax Collection*, SEATTLE TIMES (July 11, 2011), http://o.seattletimes.nwsource.com/html/businesstechnology/2015579816_amazon12.html.
[210] *Id.*
[211] *Locations*, AMAZON.COM, http://www.amazon.com/Locations-Careers/b?ie=UTF8&node=239366011 (last visited Nov. 12, 2011).
[212] *See* CAL. REV. & TAX. CODE § 6203(a), (c)(4).

Similar to how it handles web-based affiliates, California's statute attributes the nexus of subsidiaries to a parent by expanding the definition of a "retailer engaged in business" in California.[213] Under California Revenue and Tax Code section 6203(a), every "retailer engaged in business in [California] and making sales of tangible personal property for storage, use, or other consumption in [California], not exempted … shall, at the time of making the sales or … at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser." Subsection (c) defines "[r]etailer engaged in business in [California]" as "any retailer that has substantial nexus with [California] for the purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."[214] The Code then provides a non-exclusive list of examples of such retailers.[215]

One type of retailer included in section 6203(c) is a retailer that is part of a commonly controlled group that represents a combined reporting group for purposes of California's corporate income tax if another member of that commonly controlled group, "pursuant to an agreement with the retailer, performs services in [California] in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer."[216] Section 25105 defines a "commonly controlled group" in terms of majority ownership: if a parent owns "more than 50% of the voting power" of its subsidiary, or if "the same person" owns or constructively owns "stock representing 50% of the voting power" of brother/sister corporations, then the corporations will be considered part of a

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[213] *See id.* § 6203(a), (c)(4) & (5).
[214] *Id.* § 6203(c).
[215] *Id.*
[216] *Id.* § 6203(c)(4).

commonly controlled group.[217] Section 6203(c)(4) does not require an agency relationship between the commonly owned companies to trigger its application.[218]

The California legislature seemingly designed this portion of 6203(c) to ensnare Amazon specifically, perhaps responding to Amazon's refusal to collect use taxes even in states, such as California, where it has a "substantial physical presence" in the form of its or its subsidiaries' headquarters, warehouses, customer service centers, or research and development facilities.[219] For example, Lab126, an Amazon subsidiary in Cupertino, California, developed and designed the Kindle,[220] Amazon's e-reader. Amazon consistently refuses to disclose how many Kindles it has sold, instead issuing vague press releases about its Kindle sales, such as claiming that the Kindle's growth rate recently tripled,[221] that its new Kindle is "the bestselling product in Amazon's history,"[222] or that the Kindle 3 is "the fastest-selling ever."[223] In 2010 however, analysts estimated that Amazon had sold millions of Kindle devices and that Kindle sales accounted for 3-5% of Amazon's total revenue, meaning that Amazon could have generated $1.7 billion in Kindle sales in 2010.[224] Despite the phenomenal success of the Kindle, Amazon has refused to collect use tax from purchasers of its Kindle e-reader and books in California, the

[217] *Id.* § 25105(b).
[218] *California's Amazon Law*, *supra* note 142, at 88-89.
[219] Amazon has argued that it should not have to undertake the "administrative burden" of collecting state use taxes in states in which it does not have a substantial physical presence, and therefore does not receive significant state services. This argument is difficult to reconcile with Amazon's actual practices, given that it collects tax from its customers in only four states, even though it or its subsidiaries have facilities in at least 17 states. *See* MAZEROV, *supra* note 208, at 5.
[220] *About Lab126*, LAB126.COM, http://www.lab126.com/about.htm (last visited Nov. 11, 2011).
[221] Julianne Pepitone, *How Many Kindles Did Amazon Really Sell?*, CNN MONEY (Aug. 25, 2010, 1:43 PM ET), http://money.cnn.com/2010/08/25/technology/kindle_sales/index.htm.
[222] Press Release, Amazon.com, Third-Generation Kindle Now the Bestselling Product of All Time on Amazon Worldwide (Dec 27, 2010), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=176060&p=irol-newsArticle&ID=1510745&highlight.
[223] Pepitone, *supra* note 221.
[224] *Id.*

birthplace of the Kindle. The California law seeks to change this practice by attributing the physical presence of subsidiaries like Lab126 to their parent, Amazon, in order to subject Amazon to sales and use tax collection duties under *Quill* and *Scripto*.

Given Amazon's immediate opposition to the new California law, the state legislature agreed to delay implementation of the law for one-year to give Congress a chance to write and pass federal legislation resolving the states' use tax collection conflicts with e-commerce.[225] If Congress does not act within the next year and the new version of section 6203 becomes operative, Amazon is sure to file suit challenging the law's constitutionality, as it did in New York, or act to limit its liability under the new law. Such actions could effectively result in an immediate compromise of the law's intended goals. For example, Amazon, along with fellow Internet retailer Overstock, has already responded by cutting ties with thousands of its California affiliates, saying it "had no plans to begin collecting California sales taxes."[226] The actions of online sellers in either terminating their affiliate programs or forbidding those associates from soliciting business in a manner that triggers section 6203 raises questions of futility because without a trigger, the retailer will not have a statutory obligation to collect use taxes, and the state will continue to lose revenue.[227]

There are also doubts about the constitutionality of California's approach, apart from the questions of its potential effectiveness. The constitutionality of the "common ownership" approach depends on whether the courts will allow states to ignore the separate and distinct legal status of the different entities in a commonly owned group. The new version of section

[225] To delay operation of the successful amendment, the legislature passed a second bill that retroactively reinstated the prior version of section 6203 and delayed implementation of the new version until September 15, 2012. *California's Amazon Law*, *supra* note 142, at 83, 91.
[226] Metz, *supra* note 209; *California's Amazon Law*, *supra* note 142, at 95.
[227] *California's Amazon Law, supra* note 142, at 92-93.

6203(c)(4) will allow California to treat Amazon as a retailer operating in California obligated to collect California sales and use taxes because of its wholly owned subsidiaries in California, like A9.com and Lab126.[228] Amazon's situation differs from that of *National Geographic* because in that case National Geographic itself actually maintained a California office—albeit a different department than its mail order business—with National Geographic employees, meaning that National Geographic itself had a physical presence in California.[229] Conversely, Amazon's subsidiaries are separately incorporated, legally distinct companies with their own employees, meaning that Amazon itself does not have a physical presence in California.[230]

In *Scripto* and *Tyler Pipe Industries*, the Supreme Court allowed states to attribute the in-state physical presence of an out-of-state seller's representatives to the out-of-state seller.[231] However, in both cases, the representatives the states used to attribute nexus acted as the retailers' agents.[232] Section 6203(c)(4), in contrast, does not require an agency relationship between the subsidiary and principal before attributing the physical presence of one to the other.[233] This might be a problem for California because Amazon's subsidiaries are "legally separate persons from Amazon," who "have kept their corporate identities separate and intact" and who have their own operations, assets, and payrolls.[234] Although A9.com and Lab126 "produce products … that are integral to Amazon's business," that alone does not rise to the level of agency found in *Scripto* or *Tyler Pipe Industries* and it is possible that the Supreme Court will make agency, rather than just common ownership, necessary to satisfy the dormant

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[228] *Id.* at 95.
[229] *Id.*
[230] *Id.*
[231] Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 250-51 (1987); Scripto, Inc. v. Carson, 362 U.S. 207, 208-09, 211 (1960).
[232] *Tyler Pipe Indus.*, 483 U.S. at 250-51; *Scripto*, 362 U.S. at 208-08, 211.
[233] *California's Amazon Law*, *supra* note 142, at 94.
[234] *Id.* at 95.

Commerce Clause.[235] Therefore, the constitutionality of California's "common ownership" approach remains in doubt, even now, before the effective date of the new law.

B. The Information Approach - The Colorado Example

Colorado has attacked its sales and use tax problem in a manner quite distinct from that of New York or California. First, while New York's law presumes that an online seller is physically present in New York because of the presence of its in-state web-based affiliates, Colorado pioneered the "common ownership" approach later modified and adopted by California: the law presumes that an remote retailer is physically present and "doing business in [Colorado]" if it and another company with physical presence in Colorado are both members of the same commonly owned group.[236] Second, while both New York and California focused on ways to force Internet retailers to collect and remit *taxes*, Colorado's law instead requires Internet retailers to collect and remit *information*.[237]

Colorado imposes a 2.9% tax on the purchase price of all retail sales of tangible personal property made after January 1, 2001.[238] The "retailer" or "vendor" selling the property is "liable and responsible for the payment" of the tax imposed.[239] In Colorado, a "retailer" or "vendor" is "a person doing business in [Colorado], known to the trade and public as such, and selling to the user or consumer, and not for resale."[240] A retailer is a person "doing business in [Colorado]" when it sells, leases, or delivers tangible personal property in Colorado by retail sale.[241] This definition of "doing business in [Colorado]" includes maintaining a place of business in

[235] *California's Amazon Law, supra* note 142, at 95.
[236] COLO. REV. STAT. ANN. § 39-26-102(3), (8).
[237] *Id.* § 39-26-112.
[238] *Id.* §§ 39-26-104(1)(a), 39-26-106(a)(a)(II). Before January 1, 2001, the tax rate was 3%. *Id.* § 39-26-106(a)(a)(I).
[239] *Id.* § 39-26-105(1)(a).
[240] *Id.* § 39-26-102(8).
[241] *Id.* § 39-26-102(3).

Colorado, whether directly or indirectly, and soliciting business in Colorado through any means.[242] It also creates a rebuttable presumption[243] that a retailer is doing business in Colorado if that retailer "does not collect Colorado sales tax" and is "part of a controlled group of corporations" that includes "a component member that is a retailer with physical presence in [Colorado]."[244] This provision means that a remote vendor in a brother-sister or parent-subsidiary relationship with an in-state retailer will be presumed to also be "doing business in [Colorado]" for the purposes of Colorado's sales and use tax statutes.[245]

Retailers that do business in Colorado but do not collect Colorado sales tax are known as "non-collecting retailers."[246] In order to increase use tax compliance by individuals making remote purchases, Colorado imposes notice and reporting obligations on such non-collecting retailers.[247] The non-collecting retailer's obligation is threefold: (1) time of sale notice to the purchaser; (2) annual notice to the purchaser; and (3) annual reporting to Colorado's department of revenue.[248]

First, with each purchase, non-collecting retailers must notify all Colorado purchasers that the retailer does not collect Colorado sales tax, that the purchase is not exempt merely because it was made by remote means, and that the purchaser has a duty to file a sales or use tax

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[242] *Id.* § 39-26-102(3)(a), (b)(I).
[243] Retailers can rebut this presumption by submitting proof "that during the calendar year in question, the component member … with physical presence in [Colorado] did not engage in any constitutionally sufficient solicitation in [Colorado] on behalf of the retailer that does not collect Colorado sales tax." *Id.* § 39-26-102(3)(b)(II).
[244] *Id.*
[245] The Colorado statute incorporates the definitions of "controlled group of corporations" and "component member" from I.R.C. § 1536, *id.*, which provides for both "brother-sister" and "parent-subsidiary" controlled groups. *See* Edward A. Zelinksy, *The Constitutionality (and Futility) of Colorado's Amazon Law,* 56 STATE TAX NOTES 113, 119-20 (2010) [hereinafter *Colorado's Amazon Law*].
[246] COLO. CODE REGS. § 201-1:39-21-112.3.5(1)(a)(i) (2010).
[247] *See* COLO. REV. STAT. § 39-21-112(3.5); COLO. CODE REGS. § 201-1:39-21-112.3.5.
[248] COLO. REV. STAT. § 39-21-112(3.5)(c) & (d).

return with the state and pay use tax on their purchase from the retailer.[249] Retailers are subject to a five-dollar penalty for each failure to provide the required notice.[250] The amended Colorado statute also imposes annual information obligations on retailers not collecting Colorado sales tax.[251] Non-collecting retailers must send each Colorado purchaser[252] an annual statement by January 31 that states the total amount that the purchaser paid for all Colorado purchases made from the retailer in the previous calendar year.[253] The statement must be sent by first class mail; be prominently labeled "Important tax document enclosed;" summarize purchase dates, descriptions, and dollar amounts; advise the purchaser that the law requires the retailer to provide the Colorado Department of Revenue with the purchaser's total dollar amount of purchases; and again notify the purchaser of his or her obligation to file a Colorado state or use tax return.[254] Failure to provide annual statements to Colorado purchasers results in a ten-dollar penalty for each notification failure.[255] The retailer must also file a similar annual statement for each

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[249] *Id.* § 39-21-112(3.5)(c)(I); COLO. CODE REGS. § 201-1:39-21-112.3.5(2)(b).
[250] COLO. REV. STAT. § 39-21-112(3.5)(c)(II). The regulations cap the amount a non-collecting retailer owes at $5,000 if the non-collecting retailer had no actual notice of the requirement and began to provide the transactional notices within 60 days of demand by the department of revenue. COLO. CODE REGS. § 201-1:39-21-112.3.5(2)(f)(ii)(1). For non-collecting retailers failing to provide notice during the first year they were obligated to do so, the penalty cap is $50,000. *Id.* § 201-1:39-21-112.3.5(2)(f)(ii)(2).
[251] COLO. REV. STAT. § 39-21-112(3.5)(d).
[252] A non-collecting retailer does not have to send a statement to a "[d]e minimus Colorado purchaser," or a Colorado purchaser whose total Colorado purchasers for the prior calendar year are less than $500. COLO. CODE REGS. § 201-1:39-21-112.3.5(3)(c)(i).
[253] COLO. REV. STAT. § 39-21-112(3.5)(d)(I)(A).
[254] COLO. CODE REGS. § 201-1:39-21-112.3.5(3)(a).
[255] COLO. REV. STAT. § 39-21-112(3.5)(d)(III)(A). The regulations cap the non-collecting retailer's penalties at $1,000 if the retailer sent the notices within 30 days of the due date, $10,000 if the retailer had no actual knowledge of the requirement but sent the notices within 60 days of a demand by the department of revenue, and $100,000 if the retailer failed to send the required notices the first calendar year it was obligated to do so. COLO. CODE REGS. § 201-1:39-21-112.3.5(3)(d)(ii).

purchaser with the Colorado department of revenue,[256] subject to a ten-dollar penalty for each purchaser that should have been included in such annual statement but was omitted.[257]

Colorado's information approach could serve as an interesting model for other states attempting to close the gap in their sales and use tax revenue created by e-commerce and other remote purchases. However, there are two obstacles for other states seeking to adopt the Colorado approach: (1) uncertain constitutionality and (2) ineffectiveness. Before this year, it seemed possible that Colorado's version of an "Amazon law" would be found constitutional: it relied on the *physical presence* of a component member in the same group of controlled corporations as the retailer—satisfying the dormant Commerce Clause—and created a presumption that is both rational and rebuttable—comporting with due process.[258] However, on March 30, 2012, the United States District Court for the District of Colorado held the Colorado law unconstitutional and permanently enjoined its enforcement.[259]

The *Direct Marketing Ass'n* court found that Colorado's reporting requirements violated the dormant Commerce Clause both by discriminating against and placing an undue burden on out-of-state retailers.[260] With respect to the discrimination claim, the court acknowledged that "[o]n their face the Act and Regulations do not distinguish between in-state retailers… and out-of-state retailers. Rather, the Act focuses on the distinction between retailers who collect

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[256] COLO. REV. STAT. § 39-21-112(3.5)(d)(II)(A).
[257] *Id.* § 39-21-112(3.5)(d)(III)(B). The regulations provide caps at $1,000, $10,000, and $100,000 for this penalty, similar to the caps for the annual purchaser statement penalty. *See* COLO. CODE REGS. § 201-1:39-21-112.3.5(4)(f)(ii).
[258] *Colorado's Amazon Law*, *supra* note 245, at 128-29.
[259] Direct Marketing Ass'n v. Huber, No. 20-cv-01546-REB-CBS, 2012 WL 1079175 (D. Colo. Mar. 30, 2012); *see also Judge Strikes Down Colorado 'Amazon Law' Reporting Rule on Constitutional Grounds*, BLOOMBERG BNA (Apr. 6, 2012), http://www.bna.com/judge-strikes-down-n12884908828/; Sally P. Schreiber, *Colorado's "Amazon" Law Requiring Out-of-State Retailers to Report Sales Held to Be Unconstitutional*, J. ACCT. (Apr. 5, 2012), http://www.journalofaccountancy.com/Web/20125445.htm.
[260] *Direct Marketing Ass'n*, 2012 WL 1079175 at *3-9.

Colorado sales tax and those who do not collect Colorado sales tax."[261] However, the court reasoned that because Colorado law already requires all in-state retailers to collect sales tax, functionally, the notice and reporting requirements only apply to out-of-state retailers.[262] This results in "patent discrimination," since the statute and its regulations "produce, in effect, a geographic distinction between in-state and out-of-state retailers" in violation of the *Quill* doctrine and the Commerce Clause.[263] The court found this discrimination to exist despite "the veil provided by the words of the Act and the Regulations."[264] Colorado's legitimate state interests and purposes were not sufficient to overcome this discrimination, given that Colorado did not rebut the plaintiff's proffered reasonable nondiscriminatory alternatives.[265] Moreover, the court found that because "the sole purpose of the burdens imposed by the Act and Regulations is the ultimate collection of use taxes when sales taxes cannot be collected," Colorado's law is unduly burdensome because "the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in *Quill*."[266]

Even assuming the Tenth Circuit reverses the District Court and holds Colorado's reporting requirements constitutional on appeal, there is still a problem with the law's effectiveness. It is possible that the disclosure requirements could allow Colorado to audit and seek payment from individuals owing the tax far more effectively. The law's effectiveness, however, depends on its reach. Ironically, Amazon, for whom the law is named, would not fall within the law's scope because Amazon does not have the necessary direct or indirect

[261] *Id.* at *4.
[262] *Id.* at *4-5.
[263] *Id.* at *6.
[264] *Id.* at *4.
[265] *Id.* at *6.
[266] *Id.* at *8.

presence—neither Amazon nor any of its subsidiaries have a physical presence in Colorado.[267] One analyst goes so far as to refer to Colorado's "self-help" law as something of mere "symbolic value," claiming it is "superfluous" to those conventional retailers who already collect state sales taxes because of their physical presence in the state and will have only a limited affect on many Internet retailers because its reach only extends to those remote vendors who have at least an indirect physical presence in Colorado through their subsidiaries or other commonly owned group members.[268] Furthermore, just because a state would receive information about remote purchasers under this approach, "it is not clear how [this receipt] will transfer into revenue," as "states may not have the resources to receive and properly analyze such an enormous quantity of reports."[269] Accordingly, there is an argument that Colorado's law, like New York's or California's, will never be effective and that only a uniform federal solution, rather than a piecemeal state-by-state approach, will resolve the e-commerce sales and use tax controversy.[270]

V. Reinterpret *Quill*

Traditionally, those commenting on *Quill* are detractors who malign it as an outdated decision that severely constricts states and ravages their revenues and budgets in the Internet age. However, a different paradigm has recently emerged, one that actually views the *Quill* decision as providing "an ideal framework for determining when states should be allowed to subject remote e-commerce vendors to sales and use taxation."[271] The idea is that only the reporting or compliance costs stemming from the imposition of tax collection and remittance duties on the out-of-state vendor burden interstate commerce in derogation of the dormant Commerce Clause,

[267] *Colorado's Amazon Law*, *supra* note 245, at 124.
[268] *Id.* at 114.
[269] Schreiber, *supra* note 259.
[270] *See Colorado's Amazon Law*, *supra* note 245, at 129.
[271] David Gamage & Devin Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. ___ (*forthcoming* 2012) (manuscript at 3) (on file with author).

not imposition of the duties themselves.[272] Therefore, adequate compensation from the states for the reporting and compliance costs incurred by remote vendors "would completely alleviate the burden on interstate commerce," resulting in a "constitutionally permissible approach for partially subjecting remote vendors to use taxes."[273] This approach points out that *Quill* provides two justifications for its physical presence rule: the dormant Commerce Clause and *stare decisis*.[274] Adequate compensation would remove both justifications from the analysis because it would eliminate the burden on interstate commerce; therefore, it would attack the underpinnings of *Bellas Hess*, the case the *Quill* court cited as precedent.[275]

The dormant Commerce Clause does not require states to give remote vendors or e-commerce sellers an advantaged position.[276] Instead it only prevents states from disadvantaging such sellers in a way that burdens interstate commerce. Consequently, remote vendors are not entitled to continue enabling consumer tax avoidance and taking advantage of the tax loophole created by *Quill* if there is a way to require them to collect the tax due the state without subjecting them to a burden of higher aggregate compliance costs than local sellers.[277] The problem facing remote vendors, as noted by the Court in *Bellas Hess* and *Quill,* is that remote vendors face a "virtual welter of complicated obligations" because of their presence in multiple taxing jurisdictions.[278] The *Quill* court found that remote vendors were at a significant disadvantage when compared with local sellers because a remote vendor could potentially be at the mercy of "6,000-plus taxing jurisdictions," all with different rules and obligations, while a

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[272] *Id.*
[273] *Id.*, manuscript at 4, 21.
[274] *Id.*, manuscript at 13.
[275] *Id.*
[276] *Id.*, manuscript at 14.
[277] *Id.*, manuscript at 20-21.
[278] *Id.*, manuscript at 15-16 (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 310 n.6 (1992)).

local seller has the much simpler duty of complying with the single jurisdiction in which it is located.[279]

The remedy, then, is for states to alleviate this burden before subjecting remote vendors to tax. Instead of passing controversial legislation or lobbying for Congress to ratify the SSUTA, something that remains unlikely, states could simply interpret *Quill* as only restricting them from imposing use tax collection duties on remote vendors if those vendors are not adequately compensated by the state "for all such compliance costs imposed."[280] While compensated remote vendors would maintain a slight advantage over uncompensated local vendors, they would no longer be able to use tax avoidance to create a price advantage.[281] Additionally, although states would have to *fully* compensate e-sellers and other remote vendors—at an estimated cost of about 1-3% of tax revenues raised—this result would still be a substantially greater income, or approximately 97% of the revenue from e-commerce taxes, where now they receive little, if any at all.[282] The loss of revenue from compensation payouts would give states an added incentive to simplify their tax administrative systems on their own, in their own way, rather than in a fashion mandated by the SSUTA or Congress.[283] The sellers could be compensated in a simple manner: allow remote vendors to "keep a specified percentage of the use tax amounts they collect" as compensation for their compliance costs or reimburse sellers for the "actual verifiable" amount they expend to comply.[284] The best approach, and one that would be the easiest for states to administer, would be a combination method where vendors

[279] *Id.*, manuscript at 16 (quoting *Quill Corp.*, 504 U.S. at 310 n.6).
[280] *Id.*, manuscript at 21.
[281] *Id.*, manuscript at 21-22.
[282] *Id.*, manuscript at 22.
[283] *Id.*
[284] *Id.*, manuscript at 24. Compensation programs are not without precedent, as twenty-eight states already provide some degree of compensation for vendors complying with the state sales and use taxes. *Id.*, manuscript at 23.

automatically keep a set percentage of the tax collected but have the option of demonstrating "actual verifiable compliance costs" in excess of the amount kept to receive additional corresponding compensation.[285]

This approach has value in that it avoids the litigation, controversy, and economic consequences of passing individual, piecemeal "Amazon" laws at the state level. It also has the advantage of self-implementation, something important to states in the face of Congress's continuing disinterest and failure to act. However, it does come with the risk that the Court will disagree with the states' "interpretation" of *Quill* and rule against states using this method, based on the principle of *stare decisis*, despite the argument that compensation distinguishes this approach from *Quill* or *Bellas Hess*. At the very least, this interpretation of *Quill* contributes something novel to the debate over e-commerce and sales and use taxes and is certainly something states should consider, particularly those that do not already have some sort of compensation scheme to incentivize vendors to voluntarily assume collection and remittance obligations.

VI. Conclusion

Quill Corporation v. North Dakota has produced almost two decades of controversy. Ideally, Congress would accept the Supreme Court's invitation and take action to provide a national solution to the sales and use tax crisis many states are confronting. However, while Congress refuses to act, there are solutions for states interested in immediate action. While it is inadvisable for more states to adopt "Amazon" laws until the New York and Colorado laws are fully upheld, states can join the SSUTA or create compensation programs to add incentivize voluntary compliance. Over the next few years states can learn which approaches seem the most

[285] *Id.*, manuscript at 24.

likely to pass constitutional muster, and adopt them. Finally, given the increasing amount of attention to this issue, perhaps much-needed change will come and finally bring state tax codes into the Internet age.