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Vendor Compensation as an Approach For State ‘Amazon’ Laws: Part 2

by David Gamage and Devin J. Heckman

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Introduction

Taxation of interstate electronic commerce (or e-commerce) has become one of the hottest topics in state and local tax scholarship. In the first of this two-part series, we surveyed the landscapes of the constitutional impediments to states taxing interstate e-commerce transactions and of the states’ attempts to nevertheless raise revenue from these transactions through the use of “Amazon” laws.

We expressed skepticism that any of the previously used Amazon-law techniques would prove effective and explained the need for an alternative approach for taxing interstate e-commerce.

In this article, the second of our two-part series, we propose a novel solution based on fully compensating remote vendors for all tax reporting and compliance costs. To that end, we dispute the conventional wisdom on the merits of Quill and on how the case has been understood. We argue that properly interpreted, Quill provides a near ideal framework for determining when states should be allowed to subject remote e-commerce vendors to sales and use taxation. Crucially, we argue that Quill should prevent states from taxing remote e-commerce vendors only to the extent that doing so would burden interstate commerce. Quill is not entirely clear regarding what constitutes a burden on interstate commerce. Yet we contend that both the text of Quill and the policy rationales underlying the decision best support an interpretation that the burden on interstate commerce that concerned the Quill Court results only when a state imposes tax collection costs on out-of-state vendors.

In other words, we argue that interstate commerce is not burdened under Quill merely because a sales transaction between a state resident and an out-of-state vendor bears the economic incidence of a state tax. Instead, interstate commerce is burdened only when an out-of-state vendor bears reporting or compliance costs as a result of a state’s imposing tax collection duties on the out-of-state vendor. Although this distinction has not previously been


2The term “economic incidence” refers to the ultimate effect of a tax or subsidy on the cost or price of a good. Who bears a tax or subsidy is a function of the relative price elasticities of supply and demand and is not fixed by who has a legal obligation to pay the tax. See Don Fullerton and Gilbert E. Metcalf, “Tax Incidence,” in 4 Handbook of Pub. Econ. 1787, 1791 (Alan J. Auerbach and Martin Feldstein eds., 2002).

3As we will discuss in more depth infra in notes 35-37 and accompanying text, sales transactions between in-state residents and out-of-state vendors already bear the economic incidence of many state taxes, and that has not been viewed as constitutionally problematic. Most notably, many states

(Footnote continued on next page.)
analyzed in any depth, our interpretation of *Quill* is consistent with most of what has been written about the decision.\(^4\)

**Under Quill, interstate commerce is burdened only when an out-of-state vendor bears reporting or compliance costs as a result of a state’s imposing tax collection duties on the out-of-state vendor.**

What previous commentators have largely failed to recognize, however, is that this distinction potentially offers states a constitutionally permissible approach for partially subjecting remote vendors to use taxes. Moreover, our proposed approach should not require the Supreme Court to revisit *Quill*, or Congress to pass enabling legislation. Rather, we argue that a state desiring to subject remote vendors to its use tax should have only to adequately compensate the remote vendors for the compliance and reporting costs thereby imposed.\(^5\)

Because we conclude that the burden on interstate commerce at issue in *Quill* results from imposing reporting and compliance costs on out-of-state vendors, adequately compensating those vendors for those costs would completely alleviate the burden on interstate commerce. The states would benefit from our approach because adequately compensating for tax collection costs should result in each state losing only a small fraction of the potential revenue available from taxing interstate e-commerce. Yet as the Court observed in *Quill*, without adequate compensation for tax collection costs, a remote vendor selling across the United States might face a substantial burden from the aggregate costs of complying with the “virtual welter of complicated obligations” imposed by the “nation’s 6,000-plus taxing jurisdictions.”\(^6\) Our proposed approach of adequately compensating remote vendors for all tax collection costs would thus allow the states to capture most of the potential revenue available from taxing interstate e-commerce while still not burdening interstate e-commerce with excess tax collection costs.

**Adequately compensating those vendors for reporting and compliance costs would completely alleviate the burden on interstate commerce.**

Previous scholarship has generally viewed the courts as facing a dilemma between either (a) denying states the right to tax interstate e-commerce and thus effectively granting remote e-commerce vendors an unjustified tax advantage over their in-state competitors,\(^7\) or (b) allowing states the right to tax interstate e-commerce and thus potentially disadvantaging multistate e-commerce vendors — who might then be burdened by tax compliance costs from each of the nation’s 6,000-plus taxing jurisdictions,\(^8\) whereas their local competitors would face compliance costs only wherever they have a physical presence. Our proposal navigates between those two undesirable extremes. By permitting state and local taxing jurisdictions to tax remote vendors if, and only if, the remote vendors are adequately compensated for all tax compliance costs, our approach

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\(^5\)Related to our argument, John L. Mikesell has previously proposed that Congress should authorize states to levy use taxes on remote vendors if they adequately compensate the remote vendors for compliance costs. “Remote Vendors and American Sales and Use Taxation: The Balance Between Fixing the Problem and Fixing the Tax,” 53 Nat’l Tax J. 1273 (2000). However, to our knowledge, we are the first to argue that the Court’s commerce clause jurisprudence already permits the states to levy use taxes on remote vendors if the states adequately compensate for all compliance costs.

\(^6\)Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992) (“Similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions”); see also Nat’l Bellas Hess, Inc. v. Dept’ of Revenue of Ill., 386 U.S. 753, 759-760 (1967) (“Many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations”).


\(^8\)Nat’l Bellas Hess, Inc., 386 U.S. at 759-760.
would place remote vendors and their in-state competitors on a far more level playing field.

Moreover, our proposal would give incentives to state and local taxing jurisdictions for simplifying their sales and use tax regimes because they would be forced to internalize the remote vendors’ costs of complying with those regimes. Our approach thus avoids the concern that permitting states to tax interstate e-commerce might allow the states to create complicated sales and use tax regimes as protectionist bulwarks against out-of-state competitors.

**Quill, Compliance Costs, and the Solution of Adequate Vendor Compensation**

Numerous commentators have argued that *Quill* is inappropriate for the Internet age and that the decision should be overturned. Yet we see no indication that the Supreme Court intends or even has reason to revisit *Quill*. Accordingly, the states have generally attempted to work within the *Quill* framework when designing their sales and use taxes.

There are two justifications for *Quill*’s physical presence rule: preventing burdens on interstate commerce and *stare decisis*. We argue that the burden on interstate commerce that troubled the Court in *Quill* arises solely from the potential for remote vendors to be subject to excess tax compliance costs. Hence, properly implemented, our proposed solution of adequate vendor compensation would completely alleviate any potential for burdening interstate commerce. We further argue that our proposed approach should survive any constitutional challenge based on *stare decisis*, because the lack of any potential for burdening interstate commerce makes our proposal different in kind from the tax statutes that the *Quill* decision ruled unconstitutional.

**A. The Burden on Interstate Commerce in Quill**

In moving beyond its old, formalistic dormant commerce clause jurisprudence, the Court has repeatedly emphasized “the importance of looking past ‘the formal language of the tax statute [to] its practical effect.” As the Court explained in *Commonwealth Edison*:

The Court has rejected the notion that state taxes levied on interstate commerce are per se invalid. In reviewing commerce clause challenges to state taxes, our goal has instead been to “establish a consistent and rational method of inquiry” focusing on “the practical effect of a challenged tax.”

In evaluating whether the dormant commerce clause bars any state action, the threshold question then must be whether the state action would actually burden interstate commerce. The commerce clause should not bar a state from taking action that would not burden interstate commerce. As the Court explained in *Quill*:

The Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause... bars state regulations that unduly burden interstate commerce.

Crucially, the Court has “recognized that, with certain restrictions, interstate commerce may be required to pay its fair share of state taxes.” Or, in other words, the “Court has acknowledged that ‘a State has a significant interest in exacting from interstate commerce its fair share of the cost of state government.’” Perhaps most to the point, the Court stated in *Commonwealth Edison*:

To accept appellants’ apparent suggestion that the Commerce Clause prohibits the States
As those cases indicate, the Court’s modern commerce clause jurisprudence is not designed to place interstate commerce in a tax-advantaged position with respect to intrastate commerce — “even interstate business must pay its way.” A state tax that equally burdens both interstate and intrastate transactions should not run afoul of the commerce clause, because that tax would not burden interstate commerce as compared with intrastate commerce.

Why then did Quill hold that a state may not impose use tax compliance obligations on remote vendors lacking a physical presence within the state when the tax rate levied on interstate transactions would have been the same as that levied on intrastate transactions? The Court’s reason cannot have been that the commerce clause shields remote vendors from paying the same taxes or bearing the same compliance obligations as do in-state vendors. That would directly contradict the Court’s repeated proclamations that the purpose of the commerce clause is not “to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.”

Importantly, the Quill majority specified that it was upholding the physical presence rule because “it is not inconsistent with Complete Auto” and the other modern commerce clause cases. And the only justification for Quill that would be consistent with Complete Auto and with the Court’s other articulations of modern commerce clause jurisprudence must be that allowing the states to apply their use taxes to remote vendors lacking physical presence would result in those vendors bearing greater costs than do in-state vendors.

Quill indeed explained how allowing states to impose use tax compliance obligations on remote vendors could result in those vendors bearing greater costs compared with vendors that operate solely within a single state. Quoting Bellas Hess, Quill’s entire discussion of how allowing states to impose use tax obligations on remote vendors might burden interstate commerce revolved around the “virtual welter of complicated obligations” that a vendor operating in multiple taxing jurisdictions might face. Because Quill’s articulation of the potential burden on interstate commerce is crucial to our argument, it is worth quoting the relevant discussion from Quill in full:

North Dakota’s use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the Bellas Hess rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions. See National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 759-760... (noting that the “many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations”).

To repeat ourselves for emphasis, the above paragraph is the entirety of Quill’s analysis regarding how allowing states to apply their use taxes to remote vendors might burden interstate commerce. As the quoted paragraph makes clear, the Court was concerned with the imposition of a “collection duty” on remote vendors and in particular with the fear that a remote vendor might be entangled in a “virtual welter of complicated obligations” imposed by the “nation’s 6,000-plus taxing jurisdictions.”

Consistent with the Court’s modern commerce clause jurisprudence, Quill was thus justified based on the fear that overlapping compliance burdens from multiple jurisdictions could result in multi-state vendors bearing greater costs than single-state vendors. Quill was not based on any notion that remote vendors should be placed in a tax-advantaged position as compared with single-state vendors.

Moreover, Quill was correct in concluding that allowing states to impose use tax compliance obligations on remote vendors could burden interstate commerce. Quill’s analysis regarding the purposes of the commerce clause is consistent with the Court’s repeated proclamations that the purpose of the commerce clause is not “to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.”

...
commerce compared with intrastate commerce. Whereas a vendor operating exclusively within a single state must bear only the tax collection costs imposed by that state’s sales or use tax, in the absence of a physical presence rule, an e-commerce vendor operating in many states could bear tax collection costs from the use tax of each state to which the vendor ships goods. The combined costs of coping with multiple states’ use tax regimes could greatly exceed the costs of dealing with only a single state’s regime, thus forcing vendors wanting to sell to multiple states to face higher aggregate compliance costs than would vendors selling only within a single state.\textsuperscript{27}

As in \textit{Quill}, the only discussion in \textit{Bellas Hess} about how allowing states to impose use tax compliance obligations on remote vendors might burden interstate commerce relies on the overlapping compliance duties that could be imposed by multiple jurisdictions.\textsuperscript{28} Again, it is worth quoting that discussion in full:

And if the power of Illinois to impose use tax burdens on National were upheld, the resulting impediments on the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National’s interstate business 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.” The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements.\textsuperscript{29}

Both \textit{Quill} and \textit{Bellas Hess} thus justify the physical presence requirement based on the fear that a mail-order vendor (or e-commerce vendor) selling across the United States could face high aggregate compliance costs because of the nation’s many taxing jurisdictions. This fear appears to have been magnified by the concern that there is no necessary connection between the compliance costs imposed by a state or local jurisdiction’s use tax regime and the magnitude of sales a vendor conducts within that state or local jurisdiction.\textsuperscript{30} A small state or local jurisdiction could potentially impose compliance costs larger than the actual amount of sales made into the jurisdiction if the level of sales were sufficiently small and the jurisdiction’s use tax regime sufficiently complicated.

The physical presence rule of the nexus requirement might thus be viewed as a mechanism for creating a fair apportionment test for tax compliance costs analogous to the fair apportionment test for direct tax costs in the second prong of the \textit{Complete Auto} test.\textsuperscript{31} Rather than attempting to devise a rule for what minimum amount of sales—beyond that required by the due process clause—would justify a jurisdiction’s imposing compliance burdens on remote vendors, the Court instead adopted the bright-line physical presence rule.\textsuperscript{32} Again, the Court’s motive appears to have been to prevent jurisdictions from disproportionately burdening remote vendors with excess compliance costs. But for the concern about excess tax compliance costs, there would be no need to ensure fair apportionment of tax compliance costs, and there would consequently be no need for \textit{Quill}’s physical presence rule.

Even Amazon — “the No. 1 Internet retailer” and “lead dog when it comes to fighting the online tax issue”\textsuperscript{33} — publicly defends its opposition to the states’ extending their use tax regimes to e-commerce based on the same concern about excessive compliance costs as relied on in \textit{Quill} and \textit{Bellas Hess}. As The Sacramento Bee reports, “Amazon says it isn’t opposed to an Internet sales tax. It just doesn’t want to deal with the complexity of 7,500 different tax jurisdictions in the United States. Founder and Chief Executive Jeff Bezos has said he supports a unified approach that simplifies tax collection across the country.”\textsuperscript{34} Of course, skeptics argue that Amazon’s public statements are hypocritical and that the company’s true motives are to maintain for as long as possible its tax advantage as compared with competing retailers that must maintain a physical presence within major customer

\textsuperscript{27}\textsuperscript{27}We provide an extended example in support of this point infra.
\textsuperscript{28}\textit{Nat’l Bellas Hess, Inc.}, 386 U.S. at 759-60.
\textsuperscript{29}\textit{id.} (footnotes omitted) (quoting \textit{Freeman v. Hewit}, 329 U.S. 249, 253 (1946)).
\textsuperscript{30}\textit{Quill}, 504 U.S. at 313 n.6; \textit{Nat’l Bellas Hess, Inc.}, 386 U.S. at 760.
\textsuperscript{31}For a discussion of the fair apportionment rule for direct tax costs, see Gamage and Heckman, \textit{supra} note 1.
\textsuperscript{32}\textit{Quill}, 504 U.S. at 314-316.
\textsuperscript{34}\textit{id.}
Nevertheless, Amazon’s public position supports our argument that the only justifiable reason for enforcing use tax compliance is applying their use taxes to remote vendors comes from the excess compliance costs that could be generated by numerous taxing jurisdictions imposing nonuniform compliance obligations; even Amazon does not argue that remote e-commerce vendors deserve a tax advantage as compared with their in-state competitors.

Finally, that states have long been able to levy use tax liabilities on their residents who purchase from remote vendors is perhaps the strongest argument in favor of interpreting Quill’s physical presence requirement as applying only when the states impose use tax compliance obligations on remote vendors that might burden interstate commerce. In most states, when individuals purchase e-commerce goods for which the vendor did not remit sales or use tax, they legally owe use taxes to their state of residence. That state residents appear to be unaware of their use tax liabilities, and that compliance is very low, does not change the fact that the commerce clause has never been interpreted as preventing states from making their individual residents liable for use taxes on purchases from remote vendors. If the purpose of Quill’s physical presence requirement was to shield remote vendors from the economic incidence of state sales and use taxation, then the commerce clause should also block states from imposing use tax liabilities on their own residents for goods purchased from remote vendors.

The economic incidence of the tax burden generally remains the same even if the statutory incidence changes; that is, the economic incidence is not affected by whether a state resident is liable for a use tax on purchases from remote vendors or whether the remote vendors are liable for remitting the use tax. In either case, the same amount of tax is paid — raising the cost of the sales transaction between the state resident and the remote vendor by the same amount. The only major differences between these two approaches for taxing interstate transactions are that (1) states find it much easier to enforce compliance when vendors are required to remit use taxes, compared with when individual residents are required to remit the taxes; and (2) requiring vendors to remit use taxes imposes reporting and compliance costs on those vendors, whereas requiring individual residents to remit use taxes imposes the reporting and compliance costs on the individual residents. As no one has argued that enforcement difficulties make a tax less constitutionally suspect, only the second of those factors can justify the commerce clause’s barring states from imposing use tax compliance obligations on remote vendors while allowing states to impose such obligations on the state’s individual residents. Again, the only plausible way to reconcile Quill’s physical presence requirement with the Court’s other commerce clause holdings is to view the physical presence requirement as applying only when states impose compliance costs on remote vendors in a manner that burdens interstate commerce. Any other interpretation of Quill would contradict the majority’s claim that upholding the physical presence requirement is consistent with the Court’s other modern commerce clause holdings.

B. The Solution of Adequate Vendor Compensation

If, as we have argued, the burden on interstate commerce in Quill results from multistate vendors potentially facing higher use tax compliance costs compared with those of single-state vendors, a remedy is available that would allow states to collect use tax revenue from remote vendors without burdening interstate commerce. We propose that Quill be interpreted in such a way that states would be barred from imposing use tax compliance burdens on remote vendors only when the states fail to adequately compensate the remote vendors for all those compliance costs imposed.

Imagine two fictional states — Taxachusetts and New Pork — each of which wants to levy a 10 percent sales and use tax. Each state’s tax regime would impose compliance costs on vendors charged with remitting the state’s tax. Those compliance costs are unlikely to be directly proportional to the amount of tax revenue collected, because there are fixed costs associated with complying with a tax that arise from the need to research the tax regime and design systems to remit the tax. Imagine that a

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Footnote continued on next page.

36Gamage and Heckman, supra note 1.
38Jonathan Gruber, Public Finance and Public Policy, 521 (2004). There are exceptions to this rule — that is, circumstances that can lead to economic incidence varying with statutory incidence. But those exceptions are not important for our purposes here.
A typical small vendor with total sales of $500,000 would bear compliance costs for each state’s tax it is charged with remitting equal to fixed costs of $2,500 plus additional variable costs equal to 0.02 percent of the amount sold into the state.\textsuperscript{41}

A small vendor selling only to the residents of the state in which the vendor resides would thus bear compliance costs of $3,500 (the $2,500 of fixed costs plus variable costs of $1,000 — or variable costs equal to 0.02 percent of the $500,000 of sales). These compliance costs would be in addition to the $50,000 of tax revenue that the vendor would be charged with remitting (from the 10 percent tax rate). In total, the state’s tax would thus impose a burden of $53,500 on sales between the single-state vendor and the state’s residents.

Now imagine that a vendor selling exclusively to residents of Taxachusetts moves its operations to New Pork, so that the vendor no longer has a physical presence in Taxachusetts and conducts all its sales through e-commerce. If \textit{Quill}'s physical presence rule exempts the vendor from Taxachusetts sales and use tax, the vendor would now have a tax cost advantage over competitors that remain in Taxachusetts. Using the numbers above, the vendor would enjoy a tax cost advantage of $53,500 — or 10.7 percent of sales — from the combination of avoiding both direct tax costs and tax compliance costs due to moving to New Pork.

This example might suggest that the goal of treating interstate commerce and intrastate commerce equally would require allowing Taxachusetts to subject remote vendors to its sales and use tax without compensating for compliance costs. But imagine another small vendor residing in New Pork that makes half of its sales ($250,000) to individual residents of Taxachusetts and the other half to individual residents of New Pork. If this vendor were subject to the sales and use tax regimes of both Taxachusetts and New Pork, the vendor would face compliance costs from both tax regimes. In total, the vendor would face compliance costs of $6,000 (the vendor would be subject to the fixed costs of $2,500 twice, because of the need to comply with both Taxachusetts’s and New Pork’s tax regimes, plus the variable costs of 0.02 percent of the $500,000 of aggregate sales).

In the absence of \textit{Quill}'s physical presence rule, the multistate vendor could thus face higher aggregate costs than would a vendor operating solely within a single state. That tax disadvantage results from the fixed costs associated with complying with each separate tax regime.\textsuperscript{42} In our example above, the multistate vendor faced a tax disadvantage of only $2,500 (from aggregate costs of $56,000, compared with the single-state vendor’s aggregate costs of $53,500). But our example above involved only two taxing jurisdictions. With 50 states and several thousand local taxing jurisdictions, a multistate vendor might well face a significant disadvantage from aggregate use tax compliance costs in the absence of \textit{Quill}'s physical presence rule or an equivalent protection.\textsuperscript{43}

In the extreme, imagine if the $2,500 of additional tax burden resulting from the fixed costs of complying with each jurisdiction’s separate use tax was multiplied by several thousand separate taxing jurisdictions. Although it is unlikely that real-world tax compliance burdens would ever reach these levels,\textsuperscript{44} we should be wary of even the theoretical possibility of a multistate vendor with sales of only $500,000 facing use tax compliance costs in the range of several millions of dollars.\textsuperscript{45} Even if burdens reached only a small fraction of that level, use tax compliance costs could still significantly burden interstate commerce.

\textsuperscript{41}See, e.g., Cara Griffith, “Streamlining Versus ‘Amazon’ Laws: The Remote Seller Dilemma,” \textit{State Tax Notes}, Feb. 1, 2010, p. 351, Doc 2010-1816, or 2010 STT 20-6. (“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.”)

\textsuperscript{42}That disadvantage would burden small and medium-size vendors far more than it would large vendors, and the disadvantage could be alleviated to some extent by exempting small vendors from use taxation. But the burden does not completely disappear for large vendors, and even the burden facing large vendors could be significant if thousands of taxing jurisdictions are allowed to impose different use tax regimes and the differences in these regimes are sufficiently complicated.

\textsuperscript{43}If compliance burdens began to reach extremely high levels, there would likely be significant political pressure to simplify and unify use tax regimes.

\textsuperscript{44}An aggregate use tax compliance burden in the millions of dollars could result only if the vendor sold into numerous

\textsuperscript{45}(Footnote continued on next page.)
We thus have a dilemma in developing a commerce clause rule for state taxation of transactions between the state’s residents and remote vendors. Exempting remote vendors from state sales and use taxation grants those vendors a significant tax advantage, which is not the purpose of the commerce clause. But allowing states to impose the same compliance burdens on remote vendors as they do on in-state vendors could impose a substantial tax cost disadvantage on remote vendors, which could in turn burden interstate commerce. And if a state attempted to chart a middle course by imposing compliance burdens on larger remote vendors while exempting smaller remote vendors, this approach would provide the smaller remote vendors with an unjustified tax advantage compared with both larger remote vendors and in-state vendors of all sizes.

Fortunately, a better middle course is available. Because the burden on interstate commerce that justifies Quill’s physical presence rule results from tax compliance costs, rather than from the direct costs of taxation, the burden can be alleviated by permitting states to impose use tax compliance obligations on remote vendors if and only if the states adequately compensate the remote vendors for all such compliance costs imposed. Returning to our example above in which a vendor residing in New York sold to both Taxachusetts and New York residents, imagine that Taxachusetts levied its use tax on the vendor while compensating for the tax compliance costs thereby imposed. The vendor would bear $6,000 in gross compliance costs (the vendor would still be subject to the fixed costs of $2,500 twice, because of the need to comply with both Taxachusetts’s and New York’s tax regimes, plus the variable costs of 0.02 percent of $500,000). But Taxachusetts would then reimburse the vendor for $3,000 of those compliance costs (the $2,500 fixed costs of complying with Taxachusetts’s use tax, plus the variable costs of 0.02 percent of the $250,000 of sales made to Taxachusetts’s residents). The vendor would thus face net compliance costs of only $3,000 after the reimbursement. When combined with the direct tax costs of $50,000 from the 10 percent tax rate levied on sales into either state, the vendor’s sales would be subject to an aggregate burden of $53,000.

Consequently, permitting states to impose use tax compliance obligations on remote vendors only when the states adequately compensate the remote vendors for those costs would alleviate the burden on interstate commerce. Indeed, our proposal of adequate vendor compensation would likely result in remote vendors’ maintaining a small tax cost advantage compared with in-state vendors. In our numerical examples, the multistate vendor would face costs of $53,000 compared with the in-state vendor’s costs of $53,500. The reason for this tax cost advantage is that our examples require the states to compensate for the variable costs of use tax compliance in addition to the fixed costs. We suspect that it would prove administratively impractical to require states to compensate only for fixed costs, because there is no simple and straightforward mechanism for perfectly distinguishing between direct and indirect costs. Nevertheless, our proposal would still level the playing field considerably compared with completely exempting remote vendors from use taxation.

Moreover, our proposal would allow states to collect most of the potential revenue available from taxing e-commerce transactions with out-of-state vendors. In our example above, Taxachusetts would raise $25,000 of revenue by levying its 10 percent sales and use tax rate on the $250,000 of sales the remote vendor makes to Taxachusetts residents. As compensation for the compliance costs imposed by subjecting the remote vendor to its use tax, Taxachusetts would need to compensate the remote vendor only $3,000, thus producing a net revenue gain of $22,000 for Taxachusetts. This $22,000 gain amounts to 88 percent of the revenue that could have been raised from imposing the use tax on the remote vendor without compensating for compliance costs.

More generally, use tax compliance costs are estimated to be about 1 to 3 percent of tax revenue, with the costs being much higher as a percentage of

taxing jurisdictions, and some of those jurisdictions might be prevented from levying use taxes on the vendor because of the minimum contacts requirement of the due process clause, even if the jurisdictions were not prevented from imposing burdens due to the commerce clause. Nevertheless, although the example of a vendor making $500,000 in total sales being subject to millions of dollars in aggregate use tax compliance costs is unrealistically extreme, it still illustrates the general result whereby a multistate vendor could face a significant tax disadvantage from being subject to multiple use tax compliance regimes in the absence of a compensation requirement or some other protection for the vendor.

46This advantage results because we propose that states implement vendor compensation so as to ensure that remote vendors are fully and adequately compensated; in order for states to meet their constitutional obligations, we suggest that states are in the direction of overcompensating remote vendors. Were states able to compensate only for the incremental compliance costs that a remote vendor incurs from doing business in the state, then states could avoid either overcompensating or undercompensating remote vendors such that neither remote vendors nor in-state vendors would enjoy any tax cost advantages.

47And a state wanting to level the playing field would need only to compensate in-state vendors for compliance costs in addition to compensating remote vendors.
sales for small vendors than for large vendors.48 Hence, requiring states to compensate for compliance costs should result in the states being able to raise nearly all the revenue available from taxing e-commerce, while still avoiding burdening interstate commerce. If the requirement that states compensate remote vendors for compliance costs provides incentives for the states to simplify and unify their use tax regimes, the revenue loss from compensating remote vendors could end up being an even smaller percentage of the revenue states could raise without vendor compensation.

Some small states and taxing jurisdictions might find that compensating vendors for compliance costs could result in significant revenue loss, but only if the jurisdictions impose complicated use tax compliance obligations on vendors that sell only minimal amounts into the jurisdictions. If a jurisdiction exempts from its use tax vendors whose sales into the jurisdiction fall below some minimal threshold amount, the jurisdiction can ensure that vendor compensation results in only small revenue loss.

In sum, permitting the states to impose use tax compliance burdens on remote vendors, if and only if the states adequately compensate for all compliance costs thereby imposed, would effectively navigate between the harms that result either from completely blocking the states from taxing remote vendors or from allowing the states to tax remote vendors without restriction. As compared with a rule completely exempting remote vendors from sales and use taxation, our proposal would level the playing field between remote vendors and their in-state competitors considerably. No longer would remote vendors have an advantage over their in-state competitors by being shielded from both direct tax costs and compliance costs. Instead, they would enjoy only the much smaller advantage of being compensated for compliance costs. Plus, the states would mostly be protected from the revenue loss that currently results from their inability to tax e-commerce transactions between their residents and remote vendors.

Conversely, as compared with overturning Quill and allowing the states unrestricted ability to tax e-commerce transactions with remote vendors, our proposal eliminates any potential for burdening interstate commerce. Because remote vendors would be more than compensated for any excess compliance costs from being subject to multiple jurisdictions’ use taxes, remote vendors would never face a tax disadvantage as compared with in-state vendors. Moreover, the states would have incentives to simplify and unify their use tax regimes and would be prevented from using complicated use tax compliance obligations as a backdoor form of protectionism. Consequently, our proposal of adequate vendor compensation would alleviate nearly all the harms that result from the previous, strict interpretation of Quill’s physical presence rule and would do so without creating any potential for burdening interstate commerce.

C. Implementing Our Proposal for Adequate Vendor Compensation

The implementation mechanics of our proposal are not without precedent. Twenty-eight states compensate vendors to some degree for the costs of complying with sales and use taxes in some contexts.49 For instance, Utah passed a law in 2006 that reimbursed some vendors for some of their costs from complying with a reduced sales and use tax rate imposed on food and food ingredients.50 The law reimbursed vendors that remitted between $15,000

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50Sales and Use Tax Relating to Food section 3, 2006 Utah Laws 2023-2024.
and $500,000 in sales or use taxes for their “verifiable amounts... actually expended... to purchase computer hardware, software, or programming to account for sales under the reduced sales and use tax.”51

As an alternative to Utah’s approach of compensation, some states allow vendors to keep a specified portion of the sales and use taxes they collect as compensation for the compliance costs of remitting the remainder to the state. For instance, Wyoming passed a law in 2011 “allowing retailers and other vendors to take up to a 1.95 percent discount from the sales taxes they collect and remit to the state.”52 Wyoming’s approach of using specified percentages thus achieves greater administrability at the expense of being less finely tuned in measuring actual compliance costs. Another similar example of a mechanism for reimbursing vendors’ compliance costs was the proposed administration and compliance equipment cost credit in the failed National Retail Sales Tax Act of 1996, which would have allowed vendors to withhold a percentage of taxes due to be remitted as compensation for specified compliance-related expenses.53

We suggest that states use a combination of those two approaches to ensure that they adequately compensate remote vendors for all compliance costs. As a default, and without need to show verification, vendors should be allowed to opt to keep a specified percentage of the use tax amounts they collect from transactions with a state’s residents. The percentage of use tax collections that a vendor should be allowed to keep could be set based on the size of the vendor or other easily demonstrable characteristics of the vendor. Regardless, the percentage amount should be set significantly higher than the state’s estimate for the average collection costs imposed on the category of vendors. Also, vendors should be allowed to demonstrate that their actual verifiable compliance costs exceed the percentage allowed. Vendors whose actual verifiable compliance costs exceed the allowed percentage should be permitted to keep a portion of the use tax revenue collected equal to the vendor’s actual verifiable compliance costs plus the costs incurred in reporting and demonstrating those compliance costs. Finally, if the compliance costs for any vendor exceed the amount of use tax revenue the vendor collects from transactions with individual residents in a state or local taxing jurisdiction, the state or local jurisdiction should establish a process for the vendor to apply for reimbursement for those costs.54

Importantly, compensation for compliance costs must include compensation for intangible costs such as executives’ time and the risk of being subject to penalties for inadvertent noncompliance.55 The default compensation rates should be set based on outside experts’ estimates for aggregate compliance costs, including both tangible and intangible costs. Remote vendors that want to demonstrate that their actual compliance costs exceed the default amounts should be permitted to submit expert testimony substantiating the vendor’s tangible and intangible compliance costs. And the states should also compensate remote vendors for amounts expended to document their compliance costs and to dispute the amounts of the compliance costs with the states.

The states should prefer to overcompensate vendors while levying use taxes rather than to be blocked from levying use taxes altogether.

As a matter of policy, it might arguably be exces
sive to compensate for all intangible compliance costs of this sort. Were Congress to pass legislation enabling the states to tax remote vendors as long as the states adequately compensated for all compliance costs, we might favor a less strict compensation regime. But to comply with the Quill framework, the states must create procedures so that vendors can expect to be fully and adequately compensated for

54This condition is necessary to ensure that small taxing jurisdictions do not impose excess compliance costs on remote vendors.

55It is impossible to reimburse vendors for the actual penalties imposed for noncompliance (inadvertent or otherwise), but it is possible to reimburse them for the risk premium created by the possibility of being subject to sanctions for inadvertent noncompliance. A properly designed vendor compensation system should be able to compensate vendors fully and adequately for all the expected costs created by imposing use tax compliance obligations on remote vendors, and this should satisfy the standard of not imposing any burden on interstate e-commerce. Even if some small number of remote vendor firms ended up bearing larger sanctions from inadvertent noncompliance than the allowed reimbursement amounts, that would not burden interstate commerce as long as remote vendors could anticipate receiving reimbursement amounts equal to or greater than the aggregate of all their expected costs — that is, compensation amounts would be full and adequate in expectation. We thank Mark Gergen and Andy Haile for their helpful comments on this point.
all compliance costs, both tangible and intangible. Those procedures will likely result in many vendors being overcompensated. Nevertheless, the states should prefer to overcompensate vendors while levying use taxes rather than to be blocked from levying use taxes altogether.

According to a 1998 study by the Research Division of the Washington State Department of Revenue, vendors' total costs of collecting and remitting Washington's state and local sales taxes amounted to 6.47 percent of tax collections for small vendors, 3.35 percent of tax collections for medium-size vendors, and 0.97 percent tax collections for large vendors, for a total weighted average of 1.42 percent of total revenue across all vendors. According to another study by PricewaterhouseCoopers LLP in 2006, the national average for annual sales tax compliance costs amounted to 3.09 percent of total tax collections in 2003, with small retailers' costs amounting to 13.47 percent of tax collections, medium-size retailers' costs amounting to 5.2 percent of tax collections, and large retailers' costs amounting to 2.17 percent of tax collections.

Hence, a jurisdiction might set the default compensation rates at 15 percent of tax collections for small vendors, 7 percent of tax collections for medium-size vendors, and 3 percent of tax collections for large vendors. Those generous compensation rates should exceed actual compliance costs for almost all vendors. Indeed, a jurisdiction wanting to be more aggressive might opt to set the compensation rates well below those levels. In any case, vendors would have to be allowed to demonstrate that their actual compliance burdens exceed the default percentages. Again, a vendor should be allowed to keep as compensation a percentage of the use tax revenue collected equal to the greater of the amounts calculated using the relevant default compensation percentage or the amount the vendor verifiably demonstrates as the vendor's actual compliance costs.

Our proposal in this section is intended as an example of a mechanism for ensuring full and adequate vendor compensation. Other approaches to vendor compensation are certainly possible. For instance, on policy grounds it might arguably be preferable for a state to compensate only for the estimated incremental compliance costs generated by doing business in the state. Our proposed approach is designed to minimize constitutional tensions, even at the expense of overcompensating many remote vendors from a policy perspective.

D. Overcoming Stare Decisis and Quill's Bright-Line Rule

There are two major justifications for Quill's physical presence rule. So far we have focused on analyzing the first justification — the potential burden on interstate commerce that could result from excess tax compliance costs. The second justification is based on stare decisis. Because the physical presence rule had previously been adopted by the Bellas Hess decision, the Quill majority concluded that "the 'interest in stability and orderly development of the law' that undergirds the doctrine of stare decisis . . . counsel[ed] adherence to settled precedent."

The Quill decision articulated the physical presence rule as a bright-line test. As Rosen and Hedstrom explained, "Under Quill, an assessment of the actual burdens is not required; physical presence is a bright-line rule and the law of the land." Even a small potential burden on interstate commerce thus suffices to prevent states from imposing use tax compliance obligations on remote vendors that lack physical presence within the state. Although the Quill decision 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." 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."

Nevertheless, although Quill's physical presence rule applies even when the potential burden on interstate commerce is small, the physical presence rule should not prevent state action unless that action has some actual potential for burdening interstate commerce. The Quill majority adopted the physical presence rule in order to avoid the potential confusion and quagmire that could result from a balancing test. It would be difficult to balance.

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56Washington State Department of Revenue, supra note 48, at 4.
57PricewaterhouseCoopers, supra note 48, at E-1.
58We thank Eric Rakowski and Susie Morse for their helpful suggestions on this point.

65Id. at 314.
66Rosen and Hedstrom, supra note 10, at 931.
67Quill, 504 U.S. at 315.
68Id. at 315-316 (quoting Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457-458 (1959)).
69Id. at 314-16.
potential harms to interstate commerce against the states’ valid interest in levying an appropriate amount of revenue from transactions between the states’ residents and remote vendors; that comparison would be like comparing apples with aardvarks, because there is no common metric for evaluating the two competing concerns. But in the absence of any potential burden on interstate commerce, that balancing act becomes simple. When there is zero weight placed on one side of a scale, any amount of weight on the other side of the scale makes the scale tip in that direction, even if the amount of that weight is indeterminable.

Zero potential burden is thus different in kind from small potential burden. Both balancing tests and bright-line tests are designed to weigh competing burdens. Neither test is appropriate when evaluating state action that has zero potential for burdening interstate commerce. Before any commerce clause test should be applied, the threshold condition must be met that there be some potential for the state action to actually burden interstate commerce.

Before any commerce clause test should be applied, the threshold condition must be met that there be some potential for the state action to actually burden interstate commerce.

Some commentators have attempted to justify Quill’s physical presence rule apart from any potential burden on interstate commerce. Those arguments might have validity based only on Bellas Hess, as the Bellas Hess decision was unclear regarding whether the physical presence requirement was justified by the commerce clause, the due process clause, or both. But Quill clarified that the due process clause does not prevent states from imposing use tax compliance obligations on remote vendors as long as the remote vendors conduct some threshold level of sales within the state. Only the commerce clause prevents states from imposing use tax compliance obligations on remote vendors. And Quill repeatedly clarified that the nexus requirement of the commerce clause is not about “fairness for the individual defendant” but rather is justified as “a means for limiting state burdens on interstate commerce.” In the absence of any potential for burdens on interstate commerce, the physical presence rule should not apply.

In other words, we argue that imposing use tax compliance burdens while adequately compensating remote vendors for all compliance costs is substantially different regarding the commerce clause from imposing use tax compliance burdens on remote vendors without adequately compensating for compliance costs. Although the Quill Court never discusses whether its holding would apply were states to adequately compensate for compliance costs, the logic of Quill suggests that the physical presence rule should not block states from imposing use tax compliance burdens when they adequately compensate remote vendors for all compliance costs. Stare decisis does not justify extending a holding to fact patterns that substantially differ from the facts on which the original holding was based.

Although many states have established systems for compensating some vendors for compliance costs to at least some degree, existing compensation levels are “relatively small compared to the estimated retailer’s costs of collecting sales and use taxes.” To our knowledge, no state or local taxing jurisdiction has ever fully compensated vendors for their compliance costs. Hence, that some states implemented partial vendor compensation schemes prior to the Quill decision does not imply that the Quill majority considered and rejected the possibility that a full and adequate vendor compensation system could enable the states to impose use tax compliance obligations without burdening interstate commerce. Only by fully and adequately compensating remote vendors for all use tax compliance costs can a state impose use tax compliance burdens on remote vendors without creating any potential for burdening interstate commerce — thus satisfying Quill.

If there is no potential burden on interstate commerce, the physical presence rule should not apply.

Along these lines, it is worth noting that the North Dakota statute evaluated by Quill contained a provision for partial vendor compensation. That provision was not discussed by any of the U.S. Supreme Court opinions, but the North Dakota Supreme Court noted that the vendor compensation provision served to “alleviate[] any burdens created

67E.g., Rosen and Hedstrom, supra note 10, at 932.
68See Quill, 504 U.S. at 305. (“Although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.”)
69Gamage and Heckman, supra note 1.
70Quill, 504 U.S. at 312.
71Id. at 313.
72Cline and Neubig, supra note 40, at 22.
73See id. (discussing existing compensation regimes).
74We thank Kirk Stark for bringing this to our attention and for his helpful comments on this point.
by requiring Quill to collect and remit the tax.775
Because the vendor compensation provision was inadequate, however, the provision did not eliminate the North Dakota Supreme Court’s concern that allowing states to impose collection costs on remote vendors could burden interstate commerce through excess tax collection costs.76 Unlike our proposal for full and adequate vendor compensation, to merely “alleviate” burdens on remote vendors does not suffice to prevent the potential for burdening interstate commerce. That the U.S. Supreme Court did not discuss the partial vendor compensation provision in the North Dakota statute thus provides no indication as to the constitutionality of a full and adequate system of vendor compensation.77 There is no suggestion in Quill or in any of the related cases that any court considered the possibility that a state might devise a system for fully and adequately compensating remote vendors.

Somewhat relatedly, a number of commentators have suggested that the Quill majority was partially motivated by the concern that state use taxes would be applied retroactively to remote vendors if the Court fully overturned Bellas Hess.78 As the Quill majority explained, “An overruling of Bellas Hess might raise thorny questions concerning the retroactive application of those taxes and might trigger substantial unanticipated liability for mail-order houses.”79 At least one witness to the Quill oral argument thought that the justices were “very concerned about retroactivity” and that the retroactivity issue might have “tip[ped] the case against the states.”80 The Quill majority may have even been thinking of the retroactivity issue when they wrote that “a bright-line rule in the area of sales and use taxes . . . encourages settled expectations and, in doing so, fosters investment by businesses and individuals.”81 Regardless, because the states do not now reimburse vendors for all use tax compliance costs, there would be no retroactivity concern in a court ruling that states can impose use tax compliance obligations on remote vendors, if and only if the states adequately compensate for all tax compliance costs thereby imposed.

We do not mean to suggest that states could impose use tax compliance burdens on remote vendors with no fear of those burdens being held unconstitutional as long as the states adequately compensate the vendors for all compliance costs. There remains uncertainty as to how courts would respond to our proposal. We have argued that both the language and the logic of the Quill decision strongly imply that states should be permitted to impose use tax compliance obligations as long as they adequately compensate remote vendors so as to remove any potential for burdening interstate commerce. But formalist judges might still hold that Quill’s physical presence rule applies even to our proposal.

Remember, however, that the Court has repeatedly cautioned against formalism in its commerce clause holdings.82 The Court has emphasized that its commerce clause jurisprudence is grounded in “pragmatism,”83 “economic realities,”84 and “practical effect[s],”85 and is disdainful of “formalism,”86 “magic words,”87 and “labels.”88 Lower courts should thus have difficulty justifying the extension of Quill’s physical presence test to circumstances in which there is no potential for burdening interstate commerce. That extension could only be justified on formalistic grounds, and extending the physical presence rule to apply even when there is no potential for burdening interstate commerce would thus directly contradict the Court’s pronouncements about the purposes of the commerce clause.

We take Quill seriously in its statements that the purpose of the physical presence rule is to prevent burdens on interstate commerce,89 that the potential burden on interstate commerce arises from excess compliance costs,90 and that the commerce clause should be applied based on economic realities and

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77The statutes evaluated in some of the earlier cases, such as the statute at issue in Bellas Hess, also contained partial vendor compensation provisions. E.g., Nat’l Bellas Hess, Inc. v. Dep’t of Revenue of Ill., 386 U.S. 753, 764 n.7 (1967) (Fortas, J., dissenting). Those provisions are irrelevant to our discussion because there is no indication that the statutes offered full and adequate vendor compensation and because Bellas Hess and the other earlier cases concerned the due process clause in addition to the commerce clause. We do not argue that full and adequate vendor compensation would resolve potential due process clause violations, but Quill held that states can impose compliance burdens on remote vendors without violating the due process clause.
79Quill, 504 U.S. at 318 n.10.
81Quill, 504 U.S. at 316.
85Id. at 279.
86Quill, 504 U.S. at 310.
87Complete Auto, 430 U.S. at 279.
88Id.
89Quill, 504 U.S. at 313.
90Id. at 313 n.6.
practical effects rather than formally. It consequently seems clear to us that Quill’s physical presence rule should not apply when a state adequately compensates remote vendors for all compliance costs and thereby alleviates any possibility of burdening interstate commerce. Although we cannot guarantee that courts will agree with our analysis, we think that the arguments supporting the constitutionality of our proposed approach are more than persuasive enough to make our approach the best way forward for states that wish to raise revenue by taxing interstate e-commerce.

III. Implications for States, Courts, and Congress

A. Implications for the States

We propose that the states adopt our approach of requiring remote vendors to remit use taxes while compensating the remote vendors for all tax compliance costs thereby imposed. Our approach should be especially attractive to the states that are contemplating Amazon laws. We have argued that the current strategies underlying the states’ Amazon laws will be ineffective, are likely to be held unconstitutional, or both. In contrast, we have argued that our approach should be both effective and constitutional.

Granted, to the extent the states can actually reach remote vendors with the existing Amazon law strategies, our approach might generate slightly less revenue because of the need to compensate for compliance costs. But even if the need to compensate for compliance costs reduces the revenue-generating potential of our approach, that disadvantage should be more than offset because our approach would not give e-commerce vendors incentives to move their operations out of state.

Moreover, our proposed approach could be combined with the other Amazon law strategies. By combining our vendor-compensation approach with the referrer-nexus or related-entity-nexus strategies, a state could impose use tax compliance obligations on all e-commerce vendors that conduct more than some minimal amount of business with in-state residents. To the extent the courts determine that remote vendors can be imputed to have physical presence based on the referrer-nexus or related-entity-nexus principles, the states would not need to compensate the remote vendors for tax compliance costs. Also, our approach would allow the states to impose use tax compliance obligations on remote vendors that the courts determine to lack physical presence, as long as the states compensate those remote vendors for all tax compliance costs.

By using our approach as a backstop to other strategies, the states could thus greatly reduce remote vendors’ incentives to move their operations out of state.

Similarly, by combining our approach with the information reporting requirements strategy, states could greatly improve the likelihood of the information reporting requirements being held constitutional. We expect other courts to follow the lead of the U.S. District Court for the District of Colorado in determining that information reporting requirements violate the commerce clause, at least when not combined with adequate vendor compensation. But we conclude that all commerce clause concerns would be completely alleviated were a state to impose information reporting requirements while adequately compensating remote vendors for all the compliance costs they thereby incur.

Furthermore, we suggest that even states not contemplating Amazon laws adopt our approach. Because our approach eliminates any potential for burdening interstate commerce while generating revenue for the states, there is no reason for the states to continue offering remote e-commerce vendors a tax cost advantage over in-state competitors. To level the playing field, every state that levies a sales tax should adopt our approach so that in-state consumers can decide whether to purchase from in-state vendors or from remote e-commerce vendors based on market factors rather than on differential tax treatment. States that do not want to raise
additional tax revenue could use the revenue generated by adopting our approach to reduce the general sales tax rate affecting all vendors.

By combining our approach with the information reporting requirements strategy, states could greatly improve the likelihood of the information reporting requirements being held constitutional.

Finally, our approach is fully compatible with multistate efforts to simplify and unify sales and use taxation. Indeed, our approach would give the states an incentive to reduce compliance costs to the extent possible, as the states, rather than remote vendors, would bear those costs. We applaud current multistate efforts to simplify and unify sales and use tax administration — such as the Streamlined Sales and Use Tax Agreement. However, we also recognize that there may be valid reasons why states may want to avoid completely unifying their sales and use taxes. For example, centralization potentially interferes with the states’ customizing their tax laws to meet local needs and with their experimenting with new approaches so as to foster a laboratory of democracy. Our approach balances the competing goals of unification and of maintaining local discretion by causing states to internalize the costs of complexity and non-unification. Except when local needs overpower the cost-saving advantages of unifying a state’s sales and use tax laws with those of the other states, our approach should lead the states to pursue simplification and unification based on their own self-interest in minimizing the costs of compensating remote vendors.

C. Implications for the Courts

The primary implication of our analysis is that the courts should bless state attempts to place use tax compliance obligations on remote vendors as long as the states compensate the remote vendors for all tax compliance costs thereby imposed. If states adopt our approach, the courts should uphold those states’ laws against any commerce clause challenges. Furthermore, we would advise the courts reviewing commerce clause challenges to the existing state Amazon laws to note that our approach is available as a more constitutionally sound (and effective) alternative.

Indeed, realizing that our approach is available should make the courts more comfortable in ruling that the existing Amazon law strategies violate the commerce clause. We take no stance on how the courts should actually rule on evaluating the referrer-nexus or related-entity-nexus strategies. But judges uncertain about the constitutionality of those strategies might appropriately be influenced by our proposal’s being available as a superior alternative.

If the Supreme Court accepts a case challenging any of the existing Amazon laws, many scholars hope that it will overturn Quill. Even with our proposed approach available as a means for states to tax remote e-commerce vendors, those scholars might still argue that the physical presence rule grants remote e-commerce vendors an unjustified advantage over multistate retailers that have to maintain a physical presence within their customer states. If subject to use taxation, both a multistate retailer with physical presence and a multistate e-commerce retailer without physical presence would bear tax compliance costs. Yet our proposal would require states to reimburse only the multistate e-commerce vendor for those costs.

A good case can be made that the states should also provide adequate vendor compensation for multistate retailers that maintain a physical presence.

“should be taxed to avoid discrimination” and to “keep a level playing field,” and that “it is more administratively practical to collect the tax from the seller”).

within the state, but we think the case for requiring states to compensate remote e-commerce vendors for tax compliance costs is much stronger. A vendor acquires physical presence within a taxing jurisdiction by purposefully choosing to locate operations within that jurisdiction. By doing so, the vendor knowingly becomes subject to a wide variety of local laws and regulations. A vendor should thus choose to maintain physical presence within a jurisdiction only if selling to customers within that jurisdiction is of more than incidental importance to the vendor's business. In contrast, a remote e-commerce vendor may end up selling within a taxing jurisdiction because of customers within that jurisdiction finding the vendor's website, without the e-commerce vendor making any purposeful decision to sell to that jurisdiction.

That a vendor has physical presence within a jurisdiction suggests that the vendor derives significant value from selling to that jurisdiction. Unquestionably, when determining the importance of selling into a jurisdiction, evaluating the amount of sales in a jurisdiction would be a better proxy than physical presence. But courts are poorly equipped to design quantitative tests such as evaluating the magnitude of sales.

We recognize that our argument here blurs commerce clause considerations with due process clause considerations. But the commerce clause is properly concerned with preventing states and local taxing jurisdictions from disproportionately burdening multistate vendors with tax compliance costs. By creating a permissive due process clause test for when states can tax remote vendors, Quill left the commerce clause as the primary deterrent to states’ imposing excess compliance costs on multistate vendors conducting only a small magnitude of sales within a state or local taxing jurisdiction. Again, because courts have no ready means for evaluating what amount of sales is significant, physical presence can function as a rough proxy for the importance a vendor places on selling into a jurisdiction.

We would therefore oppose the Supreme Court’s overturning Quill as long as Quill is interpreted to permit our proposed approach for the states to tax interstate e-commerce while providing adequate vendor compensation. We admit that our approach would grant multistate e-commerce vendors a small tax cost advantage over multistate physical retailers (with the advantage being equal to the magnitude of tax compliance costs). But we find that weakness of our approach considerably less troubling than would be overturning Quill and allowing the states to burden interstate commerce by imposing excess tax compliance costs on multistate e-commerce vendors lacking physical presence. Whereas a retailer with physical presence must be rather large in order to make sales within thousands of taxing jurisdictions, even a small e-commerce retailer may end up selling across the entire United States. Moreover, the tax cost advantage that our approach would grant to remote e-commerce vendors is much smaller than the tax cost advantage those vendors currently enjoy because of their being shielded from both direct tax costs and tax compliance costs.

Arguably, excess tax compliance costs represent only a small burden for the largest e-commerce vendors like Amazon. Yet even a small burden on interstate commerce is worth preventing to the extent possible. If forced to choose between completely overturning Quill and thereby allowing states to tax remote vendors without restriction or interpreting Quill so that states would not be allowed to tax remote vendors even with compensation for all tax compliance costs, we prefer the former approach. But we continue to believe that our interpretation of Quill provides a better way forward than either of these alternatives. Unlike the alternatives, our approach permits the states to raise most of the revenue available from taxing interstate e-commerce without creating any burden on interstate commerce.

Moreover, focusing on the potential burden on the largest e-commerce vendors like Amazon ignores the strongest arguments for the physical presence rule. Excess compliance costs are potentially far more burdensome to smaller e-commerce vendors. A state might alleviate that concern by using a high threshold for the amount of sales within the state that would trigger a remote e-commerce vendor being subject to use taxation. But adopting such a

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101This connection is far from perfect, and the absence of physical presence does not imply that a vendor does not gain significant value from selling into a jurisdiction. Still, the maintenance of physical presence is not meaningless; for instance, it also serves as a rough proxy for representation in the political process. See Edward A. Zelinsky, “Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause,” 28 Vt. Tax Rev. 1, 51-59 (2008). Courts need not protect in-state vendors by requiring reimbursement of tax compliance costs, because in-state vendors are able to advocate for their own interests in the local political process by leveraging the benefits they bring to the state. In contrast, remote vendors may not have the same leverage.

102Swain, supra note 94, at 364.

103But a state could alleviate that advantage by also adequately compensating in-state vendors for sales and use tax compliance costs.

104As Michael Mazerov has explained, Amazon already collects sales taxes for other companies that sell on its website, implying that the burden of doing so is not prohibitive. Mazerov, Center on Budget and Policy Priorities, “Amazon’s Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny,” 4-5 (2010), available at http://www.cbpp.org/files/11-16-09sf.pdf.

105Supra note 43 and accompanying text.
high threshold would in effect discriminate against large e-commerce vendors, granting small remote e-commerce vendors an unfair tax advantage compared with both their larger competitors and with in-state vendors of all sizes. Again, we might support that outcome if the only alternative were to completely prohibit states from subjecting any remote vendors to use taxation. But our proposed approach would allow the states to better tailor their thresholds so as to only exempt from use taxation those remote vendors that conduct a truly minimal amount of sales within the state.

D. Implications for Congress

By holding that only the commerce clause prevents states from imposing use tax compliance obligations on the major e-commerce vendors — and that the due process clause does not — Quill opened the door for Congress to regulate state taxation of interstate e-commerce. There have since been repeated calls by scholars and state tax officials for Congress to authorize the states to subject remote vendors to use taxation. Many of these commentators have suggested that Congress require the states to unify and simplify their sales and use taxes along specified dimensions as a precondition for allowing the states to tax interstate e-commerce. Congress has so far shown little inclination to expand the states’ ability to tax interstate commerce. When Congress has chosen to act, it “has generally adopted even greater nexus protections” rather than facilitating state taxation of remote vendors. Nevertheless, many commentators continue to hope that Congress will eventually resolve the problems created by Quill. The most noteworthy recent action along these lines is the Main Street Fairness Act, which is sponsored by Sen. Richard J. Durbin, D-Ill., and Rep. John Conyers Jr., D-Mich. The act would authorize the states to extend their use taxes to reach remote vendors but would only do so for states that agree to the Streamlined Sales and Use Tax Agreement — a multistate compact for simplifying and unifying sales and use taxes.

We have argued that congressional action is unnecessary for the states to reach remote vendors with their use taxes as long as the states are willing to compensate the remote vendors for all tax compliance costs thereby imposed. But if Congress does decide to pass legislation enabling the states to tax remote vendors, or if the courts rule against our proposed solution, making such action necessary, we urge Congress to allow the states to impose use tax compliance obligations on remote vendors only if the states compensate the remote vendors for all tax compliance costs. Furthermore, we exhort Congress not to place any additional simplification or unification requirements on the states beyond conditioning their abilities to impose use tax compliance obligations on remote vendors on the states also compensating the remote vendors for all use tax compliance costs. Rather than force the states to adopt a specific form of simplification and unification as a precondition for taxing remote vendors, Congress should give the states incentives to unify and simplify their tax systems while allowing each state the flexibility to decide how to balance the goals of simplification and unification against local interests that might call for divergent tax design. Hence, even if Congress decides to clarify the scope of the commerce clause, we urge it to adopt our proposed approach as the best way forward for state taxation of e-commerce.

Conclusion

From the beginning, it has been understood that Quill’s separate holdings for the due process clause and the commerce clause means that Congress can authorize the states to tax remote vendors. Nevertheless, in light of Congress’s failure to act, state tax practitioners have come to see Quill as a limitation on states’ taxing powers. That Quill actually expanded states’ taxing powers regarding the due

106 For instance, Amazon has opposed federal legislation that would set a threshold of $5 million in annual nationwide sales, arguing that such a high threshold would grant small e-commerce vendors an unfair tax cost advantage as compared with larger e-commerce vendors (like Amazon) and against small Main Street retailers. Mazzerov, supra note 104, at 8-9. We think Amazon has a valid argument on that point.

107 Swain, supra note 94, at 346.


109 See Hellerstein, supra note 4, at 549-550 (describing a “broad consensus among academic tax specialists regarding general principles,” including the need for simplification to make destination-based taxation of sales feasible).

110 See, e.g., Griffith, supra note 42, at 352 (“Congress has historically been reluctant to address state revenue issues, preferring instead to leave tax administration to the states”); Swain and Hellerstein, supra note 95, at 615.

111 Swain, supra note 94, at 370.

112 E.g., Zelinsky, supra note 108, at 104.


114 Id. For discussion of the SSUTA, see sources cited supra note 95.

115 For a previous proposal along these lines, see Mikesell, supra note 5. See also Plattner et al., supra note 96, at 191. (“A major problem with the streamlined approach is that it offers a ‘one size fits all” solution to states whose circumstances widely differ.”)

116 Quill, 504 U.S., at 318-19 (majority opinion).
process clause has received comparatively little attention. Because Quill has come to stand so firmly in practitioners’ minds as a victory for remote vendors, there has been little inquiry into the implications of Quill’s overturning the physical presence rule regarding the due process clause. Even those who argue that states should be able to tax remote vendors have focused their rhetoric on criticizing Quill’s commerce clause holding.117

We believe that Quill’s due process clause holding is potentially far more important than its commerce clause holding.

In contrast, we believe that Quill’s due process clause holding is potentially far more important than its commerce clause holding. The Quill majority made clear that it was upholding Bellas Hess’s physical presence rule regarding the commerce clause because “it is not inconsistent with Complete Auto and our recent cases.”118 The Quill majority further explained that upholding the physical presence rule based on the commerce clause is compatible with Complete Auto because the physical presence rule serves to “limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.”119 The Quill majority then cited Bellas Hess to explain that the potential burden on interstate commerce that justified upholding the physical presence rule results from the excess tax compliance costs that “might be imposed by the Nation’s 6,000-plus taxing jurisdictions.”120 By basing the potential burden on interstate commerce on excess tax compliance costs — rather than on direct tax costs — the Quill majority reconciled the physical presence rule with Complete Auto’s affirmation that it is “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 business.”121

As we have argued, the very steps the Quill majority took to demonstrate that a physical presence rule under the commerce clause is compatible with Complete Auto and other modern commerce clause cases limit the scope of the physical presence rule to apply only when remote vendors might be burdened by excess tax compliance costs. As a result, the physical presence rule should not apply if states fully and adequately compensate remote vendors for all tax compliance costs such that there is no potential for burdening interstate commerce. Any other interpretation of Quill would be incompatible with Complete Auto and would thus contradict the Quill majority’s justification for upholding the physical presence rule under the commerce clause because “it is not inconsistent with Complete Auto and our recent cases.”122

Quill’s expansion of state taxing powers regarding the due process clause thus paves the way for our proposed solution of adequate vendor compensation as an effective and constitutional means for states to tax interstate e-commerce. We urge the states to adopt our approach, either on its own or in combination with the existing state Amazon law strategies. We predict that once the states begin to do so, there will be a rapid end to the sales and use tax exemption currently enjoyed by Amazon and the other major e-commerce vendors, moving us toward a fairer and more efficient multistate sales and use tax regime.

117 E.g., Swain, supra note 94, at 356-365.
118 Quill, 504 U.S., at 311.
119 Id. at 313.
120 Id. at 313 n.6.
122 Quill, 504 U.S. at 311.