Vendor Compensation as an Approach for State "Amazon" Laws: Part 1

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Introduction

Recent years have witnessed an explosion in revenues from electronic commerce (or, "e-commerce"),[1] just as U.S. state governments have suffered severe budget shortfalls due to the financial crisis and ensuing recession.[2] Yet because of a 1992 Supreme Court decision — *Quill Corp. v. North Dakota* — major interstate e-commerce vendors have been effectively exempt from state sales and use taxes.[3] The rapid growth of e-commerce has thus eroded the states' sales and use tax bases, depriving the states of much-needed revenue.[4]

Quill held that states can impose the burden of collecting sales and use taxes only on vendors that have a physical presence within the taxing state.[5] The taxpayer in *Quill* was a mail-order catalog vendor, but the holding applies equally to interstate e-commerce.[6] Recently, several states have passed legislation aggressively interpreting *Quill*'s physical presence requirement in an attempt to reach out-of-state e-commerce vendors.[7] Commonly referred to as "Amazon" laws,[8] those statutes have taken several forms, such as imputing physical presence when a

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[1]E-commerce constituted 7 percent of all retail sales in 2010, and this share is expected to grow rapidly over the coming years. *See, e.g.*, "Online Retail Sales," National Retail Foundation, http://www.nrf.com/modules.php?name=Pages&sp_id=1240 (last visited Feb. 20, 2012).

[2]*See, e.g.*, Elizabeth McNichol, Phil Oliff, and Nicholas Johnson, "States Continue to Feel Recession's Impact," Center on Budget and Policy Priorities (2011), *available at* http://www.cbpp.org/files/9-8-08sfp.pdf (estimating the states' total budget shortfall to be $103 billion).

[3]*Quill Corp. v. North Dakota*, 504 U.S. 298, 309-319 (1992).

[4]Annual national state and local sales tax losses on e-commerce are predicted to total $11.4 billion in 2012 and to continue growing rapidly thereafter. Donald Bruce, William Fox, and LeAnn Luna, "State and Local Sales Tax Revenue Losses From E-Commerce," *State Tax Notes*, May 18, 2009, p. 537, *Doc 2009-8902*, or *2009 STT 94-1*.

[5]*Quill*, 504 U.S. at 317-318.

[6]Walter Hellerstein, "State Taxation of Electronic Commerce," 52 *Tax L. Rev.* 425, 437 (1997).

[7]For further discussion, see *infra*.

[8]Amazon is both the leading Internet retailer and has been among the most aggressive in combating the states' attempts to tax interstate e-commerce. Dale Kasler, "Amazon Takes on California Over Sales Tax," *The Sacramento Bee*, July 17, 2011, at 1A, *available at* http://www.sacbee.com/2011/07/17/v-print/3774593/amazon-takes-on-california-over.html.

remote vendor has sales affiliates within a state[9] or attributing physical presence whenever a remote vendor licenses trademarks to an in-state firm.[10]

Although litigation remains ongoing, many commentators have concluded that the recent state Amazon laws will prove unconstitutional, ineffective, or both.[11] Even if courts allow the states to stretch the definition of physical presence to include affiliations with in-state firms, major e-commerce vendors like Amazon can respond by simply terminating those relationships in order to retain their sales and use tax exemption.[12]

At the same time, *Quill* has been widely criticized. The case was recently nominated for "the most maligned Supreme Court tax decision."[13] Numerous commentators have called for the Court to revisit the decision[14] or for Congress to pass legislation enabling the states to tax out-of-state e-commerce vendors.[15] It seems that an academic consensus has developed against the *Quill* framework for governing when state sales and use taxes can reach interstate e-commerce.[16]

In this article, the first of a two-part series, we argue that the existing approaches used by state Amazon laws are unlikely to be effective in taxing interstate e-commerce vendors. In the process, we survey the constitutional and statutory landscapes surrounding the application of sales and use taxes to interstate e-commerce transactions. In particular, we focus on the Supreme Court's analysis in *Quill* and related cases, the recent legislative attempts by several states to capture lost revenue by passing Amazon laws, and the compromises that have been brokered in their wakes.

> ***The existing approaches used by state Amazon laws are unlikely to be effective in taxing interstate e-commerce vendors.***

In our companion article, the second in the series, we will build on that foundation by outlining a new approach that states might employ for taxing interstate e-commerce, based on adequately compensating remote vendors for all tax compliance costs.[17] Yet

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[9]*See, e.g., N.Y. Tax Law section 1101(b)(8)(vi) (McKinney Supp. 2011); see also N.Y. State Dep't of Taxation and Fin., "New Presumption Applicable to Definition of Sales Tax Vendor," TSB-M-08(3)S (May 8, 2008); Michael R. Gordon, "Up the Amazon Without a Paddle: Examining Sales Taxes, Entity Isolation, and the 'Affiliate Tax,'" 11 N.C. J.L. & Tech. 299, 309 (2010).*

[10]*See, e.g.*, Ala. Code 40-23-190(a)(2) (2003); HB 3659, 95th Gen. Assemb. (Ill. 2011); *see also* Edward A. Zelinsky, "Lobbying Congress: 'Amazon' Laws in the Lands of Lincoln and Mt. Rushmore," *State Tax Notes*, May 23, 2011, p. 557, *Doc 2011-7795*, or *2011 STT 99-3*.

[11]*See, e.g.*, Stephen P. Kranz, Diann L. Smith, and Beth Freeman, "Colorado's End Run: Clever, Coercive, and Unconstitutional," *State Tax Notes*, Apr. 5, 2010, p. 55, *Doc 2010-6640*, or *2010 STT 64-9* (maintaining that Colorado's Amazon law is unconstitutional); Edward A. Zelinsky, "New York's 'Amazon' Law: Constitutional but Unwise," *State Tax Notes*, Dec. 7, 2009, p. 715, *Doc 2009-24938*, or *2009 STT 232-1* [hereinafter Zelinsky, "New York's 'Amazon' Law"] (arguing that New York's Amazon law is ineffective); Edward A. Zelinsky, "The Siren Song of 'Amazon' Laws: The Colorado Example," *State Tax Notes*, Mar. 7, 2011, p. 695, *Doc 2011-3777*, or *2011 STT 44-2* [hereinafter Zelinsky, "The Siren Song"] (claiming that Colorado's Amazon law is unconstitutional).

[12]Major e-commerce vendors have already ended many of their relationships with affiliates in states that have passed Amazon laws, and they can be expected to terminate their remaining affiliations if they lose in litigation over the definition of physical presence. *E.g.*, Dale Kasler, "California Affiliates Hurt by Tax Bill Targeting Amazon.com," *The Sacramento Bee*, July 7, 2011, at 1A, *available at* http://www.sacbee.com/2011/07/07/3752677/california-affiliates-hurt-by.html. ("Hoping to exempt itself from the law, Amazon has fired its 10,000 California affiliates, cutting off their commissions. Scores of other e-commerce companies affected by the law, including Overstock.com and a slew of smaller firms, have done the same.").

[13]Paul L. Caron, "Pepperdine Hosts Symposium on the Most Maligned Supreme Court Decisions," Tax Prof. L. Blog (Apr. 1, 2011), http://taxprof.typepad.com/taxprof_blog/2011/04/supreme-mistakes.html.

[14]*See, e.g.*, David Brunori, "It's Time to Overturn *Quill*," *State Tax Notes*, Feb. 15, 2010, p. 497, *Doc 2010-2948*, or *2010 STT 30-2*; Arthur R. Rosen and Matthew P. Hedstrom, "*Quill* — Stare at the Decision," *State Tax Notes*, June 27, 2011, p. 931, *Doc 2011-11848*, or *2011 STT 123-2* ("Indeed, many have expressed and continue to express an interest in 'overturning' *Quill*." (footnote omitted)).

(Footnote continued in next column.)

[15]*E.g.*, Edward A. Zelinsky, "New York Appellate Division Upholds 'Amazon' Law: Analysis," *State Tax Notes*, Jan. 10, 2011, p. 93, *Doc 2011-26057*, or *2011 STT 6-1*. Because the *Quill* decision was decided on dormant commerce clause grounds, states are barred from taxing out-of-state vendors only in the absence of congressional action authorizing that taxation.

[16]Walter Hellerstein, "Deconstructing the Debate over State Taxation of Electronic Commerce," *13 Harv. J.L. & Tech.* 549, 549-550 (2000). ("There is a broad consensus among academic tax specialists regarding the general principles that should guide any effort to deal with sales and use taxation of electronic commerce. . . . Remote sales, including electronic commerce, should, to the extent possible, be taxed by the state of destination of sales, regardless of whether the vendor has a physical presence in the state.").

Indeed, even those who praise *Quill* do so primarily on the grounds that Congress, not the courts, is the proper actor for specifying how the states should be able to tax interstate. Hence, even most of the "praise" for the case does not necessarily support the continuation of the physical presence rule for governing when states should be able to subject remote vendors to their sales and use taxes. *e.g.*, Rosen and Hedstrom, *supra* note 14, at 936.

[17]David Gamage and Devin J. Heckman, "Vendor Compensation as an Approach for State 'Amazon' Laws: Part 2, Our Proposed Solution." *State Tax Notes* [forthcoming].

before we can outline our proposed approach for state Amazon laws, we must first survey the current landscape.

Quill and the Constitutional Limitations on State Taxation of E-Commerce

Forty-five states and the District of Columbia levy sales taxes.[18] As corollaries to those sales taxes, the states also impose use taxes.[19] Use taxes apply when a state resident purchases nonexempt goods or services for use within the state for which sales taxes have not been paid.[20]

In most states, individuals are responsible for paying use taxes on any e-commerce goods they purchase for which the e-commerce vendor did not previously remit sales or use taxes.[21] Hence, if state residents generally paid the use taxes they owed on e-commerce purchases, there would be no problem with state taxation of e-commerce, because the states' inability to levy sales or use taxes on e-commerce vendors would be remedied by the residents instead paying use taxes on these purchases. States have found it nearly impossible, however, to collect use taxes from individual residents.[22] Accordingly, when states are unable to impose use tax reporting or collection duties on vendors, use tax compliance is very low.[23]

The Supreme Court decided two cases in 1944 that created divergent constitutional rules for sales taxes and use taxes.[24] In *McLeod v. J.E. Dilworth Co.*,[25] the Court ruled that an Arkansas sales tax could not be applied to goods sold by traveling salespersons residing in Tennessee who solicited orders in Arkansas in person, by mail, or by telephone.[26] On the same day, the Court held in *General Trading Co. v. State Tax Commission* that an Iowa use tax could be levied on orders solicited through traveling salespersons residing in Minnesota.[27] The facts of those two cases were nearly identical, with the different outcomes turning solely on whether the retailer or the purchaser was obligated to collect and remit the tax.[28] Together, those two cases established a dichotomy between sales and use taxes that remains in effect to this day: Purchases that occur within a state may be subject to sales taxation while purchases from remote vendors may only be subject to use taxation.[29]

The remainder of this part analyzes the constitutional limitations on a state's ability to impose use tax compliance duties on remote vendors. These limitations arise from the due process clause of the 14th Amendment and from the dormant commerce clause. In brief, the due process clause requires only "some definite link, some minimum connection, between a state and the person, property or transaction" that the state seeks to tax or regulate.[30] In contrast, the dormant commerce clause broadly invalidates state legislation that has a "burdening effect upon [interstate] commerce."[31] State regulation and taxation of interstate commerce must satisfy both clauses to be constitutionally permissible, but typically it is the dormant commerce clause that invalidates them.

A. The Due Process Clause

The due process clause of the Fourteenth Amendment provides the baseline restriction on a state's ability to subject out-of-state vendors to sales and use taxation. More generally, the due process clause places a floor on the amount of connection that is required between a state and an out-of-state entity before the state may tax or regulate its conduct.

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[18]Walter Hellerstein, Kirk J. Stark, John A. Swain, and Joan M. Youngman, *State and Local Taxation: Cases and Materials* 607 (9th ed. 2009); 1 Richard D. Pomp and Oliver Oldman, *State and Local Taxation*, section 6-2 (5th ed. 2005) ("The only states still without a sales tax are Delaware, New Hampshire, Montana, Oregon, and Alaska."); John L. Mikesell, "State Sales Taxes in 2010: Collections Still in Recession," *State Tax Notes*, June 6, 2011, p. 709, *Doc 2011-9541*, or *2011 STT 108-6*.

[19]Zelinsky, *supra* note 10, at 665. ("To backstop their sales taxes, the states and localities imposing them also levy use taxes if a resident makes a retail purchase but fails to pay sales tax on the purchase.")

[20]*Id.*; *see also* "Use Tax," Wash. St. Department of Revenue, http://dor.wa.gov/content/findtaxesandrates/usetax/ (last visited Feb. 20, 2012).

[21]*Id.*

[22]Charles E. McLure, Jr., "Sales and Use Taxes on Electronic Commerce: Legal, Economic, Administrative, and Political Issues," 34 *Urb. Law.* 487, 489 (2002). ("Use taxes are the legal liability of purchasers. With two exceptions — for automobiles and other products that must be registered to be used in the state and for purchases by business that can be audited — tax is likely to be paid only if vendors collect it.") Most state residents appear to be unaware that they even owe use taxes on goods purchased from out-of-state e-commerce vendors. "The Amazon War: More Complicated Than the Boston Tea Party, but Potentially as Colorful," *The Economist*, July 23-29, 2011, at 28. ("In theory, consumers are supposed to keep receipts and pay so-called 'use taxes', but few people have ever heard of them.")

[23]John A. Swain, "Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?" 75 *S. Cal. L. Rev.* 419, 428 n.53 (2002).

[24]The discussion in this paragraph follows prior work by John Swain. *Id.* at 427-429.

[25]322 U.S. 327 (1944).

[26]*Id.* at 331.

[27]322 U.S. 335 (1944).

[28]Swain, *supra* note 23, at 428.

[29]*Id.*

[30]*Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1991) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954)).

[31]*Id.* (quothing *Int'l Harvester Co. v. Dep't of Treasury*, 322 U.S. 340, 353 (1944) (Rutledge, J., concurring in part and dissenting in part)).

That floor cannot be modified by a state or by Congress.[32] This test has been formulated in a variety of ways, but the touchstone is generally accepted to be "whether a defendant's contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend [a] suit in that State."[33]

The Supreme Court has taken several opportunities to clarify the amount of contact required by the due process clause. For instance, the Court has ruled that soliciting sales from a state's residents through independent contractors is sufficient contact to satisfy due process.[34] More broadly, the Court's modern due process jurisprudence allows states to reach out-of-state actors who "purposefully avail" themselves of the state's economic market.[35]

Modern due process jurisprudence thus imposes a light burden on a state's ability to exercise jurisdiction over out-of-staters that do business within a state. In contrast, for some time, it was unclear whether a state could, consistent with the due process clause, exercise power over mail-order retailers that had *no* physical presence in that state. Previous due process case law had focused on the requirement that persons subjected to a state's power had a "presence" in that state; the shift to testing based on "minimum contacts" and "purposeful availment" thus created uncertainty that was ultimately resolved by the *Quill* decision.

In *Quill*, the Court decisively ruled that physical presence is unnecessary under the due process clause and that the due process clause does not bar states from subjecting vendors who conduct a significant amount of sales within a state to the state's use tax. The *Quill* case involved North Dakota suing a remote mail-order vendor for unpaid use taxes on its sales to North Dakota residents.[36] The vendor in *Quill* owned no tangible property in the state and had no employees there, but it did sell almost $1 million worth of merchandise to about 3,000 North Dakotans.[37] The Court upheld the tax, concluding, "There is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the state."[38]

The *Quill* decision thus resolved any doubt about whether the due process clause prevents the exercise of a state's regulatory or taxing powers over out-of-state retailers who sell to a significant number of in-state residents. It is yet to be determined exactly what magnitude of sales to in-state residents is required to satisfy the due process clause. Nevertheless, it seems clear that the due process clause does not prevent states from subjecting major e-commerce vendors to use taxes, even when the vendors do not have a physical presence within the state.[39] To comply with the due process clause, a state or local taxing jurisdiction need only exempt from its use tax those remote vendors whose sales within the jurisdiction fall below some minimal threshold.[40]

B. The Dormant Commerce Clause

Just as *Quill* removed a potential limitation to state taxing power based on the due process clause, it fortified another restriction based on the dormant commerce clause. The Court has long held that the power granted to Congress to "regulate Commerce with foreign Nations, and among the several States"[41] can prevent the states from interfering with interstate commerce even in the absence of congressional action.[42] This "dormant" or "negative" commerce clause, first recognized by Justice Herbert

[32] *Id.* at 305. Thus, even if Congress passed legislation permitting states to require e-tailers to collect a use tax for sales to in-state residents, the states' exercise of that authority must be consistent with the due process clause.

[33] *Id.* at 307.

[34] *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960).

[35] *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985) ("[I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." (citing *Hanson v. Denckla*, 357 U.S. 235, 253 (1958))).

[36] *Quill*, 504 U.S. at 303.

[37] *Id.* at 302.

[38] *Id.* at 308.

[39] *Id.* ("The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of due process.")

[40] State Amazon laws thus generally apply only to out-of-state vendors that conduct more than some threshold level of sales to in-state residents. *See e.g.*, N.Y. Tax Law section 1101(b)(8)(iv) (McKinney Supp. 2011) ("A person shall be presumed to be regularly or systematically soliciting business in this state if . . . the cumulative total of such person's gross receipts from sales of property delivered in this state exceeds three hundred thousand dollars and such person made more than one hundred sales of property delivered in this state."); Colo. Code Regs section 39-21-112.3.5(1)(a)(iii) (2010) (providing that "[a] 'retailer that does not collect Colorado sales tax' does not include a retailer whose sales in Colorado are de minimis," and that de minimis sales are presumed when the retailer makes "less than $100,000 in total gross sales in Colorado in the prior calendar year").

[41] U.S. Const. art. I, section 8, cl. 3.

[42] *Quill*, 504 U.S. at 309.

A. Johnson in *Gibbons v. Ogden*,[43] imposes special restrictions on the states' taxing powers.

The Court's dormant commerce clause jurisprudence has evolved over time to become more permissive regarding state taxation. In 1888 the Court held that "no State has the right to lay a tax on interstate commerce in any form."[44] The Court later narrowed this holding to prohibit only "direct burdens on interstate commerce."[45] Finally, in *Complete Auto Transit, Inc. v. Brady*,[46] the Court jettisoned the direct/indirect distinction and shifted the question to whether a state tax, in substance, "produces a forbidden effect"[47] by "discriminat[ing] against interstate commerce."[48]

The *Complete Auto* decision established a four-part test that continues to govern the applicability of the dormant commerce clause to state taxation.[49] The Court has relied on this four-part test in almost every dormant commerce clause challenge to a state or local tax since *Complete Auto* was decided in 1977.[50] Under the *Complete Auto* test, a state tax survives a dormant Commerce Clause challenge if 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."[51]

The first prong of the *Complete Auto* test requires that a tax be "applied to an activity with a substantial nexus with the taxing state."[52] In analyzing the constitutionality of existing Amazon laws, this first prong is by far the most important component of the *Complete Auto* test. The *Quill* decision ruled that vendors without a physical presence in the taxing state do not have the substantial nexus required by this first prong.[53] In the Court's words, "a vendor whose only contacts with the taxing state are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."[54] The majority in *Quill* justified the physical presence test for nexus based on *stare decisis* and on the concern that allowing states to impose use tax compliance obligations on remote vendors could burden interstate commerce by entangling remote vendors in a "virtual welter of complicated obligations" imposed by the "Nation's 6,000-plus taxing jurisdictions."[55]

The second prong of the *Complete Auto* test requires that a tax be fairly apportioned.[56] Fair apportionment ensures that multistate economic activity does not become doubly taxed by being subject to the full taxing regimes of multiple states.[57] For instance, state corporate income taxes are considered fairly apportioned when a state taxes only a portion of a multistate corporation's national income based on what percentage of the corporation's total sales, payroll, and property occurs within the state.[58] For state sales and use taxes, fair apportionment is achieved when either the state in which the vendor resides or the state in which the customer resides taxes the transaction; fair apportionment would be violated if both states taxed the transaction.[59] Hence, the Court has held that use taxes are fairly apportioned when they provide "a credit . . . for sales taxes that have been paid in other States."[60] More generally, a use tax should fail the fair apportionment test only if it is levied on transactions that were already subject to a sales or use tax in another state and it does not offer a credit for sales taxes paid in other states.[61]

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[43] 22 U.S. 1, 231-232, 239 (1824) (Johnson, J., concurring).

[44] *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888).

[45] *Quill*, 504 U.S. at 309 (citing, among other cases, *Sanford v. Poe*, 69 F. 546 (6th Cir. 1895), *aff'd sub nom. Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897)).

[46] 430 U.S. 274 (1977).

[47] *Id.* at 288.

[48] *Id.* at 287.

[49] *Id.* at 297.

[50] Bradley Joondeph, "Rethinking the Role of the Dormant Commerce Clause in State Tax Jurisdiction," 24 *Va. Tax Rev.* 109, 117 (2004).

[51] *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.* at 313 n.6 (quoting *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 759-760 (1967)).

[56] *Id.* at 311.

[57] Bradley W. Joondeph, "The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation" 71 *Fordham L. Rev.* 149, 158 (2002); *see also Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 186 (1995). ("We have assessed any threat of malapportionment by asking whether the tax is internally consistent and, if so, whether it is externally consistent as well. . . . Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. . . . External consistency, on the other hand, looks not to the logical consequences of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State" [internal quotation marks omitted].)

[58] Elliott Dubin, "Changes in State Corporate Tax Apportionment Formulas and Tax Bases," *States Tax Notes*, Feb. 22, 2010, p. 563, *Doc 2010-899*, or *2010 STT 34-2*; Joondeph, *supra* note 50, at 117.

[59] *Jefferson Lines*, 514 U.S. at 190; Charles E. McLure, Jr., *supra* note 22, at 492-493; Swain, *supra* note 23, at 438.

[60] *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 31 (1988).

[61] The typical approach for ensuring that use taxes are fairly apportioned is to levy the use tax only on transactions that were not subject to sales or use taxes in other states. Washington's use tax, for example, applies only when goods "are purchased in another state that does not have a sales tax or a state with a sales tax lower than Washington's." "Use Tax," *supra* note 20.

The third prong of the *Complete Auto* test requires that a tax "not discriminate against interstate commerce."[62] A use tax should generally satisfy this prong as long as the rate of the use tax does not exceed the sales or use tax rate that would apply to an intrastate sale.[63] Indeed, the Court held that a Louisiana use tax satisfied the nondiscrimination test because the tax "was designed to compensate the State for revenue lost when residents purchase out-of-state goods for use within the state" and the rate of the tax was "equal to the sales tax applicable to the same tangible personal property purchased in-state."[64] A properly designed use tax should thus have no trouble satisfying the nondiscrimination requirement.

The fourth prong of the *Complete Auto* test requires that a tax be "fairly related to the services provided by the State."[65] This fourth prong "is closely connected to the first prong of the *Complete Auto Transit* test."[66] Beyond the substantial nexus requirement of the first prong, the fourth prong "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the [taxpayer's] contact" with the state.[67] The Court has repeatedly interpreted this fourth prong as being met when a tax is measured as a percentage of some proxy for the value of the taxpayer's economic activity occurring within the state.[68] However, as long as a tax is measured based on some proxy for the value of the services a taxpayer receives from a state, the Court has declined to inquire into the appropriate level or rate of the tax based on that proxy, ruling that determinations about the appropriate levels of taxation must be made by the political process.[69] Regarding use taxes, an interstate sale jointly benefits from the services provided by the state in which the vendor resides and the state in which the customer resides.[70] Consequently, a use tax should meet the fourth prong of the *Complete Auto* test as long as the tax applies only to transactions that were not subject to a sales or use tax in another state or if the tax allows a credit for sales or use taxes paid to another state.[71]

In sum, only the physical presence requirement of the first prong of the *Complete Auto* test prevents states from imposing use tax compliance obligations on the major e-commerce vendors. A properly designed use tax can avoid any due process concerns as long as it exempts remote vendors who conduct less than some minimal amount of sales within the state. Likewise, a properly designed use tax can avoid any other commerce clause concerns — beyond those arising from the nexus requirement — as long as it (1) applies a tax rate to interstate transactions no higher than the sales or use tax rate that applies to intrastate transactions and (2) either exempts transactions that were already subject to a sales or use tax in another state or else offers a credit for any sales or use taxes paid to another state.

The States' 'Amazon' Laws

Frustrated by *Quill* and desperate for revenue, the states have become increasingly aggressive in attempting to tax interstate e-commerce. As of June 2012 at least 12 states have passed "Amazon" laws designed to collect use taxes from remote vendors.[72] These laws have been described by other commentators as unconstitutional, ineffective, or both,[73] and they have been the subject of litigation across the nation.[74]

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[62]*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

[63]*Id.* at 313.

[64]*D.H. Holmes*, 486 U.S. at 32.

[65]*Complete Auto*, 430 U.S. at 279.

[66]*Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 625-626 (1981).

[67]*Id.* at 626.

[68]*E.g.*, *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 198-199 (1995); *Exxon Corp. v. Wis. Dep't of Revenue*, 447 U.S. 207, 228 (1989) (finding that Wisconsin demonstrated fair apportionment of a tax and that the tax was fairly related to state services such as "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society'" (quoting *Japan Line Ltd. v. Cnty. of Los Angeles*, 441 U.S. 434, 445 (1979))); *Commonwealth Edison Co.*, 453 U.S. at 626.

[69]*Commonwealth Edison Co.*, 453 U.S. at 626.

[70]*See* John A. Swain, "State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective," 45 *Wm. & Mary L. Rev.* 319, 344-45 (2003). ("It is well-settled that state power to tax can arise both from residence and source. . . . The fundamental rationale for allowing states to tax income with an in-state source is that the state provides benefits and protections that allow the income to arise in the first instance.")

[71]*See D.H. Holmes Co. Ltd. v. McNamara*, 486 U.S. 24, 32 (1988) (holding that a use tax is fairly related to the benefits provided by the state because it is related to the services provided by the state, such as the state's provision of mass transit and public roads for the benefit of the vendor's customers). Arguably, a use tax that fails the substantial nexus requirement of the first prong of the *Complete Auto* test might also fail the fourth prong. But there can be no doubt that interstate sales benefit from services provided by the state in which the customer resides, as the various benefits provided by that state create the framework within which the customer was able to earn funds to make the purchase.

[72]*See infra* note 76 and accompanying text. Because of the difficulty of determining what should properly be counted as an Amazon law, we have not updated our survey to account for new state legislation after May 2012.

[73]*See, e.g.*, Kranz, Smith, and Freeman, *supra* note 11, at 55 (unconstitutional); Zelinsky, "New York's 'Amazon' Law," *supra* note 11, at 715 (ineffective); Zelinsky, "The Siren Song," *supra* note 11, at 695 (unconstitutional).

[74]*See, e.g.*, *Direct Mktg. Ass'n v. Huber*, No. 10-cv-01546-REB-CBS, 2011 U.S. Dist. LEXIS 9589 (D. Colo. Jan. 26, 2011); *Amazon.com, LLC v. New York State Dep't of Tax'n & Fin.*, 13 N.Y.S.2d 129 (N.Y. App. Div. 2010).

New York passed the first Amazon law in 2008.[75] At least 11 additional states have since followed New York's lead.[76] The action became particularly intense during the summer of 2011 with both California[77] and Texas[78] passing new Amazon legislation. A number of other state legislatures have also been debating their own Amazon laws.[79] Even if the states conclude that these laws are unlikely to be successful, passing them can help the states muddle through their current-year budget crises as long as the laws can be scored as generating additional revenues.[80]

Although there is considerable variation in the content of the states' Amazon laws, current legislation can be roughly categorized into three different approaches: referrer-nexus, related-entity nexus, and information-reporting requirements. Previous scholars have analyzed these Amazon laws in depth;[81] we will not repeat their efforts here. Instead, we aim only to outline some of the major features of these laws to demonstrate why the laws are unlikely to succeed in enabling the states to tax interstate e-commerce.[82]

The referrer-nexus approach presumes that a vendor has a physical presence within a state whenever the vendor makes sales and marketing arrangements with in-state residents. Referrer-nexus statutes typically trigger use tax liability for a remote vendor if two conditions are satisfied. First, the remote vendor must have some agreement with in-state residents under which the in-state residents directly or indirectly refer potential customers — "whether by a link on an internet website or otherwise" — to the vendor for some consideration.[83] Second, the "cumulative gross receipts" from sales to in-state residents made by all those referrals must exceed some amount in the previous year —

[75]Act of Apr. 23, 2008, ch. 57 pt. OO-1, 2008 N.Y. Laws 2844 (codified at N.Y. Tax Law section 1101(b)(8)(vi) (McKinney 2011)); N.Y. State Dep't of Taxation and Fin., *supra* note 9, at 2.

[76]Harley Duncan and Sarah McGahan, "An Overview of Recent Sales and Use Tax Legislation," *State Tax Notes*, Aug. 22, 2011, p. 483, *Doc 2011-17205*, or *2011 STT 162-2* (listing the states that have passed Amazon laws: Arkansas, California, Colorado, Connecticut, Illinois, New York, North Carolina, Oklahoma, Rhode Island, South Dakota, Texas, and Vermont); *see also* Stephen P. Kranz, Lisbeth A. Freeman, and Mark W. Yopp, "Is *Quill* Dead? At Least One State Has Written the Obituary," *State Tax Notes*, Aug. 2, 2010, p. 307, *Doc 2010-16154*, or *2010 STT 147-1* (listing Alabama, Georgia, Minnesota, and Wisconsin as states that have passed Amazon laws); Robert D. Plattner, Daniel Smirlock, and Mary Ellen Ladouceur, "A New Way Forward for Remote Vendor Sales Tax Collection," *State Tax Notes*, Jan. 18, 2010, p. 187, *Doc 2009-28458*, or *2010 STT 11-2* (listing Alabama, Idaho, Indiana, Kansas, Minnesota, and Wisconsin as states that have passed Amazon laws).

Our preliminary research suggests that as many as 16 states may have passed Amazon laws as of May 2012, including Alabama, Arkansas, California, Colorado, Connecticut, Georgia, Illinois, Minnesota, New York, North Carolina, Oklahoma, Rhode Island, South Dakota, Texas, Vermont, and Wisconsin. However, one might question whether the legislation enacted by some of those states should be counted as Amazon laws, and some of those states may repeal their Amazon laws if they reach compromises with major e-commerce vendors (such as Amazon). *See infra* note 111.

[77]Karen Setze and John Buhl, "California Governor Signs 'Amazon' Law," *State Tax Notes,* July 7, 2011, *Doc 2011-1480,* or *2011 STT 126-2*.

[78]Billy Hamilton, "How Amazon's Texas Deal Unraveled," *State Tax Notes*, July 18, 2011, p. 191, *Doc 2011-14671*, or *2011 STT 137-2*.

[79]Billy Hamilton, "The Empire Strikes Back: Amazon Fights Against Online Tax Efforts," *State Tax Notes*, June 27, 2011, p. 959, *Doc 2011-13071*, or *2011 STT 123-4* ("Another 10 states are considering or have recently considered similar legislation — Arizona, California, Hawaii, Louisiana, Minnesota, Mississippi, Nevada, New Mexico, Texas, and Vermont."); *see also* Dolores W. Gregory and Nancy J. Moore, "As States Crank Up Efforts to Force Use Tax Collection, Amazon Threatens to Shutter Operations in Texas and California," *BNA Daily Tax Report*, Mar. 22, 2011, No. 55, at J-1 (describing proposed and actual legislation by Arizona, Arkansas, California, Colorado, Connecticut, Hawaii, Illinois, Maine, Massachusetts, Minnesota, Mississippi, New Mexico, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, and Vermont).

[80]For a general discussion of how states muddle through budget crises, *see* David Gamage, "Preventing State Budget Crises, Managing the Fiscal Volatility Problem," 98 *Calif. L. Rev.* 749, 754-768 (2010).

[81]*E.g.*, Michael Mazerov, Center on Budget and Policy Priorities, "Amazon's Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny," (2010), *available at* http://www.cbpp.org/files/11-16-09sfp.pdf; Andrew Haile, "Defending Colorado's Use Tax Reporting Requirement," *State Tax Notes*, Sept. 20, 2010, p. 761, *Doc 2010-16462*, or *2010 STT 181-1*; Zelinsky, *supra* note 10, at 557.

[82]Ultimately, we believe that only our proposed solution of adequate vendor compensation — described in our companion article — offers the states an effective way forward in their attempts to preserve their sales and use tax bases against the erosion caused by the growth of e-commerce. *See, e.g.*, Zelinsky, *supra* note 10, at 578. ("Why are Amazon laws suddenly proliferating as they are now? At one level, that proliferation seems particularly quixotic, given the unconstitutionality and futility of these state laws.")

[83]N.Y. Tax Law section 1101(b)(8)(vi) (McKinney 2011). It appears that the state may chain those connections back to the remote vendor, even if the remote vendor contracts solely with another out-of-state business that in turn contracts with an in-state business. *See* N.Y. State Dep't of Taxation and Fin., *supra* note 9, at 2.

$10,000, in the case of New York's statute.[84] These statutes provide that remote vendors who have those agreements are presumed to be soliciting sales through in-state residents[85] and therefore are subject to the state's use tax.

The referrer-nexus approach is sometimes called the affiliate tax approach[86] or the click-through nexus[87] approach. The first state Amazon law — passed by New York in 2008 — relied on that approach,[88] and many of the later state Amazon laws have done the same.[89] New York's referrer-nexus statute provides that a vendor can rebut the presumption of physical presence if it can prove 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."[90] The litigation[91] surrounding New York's statute consequently centered on the statute's application — in particular, whether a remote vendor may be subject to use taxation if the vendor's only solicitation activities within the state are compensating in-state residents for linking to the vendor on the residents' websites.[92]

Even if Amazon loses its constitutional challenge to New York's statute, we expect that the referrer-nexus approach will still prove ineffective. Overstock.com has already suspended its relationships with marketing associates in New York in order to avoid being subject to New York's use tax.[93] Amazon has similarly suspended relationships with marketing associates in other states that have passed referrer-nexus laws.[94] Presumably, the only reason that Amazon has not also done so in New York is to maintain standing to challenge New York's statute.[95] If Amazon loses the litigation it likely will respond by terminating all click-through marketing relationships with New York residents so as to remain exempt from New York's use tax.[96] The referrer-nexus approach ultimately fails as a way forward for the states to tax e-commerce for the simple reason that e-commerce vendors can easily end all referral relationships with in-state residents.

Similar in many ways to the referrer-nexus approach, the related-entity-nexus approach attempts to satisfy the commerce clause's nexus requirement by attributing physical presence to remote vendors that have specific business relationships with in-state firms. The approach is sometimes called the affiliate-nexus approach.[97] Under either name, the approach involves triggering a remote vendor's use tax liability under one of two circumstances: (1) if the remote vendor controls or is controlled by an in-state business or is under common control with an in-state business,[98] or (2) if the remote vendor and an in-state business "use an identical or substantially similar name, tradename, trademark, or

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[84]N.Y. Tax Law section 1101(b)(8)(vi).

[85]Section 1101(b)(8)(vi) creates a presumption that out-of-staters are soliciting sales through in-state residents if its requirements are met. *See id.* The presumption appears definitional, however, and is likely difficult to rebut unless the out-of-state business can prove that it should fit within the statutory exclusion.

[86]*See, e.g.*, Gordon, *supra* note 9, at 309.

[87]*See, e.g.*, Kranz, Freeman, and Yopp, *supra* note 76, at 309.

[88]*See supra* note 75.

[89]*See, e.g.*, R.I. Gen. Laws section 44-18-15(a)(2) (2010); N.C. Gen. Stat. section 105-164.8(b)(3) (2009).

[90]N.Y. Tax Law section 1101(b)(8)(vi) (McKinney 2011).

[91]The New York Appellate Division recently upheld New York's statute as facially constitutional. *Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin.*, 913 N.Y.S.2d 129 (N.Y. App. Div. 2010). However, the question remains to be decided on remand as to whether the statute can constitutionally be applied to major e-commerce vendors like Amazon. Zelinsky, *supra* note 15, at 104. And Amazon will undoubtedly appeal if it loses the as-applied challenge. According to Zelinsky, "Ultimately, this controversy is likely to play out before the U.S. Supreme Court." *Id.* at 93. *See also Performance Marketing Ass'n, Inc. v. Hamer*, No. 2011 CH 26333 (Ill. Cir. Ct. Cook Cty. May 7, 2012) (finding Illinois's click-through nexus law unconstitutional).

[92]Guidance by New York's Department of Taxation and Finance indicates that an in-state resident's linking to the remote vendor's website without any other "solicitation activity in the state targeted at potential New York State customers on behalf of the seller" does not on its own trigger the vendor's being subject to use taxation. N.Y. State Dep't of Taxation and Fin., *supra* note 9, at 4. That language, however, appears inconsistent with one of the accompanying examples, which describes a remote vendor that enters into an agreement with a service provider, who in turn contracts with New York state residents to refer potential customers back to the remote vendor. The referrals take the form of "placing [the

(Footnote continued in next column.)

vendor's] product links on their Web sites," with commissions paid by the service provider for sales made through those links. *Id.* at 3. The example concludes that the remote vendor is presumed to be soliciting sales through in-state residents. *Id.* at 4. Later guidance provided another safe harbor, under which remote vendors could rebut the nexus presumption by including in their referral agreements a provision prohibiting their in-state representatives from "engaging in solicitation activities in New York." N.Y. State Dep't of Taxation and Fin., "Additional Information on How Sellers May Rebut the New Presumption Applicable to the Definition of Sales Tax Vendor as Described in TSB-M-08(3)S, TSB-M-08(3.1)S," at 1 (2008). This safe harbor requires the in-state residents to certify annually that they have not engaged in any prohibited solicitation during the prior year. *Id.*

[93]Zelinsky, *supra* note 15, at 102.

[94]*E.g.*, Joe Hanel, "Amazon Drops Colorado Affiliates in Response to Law," *State Tax Notes*, Mar. 12, 2012, p. 735, *Doc 2012-4986,* or *2010 STT 45-5*. 735 (2010); Geoffrey A. Fowler, "Corporate News: Amazon Cuts North Carolina Affiliates to Avoid Tax," *The Wall Street Journal*, June 27, 2009, http://online.wsj.com/article/SB124603593605261787.html.

[95]Zelinsky, *supra* note 15, at 102.

[96]*Id.*

[97] Swain, *supra* note 23, at 419.

[98]*See, e.g.*, Ala. Code section 40-23-190(a)(1)-(3), (b)(1) (2003).

goodwill, to develop, promote, or maintain sales"[99] or otherwise substantially coordinate their business practices. In effect, the related-entity-nexus approach attempts to circumvent the commerce clause's prohibitions by disregarding corporate structure and treating related business entities as though they were a single unitary business. States that have passed legislation based on the related-entity-nexus approach include Alabama, Arkansas, California, Georgia, Idaho, Indiana, Kansas, Minnesota, New York, Oklahoma, Texas, and Wisconsin.[100]

> ***The referrer-nexus approach ultimately fails as a way forward for the states to tax e-commerce for the simple reason that e-commerce vendors can easily end all referral relationships with in-state residents.***

Like the referrer-nexus approach, the related-entity-nexus approach may be "constitutionally suspect."[101] Stephen Kranz, Lisbeth Freeman, and Mark Yopp argue, "Nowhere does the Constitution, or the cases applying it, give support to the idea that two retailers that are simply members of the same controlled group of corporations create nexus for each other."[102] In contrast, John Swain argues, "Although no Supreme Court decision has addressed directly the issue of affiliate nexus, the Court has [addressed related concepts] which serve as building blocks for a theory of affiliate nexus."[103] He thus concludes that "states should feel unconstrained in enforcing sales tax collection obligations against companies currently attempting to avoid taxation through entity isolation techniques."[104] As those competing views indicate, there is no consensus about the constitutionality of the related-entity-nexus approach, and litigation remains ongoing.[105]

We do not believe that the related-entity-nexus approach — regardless of its constitutionality — offers the states an effective means for taxing interstate e-commerce. Maintaining their sales and use tax exemption is sufficiently important to major e-commerce vendors like Amazon that they can be expected to terminate most relationships that would cause them to lose that exemption. Alternatively, e-commerce vendors can move their subsidiaries or other related entities out of the states that pass related-entity-nexus statutes. As evidence of that willingness, Amazon has previously threatened to close warehouses and other facilities in several states.[106]

Some e-commerce vendors may place sufficient importance on maintaining their related operations within the states in which they now operate that they will remain subject to related-entity-nexus statutes. But we predict that many e-commerce vendors will go to extreme lengths to reorganize their operations in order to maintain their sales and use tax exemption, once the vendors have exhausted litigation and alternative options for challenging those statutes. For instance, *The Wall Street Journal* has reported that Amazon originally located in Washington state, rather than in California, to avoid being subject to California's sales tax.[107] And Amazon has continued to aggressively manage its business operations so as to avoid being subject to the sales and use taxes of major customer states.[108]

California's recently passed Amazon law attempted to subject Amazon to use taxation based on the related-entity-nexus strategy because Amazon maintains a subsidiary in California responsible for developing the Kindle e-book reader.[109] Consequently, Amazon challenged California's Amazon law both through litigation and by sponsoring a referendum to overturn the law.[110] Amazon later

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[99]*Id.* section 40-23-190(a)(2).

[100]Kranz, Freeman, and Yopp, *supra* note 76, at 311; Plattner, Smirlock, and Ladouceur, *supra* note 76, at 194

[101]Kranz, Freeman, and Yopp, *supra* note 76, at 311.

[102]*Id.* at 309; *see also* Edward Zelinsky, "California's Once and Future Amazon Law," *State Tax Notes*, Oct. 10, 2011, p. 83, *Doc 2011-19694*, or *2011 STT 196-1*. ("As a constitutional matter, common ownership is not a substitute for physical presence in the taxing state.")

[103]Swain, *supra* note 23, at 424.

[104]*Id.*

[105]Gregory and Moore, *supra* note 79. ("Whether Amazon's position will be upheld in court is an open question.")

[106]*E.g.*, Bill Kidd, "Amazon Closing Texas Facility Over Sales Tax Dispute," *State Tax Notes*, Feb 21, 2011, p. 519, *Doc 2011-3091,* or *2011 STT 30-22*.

[107]Stu Woo, "Amazon Battles States Over Sales Tax," *The Wall Street Journal*, Aug. 3, 2011, at A1. ("Amazon's Mr. Bezos has said he established the company in Washington partly because it has a tech-savvy but relatively small population, so state taxes wouldn't affect many potential customers.")

[108]*Id.* ("Former Amazon staffers say the tactic is typical of its aggressive approach to minimizing sales tax. Early employees recall requirements to consult lawyers before arranging trips to states including California. Former staffers say they got grilled about the purpose of trips and warned to avoid soliciting new customers, promoting products and doing similar activities in certain states because of tax concerns."); *see also* Mazerov, *supra* note 81, at 6-7 (discussing Amazon's history of aggressive tax planning).

[109]Laura Mahoney, "Retailers, Lawyers, Regulators, Scramble to Interpret 'Amazon' Law," *Daily Tax Rep.* (Bureau of Nat'l Affairs, Arlington, Va.), July 6, 2011, No. 83, at H-2. Amazon actually has two subsidiaries in California — A9.com, Inc. and Lab126. Zelinsky, *supra* note 102, at 83.

[110]Karen Setze, "Amazon Wants Repeal of California's Click-Through Law," *State Tax Notes*, July 18, 2011, p. 151 *Doc 2011-15212,* or *2011 STT 134-2*. *See also* Zelinsky, *supra* note 102, at 83.

said as part of a deal with the state that it might voluntarily collect sales tax on its California sales after a year-long exemption period.[111] Exactly what Amazon has committed itself to as part of this deal is unclear; Amazon has withdrawn its referendum, but Amazon may still have the option of challenging the California statute in court or moving its operations out of state after the end of the yearlong exemption period. Yet even if Amazon does eventually comply with California's related-entity-nexus statute, the related-entity-nexus approach seems less likely to succeed for states other than California that lack unique regions like Silicon Valley that might deter the major e-commerce vendors from moving all of their operations out of state.[112]

The final method by which states have attempted to tax sales by remote vendors to in-state residents — the "information-reporting requirements" approach — does not involve taxing the remote vendors at all. Rather, the approach involves requiring remote vendors to divulge information about the vendors' sales to in-state residents necessary for the state to effectively collect use taxes from the state's residents.[113]

Notice and reporting requirements facilitate the collection of use taxes in a manner similar to how W-2s facilitate income tax collection. The information reported has to contain only the total amount of a resident's purchases and some information capable of uniquely identifying the resident (such as an address). The most well-known state attempt to impose notice and reporting requirements is Colorado's HB 10-1193, which imposes three separate requirements on remote vendors that do not voluntarily collect use taxes on sales to Colorado residents.[114] First, those vendors must include a notice on invoices sent to Colorado purchasers informing them that use tax may be due to Colorado's Department of Revenue.[115] Second, the vendors must provide a year-end summary of all sales to Colorado residents who purchased $500 or more of taxable items in the previous year.[116] Finally, and most crucially, the vendors must provide the Colorado DOR with an annual summary of purchases made by Colorado residents and the aggregate amount that each resident purchased.[117] Failure to satisfy any of those requirements results in a fine, which ranges from $5,000 to $100,000.[118]

> ***We do not believe that the related-entity-nexus approach — regardless of its constitutionality — offers the states an effective means for taxing interstate e-commerce.***

We think that the information-reporting-requirements approach, unlike the referrer-nexus and related-entity-nexus approaches, would be largely successful were it constitutional. However, we conclude that of the three major approaches, the information-reporting-requirements approach most clearly violates the commerce clause and *Quill*'s physical presence requirement. As Zelinsky argues, "Six thousand different state and local reporting requirements would constitute the same 'welter of complicated obligations' as an equivalent number of conflicting tax collection responsibilities."[119] If we take the *Quill* decision seriously that the purpose of the physical presence requirement is to prevent the excess burden on remote vendors that might result from numerous taxing jurisdictions imposing tax compliance obligations, the physical presence rule should also apply to information-reporting requirements.

[111] *See* Stu Woo, "Amazon to Collect California Sales Tax by 2013," *The Wall Street Journal*, Sept. 28, 2011, http://online.wsj.com/article/SB10001424052970204138204576598883358407422.html. For further examples of compromises between states and Amazon concerning sales tax collection, *see, e.g.*, Karen Setze, "Tennessee Governor Announces Amazon Agreement," *State Tax Notes*, Oct. 10, 2011, p. 72, *Doc 2011-21142,* or *2011 STT 195-22*. John Buhl, "Amazon Reaches Tax Deal With Nevada, Negotiating With Texas," *State Tax Notes*, Apr. 30, 2012, p. 273, *Doc 2012-8704*, or *2012 STT 80-1*; John Buhl, "Virginia Governor Approves Amazon Sales Tax Deal," *State Tax Notes*, Apr. 9, 2012, p. 85, *Doc 2012-7281*, or *2012 STT 67-22*. John Buhl, "New Jersey Governor, Amazon Reach Collection Agreement," *State Tax Notes*, June 4, 2012, p. 676, *Doc 2012-11669,* or *2012 105-19*.

[112] Amazon and other major e-commerce vendors probably have to maintain warehouses and other related facilities in at least some states, but as long as a few geographically dispersed states do not pass affiliate-nexus statutes, Amazon should be able to cease operations in those states that do pass those statutes. The states face a holdout problem in attempting to cooperate to prevent Amazon from moving operations to states that do not attempt to enforce affiliate-nexus laws. We expect that a sufficient number of states will be willing to continue granting Amazon and other major e-commerce vendors use tax exemptions in order to lure warehousing and other business operations. For small states, the benefit of having those operations moved to within the state can easily exceed the revenue lost from granting use tax exemptions.

[113] *E.g.*, Colo. Rev. Stat. section 39-21-112(3.5) (2011); AB 155 section 3, 2011-2012 Reg. Sess. (Cal. 2011).

[114] The vendor must first be considered a retailer doing business within the state in order to be subject to notice and reporting requirements. *See* Colo. Rev. Stat. section 39-26-102(8) (2011); *id.* section 39-21-112(3.5)(c), (d) (requiring retailers that do not collect Colorado use tax to satisfy the notice and reporting requirements).

[115] *See* Colo. Reg. 39-21-112.3.5(2) (2010).

[116] *Id.* 39-21-112.3.5(3)(c).

[117] *Id.* 39-21-112.3.5(4).

[118] *Id.* 39-21-112.3.5(2)(f)(i), (4)(f)(ii)(3).

[119] Zelinsky, "The Siren Song," *supra* note 11, at 698.

Haile has argued that information-reporting requirements are "significantly less onerous than the burden of actually collecting use taxes."[120] That may be so,[121] but *Quill*'s bright-line rule was designed so that neither courts nor legislatures would inquire into the magnitude of the burden on interstate commerce.[122] Haile has also argued that information-reporting requirements should be evaluated as regulations rather than as taxes, so that *Quill*'s physical presence requirement should not apply to information-reporting requirements.[123] Although that seems plausible, we ultimately are unpersuaded. The sole purpose of imposing information-reporting requirements is to support a use tax regime. Given that the Court has repeatedly emphasized that the analysis of sales and use taxes under the commerce clause is to be based on "practical effects"[124] and "economic realities"[125] rather than on "formalism,"[126] we think it unlikely that lower courts would uphold a measure such as information-reporting requirements that has nearly identical practical effects and economic realities to requiring the actual collection of use taxes. Ultimately, unless the information-reporting-requirements approach is combined with our proposed solution of adequate vendor compensation, we expect courts to conclude that imposing information-reporting requirements fails *Quill*'s physical presence test. As Zelinsky concludes, "Haile's characterization of the Colorado Amazon law as tax-related but nevertheless a 'nontax' law [is unhelpful]. . . . It is more persuasive to characterize tax reporting laws as tax laws, subject to the dormant commerce clause constraints on tax laws."[127]

Of the three major approaches, the information-reporting-requirements approach most clearly violates the commerce clause and* Quill*'s physical presence requirement.

For those reasons, the U.S. District Court for the District of Colorado has permanently enjoined the enforcement of Colorado's information-reporting requirements.[128] In finding the law unconstitutional, the court held that "the information reporting obligations of the Colorado Amazon statute are indistinguishable from the responsibility to collect tax."[129] Although litigation remains ongoing, we are skeptical that the courts will allow states to tax interstate e-commerce using the information-reporting-requirements approach, unless that approach is combined with our proposed solution of adequate vendor compensation.[130]

Conclusion

We think it likely that the current attempts by state governments to tax remote e-commerce vendors such as Amazon will be unsuccessful, either because major e-commerce vendors will sever (or have severed) their ties with those states that pass Amazon laws or because such laws will be held unconstitutional. Thus, states desiring to tax sales by remote vendors to in-state residents should consider alternative modifications to their sales and use tax regimes. We propose one promising alternative approach in our forthcoming companion article.[131] ✰

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[120] Haile, *supra* note 81, at 764. *But see* Zelinsky, "The Siren Song," *supra* note 11, at 698 (questioning Haile's argument).

[121] However, to comply with information-reporting requirements, a remote vendor must know each taxing jurisdiction's rules for tax-exempt sales, sales tax holidays, and product coding. And "determining how to handle tax-exempt sales, sales tax holidays, and product taxability coding can be a daunting task, particularly for small and midsize businesses. It has been estimated that sales tax exemptions account for 60 percent of the cost of compliance for small businesses." Cara Griffith, "Streamlining Versus 'Amazon' Laws: The Remote Seller Dilemma," *State Tax Notes*, Feb. 1, 2010, p. 351, *Doc 2010-1816*, or *2010 STT 20-6*.

[122] Although *Quill* acknowledged that the physical presence rule, "like other bright-line tests[,] . . . appears artificial at its edges," the *Quill* majority nonetheless concluded that "this artificiality . . . is more than offset by the benefits of a clear rule." 504 U.S. at 315. By adopting the clear, bright-line physical presence rule, the *Quill* majority hoped to reduce litigation and to avoid the "quagmire" and "confusion" that might otherwise arise in the absence of "precise guides to the States in the exercise of their indispensable power of taxation." *Id.* at 315-316 (quoting *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-458 (1959)).

[123] Haile, *supra* note 81, at 763-764.

[124] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

[125] *Id.*

[126] *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992).

[127] Zelinsky, "The Siren Song," *supra* note 11, at 698.

[128] *Direct Mktg. Ass'n v. Huber*, No. 10-cv-01546-REB-CBS (D. Colo. Mar. 30, 2012).

[129] Zelinsky, "The Siren Song," *supra* note 11, at 698.

[130] For further discussion, *see* David Gamage and Darien Shanske, "The Saga of State 'Amazon' Laws: Reflections on the Colorado Decision," *State Tax Notes*, July 16, 2012, p. 197, *Doc 2012-13634,* or *2012 STT 136-4*.

[131] Gamage and Heckman, note 17, *supra*.