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New York's Unconstitutional Tax on the Internet: *Amazon.com v. New York State Department of Taxation & Finance and the Dormant Commerce Clause**

INTRODUCTION

As the current economic downturn continues to ripple through every sector of the economy, state governments from North Carolina to California are struggling to develop innovative tax policies to boost their plummeting revenues.¹ Traditional methods of taxation are no longer sufficient to satisfy State expenditures—either government spending must change drastically² or legislatures must approve new taxes to bolster falling revenues.³ The recent “Amazon tax” passed by the New York State Assembly⁴ is a prime example of the latter. The tax requires out-of-state retailers—such as Amazon.com, Inc. (“Amazon.com” or “Amazon”) and Overstock.com, Inc. (“Overstock.com”)—to collect a use tax⁵ from in-state consumers if

* © 2010 Daniel Tyler Cowan.

1. See Kevin Kiley, *Lawmakers May Slap Sales Tax on Services*, NEWS & OBSERVER (Raleigh, N.C.), June 23, 2009, at 1A (considering the expansion of the sales tax to various commonplace services); Loren Bende, *California's Proposed "Amazon Tax"—A Destructive Solution*, VENTURE BEAT, Apr. 24, 2009, <http://venturebeat.com/2009/04/24/california-s-proposed-amazon-tax-bad-for-california/> (proposing a tax on Web-based business advertising).

2. See Mitch Daniels, Opinion, *The Coming Reset in State Government*, WALL ST. J., Sept. 3, 2009, at A17 (pointing out that decreased state tax revenues virtually mandate a reduction in “the size and scope of . . . state governments”).

3. *Id.*; Conor Dougherty, *Falling Tax Revenues Slam States*, WALL ST. J., Sept. 30, 2009, at A4 (“State tax revenues in the second quarter plunged 17% from a year earlier as rising unemployment and reduced spending hurt sales- and income-tax collections . . .”).

4. See N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney Supp. 2010) (expanding the definition of a vendor for sales tax purposes); see also Kenneth Corbin, *'Amazon Tax' Lands in New York*, INTERNETNEWS.COM, Apr. 10, 2008, <http://www.internetnews.com/government/article.php/3740056/Amazon+Tax+Lands+in+New+York.htm> (“The so-called ‘Amazon tax’ closes a loophole for Internet retailers who derive sales through affiliate programs in which Web site owners place a link to the merchant on their site and earn a commission on sales made from referrals.”).

5. This Recent Development uses the terms “use tax” and “sales tax” interchangeably. While a use tax is “technically levied” on the *individual*, most states try to force the *company* to collect and remit the tax since the individual avoids paying sales tax on the item. Adam L. Schwartz, Note, *Nexus or Not? Orvis v. New York, SFA Folio v. Tracy and the Persistent Confusion over Quill*, 29 CONN. L. REV. 485, 491–92 (1996); see also Megan E. Groves, Note, *Where There's a Will, There's a Way: State Sales and Use Taxation of Electronic Commerce*, 74 IND. L.J. 293, 308 (1998) (“Collection of use taxes serves to prevent sales tax evasion by out-of-state buyers, to adjust between local and

the retailers have marketing affiliates in the state which produce at least \$10,000 in sales.⁶ No fewer than sixteen other states have considered passing a similar tax.⁷

In *Quill Corp. v. North Dakota*,⁸ however, the United States Supreme Court held that, under the Commerce Clause of the Constitution,⁹ a State cannot require an out-of-state retailer to collect and remit a use tax unless the retailer has a “substantial nexus” with the taxing state.¹⁰ The Court invalidated a sales tax imposed by North Dakota on an out-of-state mail-order retailer, which had no offices or employees in the state.¹¹ By invalidating this tax, the Court reaffirmed the bright-line rule of *National Bellas Hess, Inc. v. Department of Revenue of Illinois*¹² that “a vendor whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause,”¹³ in other words, some physical presence is required.¹⁴ Attempts by New York and other states to create statutorily this substantial nexus between out-of-state Internet retailers and the taxing state through the retailers’ marketing affiliates¹⁵ run afoul of *Quill* and its bright-line rule.

Part I of this Recent Development examines States’ ability to tax out-of-state retailers and the history of New York’s Amazon tax. Part II discusses the Supreme Court’s decision in *Quill* and the

interstate businesses, and to prevent interstate discrimination.”). Thus, in practice, either tax will be collected and remitted by the retailer but imposed on the individual. See Schwartz, *supra*, at 491–92. Furthermore, a use tax is intended to “level the playing field” among in-state and out-of-state retailers. See 68 AM. JUR. 2D *Sales & Use Taxes* § 167 (1973) (“A use tax is designed to protect a state’s revenues by taking away the advantages to residents of traveling out of state to make untaxed purchases, and to protect local merchants from out-of-state competition which, because of its lower or nonexistent tax burdens, can offer lower prices. It is designed to preclude the avoidance of sales tax. The imposition of a use tax allows a state to collect the same amount regardless of where property is purchased.”).

6. § 1101(b)(8)(vi). “Affiliate marketing involves entities or individuals that derive income by directing ‘traffic’ to various Internet Web sites through different marketing methods including e-mail, banner, and pop-up advertising” Roger Colaizzi, *A Discussion of Internet-Related Trademark Cases and Trademark Fraud*, in RECENT TRENDS IN TRADEMARK PROTECTION: A DISCUSSION OF INTERNET-RELATED TRADEMARK CASES AND TRADEMARK FRAUD (2009) 41, 49–50.

7. See *infra* notes 41–56 and accompanying text.

8. 504 U.S. 298 (1992).

9. U.S. CONST. art. 1, § 8, cl. 3.

10. *Quill*, 504 U.S. at 311.

11. *Id.* at 301–02.

12. 386 U.S. 753 (1967), *overruled in part by Quill*, 504 U.S. 298.

13. *Quill*, 504 U.S. at 311; see *Bellas Hess*, 386 U.S. at 758–60.

14. *Quill*, 504 U.S. at 315 (arguing that “a small sales force, plant, or office” is necessary to satisfy the physical presence requirement).

15. See *infra* notes 40–56 and accompanying text.

constitutional requirements for taxing out-of-state retailers. In Part III, this Recent Development analyzes the recent New York County Civil Supreme Court¹⁶ decision, *Amazon.com v. New York State Department of Taxation & Finance*,¹⁷ which upholds the constitutionality of the tax. The focus in Part III is on Amazon's dormant Commerce Clause argument and the trial court's application of the Supreme Court's decision in *Quill*. This Recent Development argues that the New York trial court failed to apply *Quill*'s substantial nexus test properly and exaggerated the role of Amazon's associates.¹⁸ As a result, the trial court incorrectly held that the tax on Amazon did not violate the Commerce Clause.¹⁹ When applied correctly, the *Quill* decision should invalidate New York's tax on Amazon and similar out-of-state Internet retailers. Finally, Part IV of this Recent Development examines the continuing vitality of *Quill* in today's technologically driven economy and proposes two solutions to the problem of uniformly taxing out-of-state Internet retailers.

I. THE SALES AND USE TAX AND THE COMMERCE CLAUSE

State legislatures have tried for decades to impose sales and use taxes on out-of-state retailers, particularly mail-order companies.²⁰ Whether called a sales tax or a use tax, the practical implication of these taxes is the same: out-of-state retailers that sell goods to residents within the taxing state must collect and remit the tax to the taxing state.²¹

16. The New York County Civil Supreme Court is New York's district or trial court. See Quintin Johnstone, *New York State Courts: Their Structure, Administration and Reform Possibilities*, 43 N.Y.L. SCH. L. REV. 915, 916 (2000).

17. 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009).

18. *Id.* at 845; see also Brief for Tax Foundation as Amicus Curiae in Support of Plaintiffs-Appellants at 9, *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, No. 601247/08 (N.Y. App. Div. filed Sept. 9, 2009) (arguing that the trial court "confused elements from the two separate tests for substantial nexus").

19. *Amazon.com*, 877 N.Y.S.2d at 849 ("Amazon's first cause of action for declaratory relief based on violation of the Commerce Clause is therefore dismissed.").

20. See JOHN F. DUE & JOHN L. MIKESSELL, *SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION* 252 (2d ed. 1994); Christina T. Le, Comment, *The Honeymoon's Over: States Crack Down on the Virtual World's Tax-Free Love Affair with E-Commerce*, 7 HOUS. BUS. & TAX L.J. 395, 401 (2007). Even after *Quill*, states continue to tax mail-order companies that satisfy *Quill*'s substantial nexus requirement. See, e.g., N.C. GEN. STAT. § 105-164.8(b) (2009) (imposing an obligation on retailers who make mail-order sales to collect and remit taxes).

21. For example, if Delaware imposes a 5% sales and use tax on all out-of-state retailers, any time an out-of-state retailer makes a sale to a Delaware resident, the retailer must collect the 5% sales and use tax from the consumer and remit it to Delaware.

New York was the first state to attempt to satisfy statutorily the substantial nexus requirement of *Quill* with the passage of its Amazon tax. Then-Governor Eliot Spitzer originally proposed the tax in November 2007,²² but tabled it shortly thereafter—perhaps over fears of legal challenges to the policy.²³ However, the tax was reconsidered in early 2008 and included in the State’s budget, despite Amazon’s intensive lobbying efforts.²⁴ The New York State Assembly approved the tax on April 9, 2008,²⁵ and it took effect on June 1, 2008.²⁶ The new tax expands the definition of a vendor for sales and use tax purposes.²⁷ Under the new definition,

a person making sales of tangible personal property . . . shall be presumed to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller²⁸

22. Joseph Goldstein, *Spitzer’s Christmas Tax Surprise*, N.Y. SUN, Nov. 14, 2007, <http://www.nysun.com/new-york/spitzers-christmas-tax-surprise/66382/>.

23. See Kenneth Corbin, *New York’s About-Face on E-Commerce Taxation*, INTERNETNEWS.COM, Nov. 14, 2007, <http://www.internetnews.com/bus-news/article.php/3711236> (“Spitzer’s move could have come from fears that the policy would have run afoul of the 1992 U.S. Supreme Court ruling in *Quill Corporation v. North Dakota*”); Jacob Gershman, *Spitzer Abandons Amazon Tax*, N.Y. SUN, Nov. 15, 2007, <http://www.nysun.com/new-york/spitzer-abandons-amazon-tax/66465/> (suggesting online retailers may challenge “the state’s interpretation of its sales tax nexus laws” which govern whether the retailers must collect local taxes). The original Amazon tax was proposed simply as a clarification to current tax policy by memorandum of the New York Department of Taxation and Finance, but the memorandum was quickly withdrawn. See N.Y. Dep’t of Taxation & Fin. Mem. TSB-M-07(6)S (Nov. 9, 2007), available at 2007 WL 3390905, *withdrawn* TSB-M-07(6.1)S (Nov. 15, 2007), available at http://www.tax.state.ny.us/pdf/memos/sales/m07_6_1s.pdf.

24. See Kenneth Corbin, *Amazon Doesn’t Love New York Tax Plan*, INTERNETNEWS.COM, Feb. 13, 2008, <http://www.internetnews.com/ec-news/article.php/3727991/Amazon+Doesnt+Love+New+York+Tax+Plan.htm>. Then-Governor Spitzer estimated that the tax would increase state revenue by \$120 million over the next two years. *Id.*

25. See New York Legislative Information, <http://public.leginfo.state.ny.us/menugtf.cgi> (enter “S6807-C”; then select “2008”; then select “Search”) (last visited Apr. 14, 2010); Jeremy W. Peters, *Legislators Back Spending Rise in State’s Budget*, N.Y. TIMES, Apr. 10, 2008, at A1 (discussing the new tax for online retailers).

26. See Act of April 9, 2008, 2008 N.Y. Laws 2704, 2844 pt. OO-1; Michael Santo, “Amazon Tax” Begins Tomorrow; Goodbye to the Sales Tax-Free Internet?, REAL TECH NEWS, May 31, 2008, <http://www.realtechnews.com/2008/05/31/amazon-tax-begins-tomorrow-goodbye-to-the-sales-tax-free-internet/>.

27. N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney Supp. 2010).

28. *Id.* For a more detailed explanation of performance-based marketing, see *infra* notes 93–98 and accompanying text.

This expanded definition encompasses Amazon and other out-of-state Internet retailers by attempting to create a substantial nexus with New York based on their marketing affiliates located in the state. As the New York trial court explained: “The Commission-Agreement Provision thus requires collection of New York taxes from New Yorkers by out-of-state sellers that contractually agree to pay commissions to New York residents referring potential customers to them, provided that more than \$10,000 was generated from such New York referrals during the preceding four quarterly periods.”²⁹ Legislators and business leaders in New York claimed that this tax would put in-state retailers on a level playing field with out-of-state Internet retailers.³⁰

Initially, the Supreme Court’s interpretation of the Commerce Clause swept broadly and declared “no State has the right to lay a tax on interstate commerce in any form,”³¹ thus preventing States from imposing any sales and use taxes on out-of-state retailers. Over time, however, the Supreme Court’s Commerce Clause jurisprudence has become more accommodating to States wishing to tax out-of-state retailers.³² In two seminal cases, *Bellas Hess* and *Quill*, the Supreme Court held that out-of-state retailers may be subject to a sales and use tax if they have a substantial nexus with the taxing state: “a vendor whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.”³³

29. *Amazon.com v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842, 846 (N.Y. Sup. Ct. 2009).

30. Corbin, *supra* note 4.

31. *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888); *see also* Jennifer L. Larsen, Comment, *Discrimination in the Dormant Commerce Clause*, 49 S.D. L. REV. 844, 845 (2004) (“The negative aspect of the Commerce Clause, the dormant Commerce Clause, ‘directly limits the power of the States to discriminate against interstate commerce.’ The doctrine thus prevents states from establishing regulations that discriminate or impose an undue burden on interstate commerce.” (quoting *Wyoming v. Oklahoma*, 502 U.S. 437, 454 (1992))).

32. *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992) (“*Complete Auto* emphasized the importance of looking past ‘the formal language of the tax statute [to] its practical effect.’” (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977))); *see also* Schwartz, *supra* note 5, at 485 (“A state can require out-of-state companies doing business via mail order to collect and remit a use tax on goods that the company sells into the state.”); Carol Schultz Vento, Annotation, *Sufficient Nexus for State to Require Foreign Entity to Collect State’s Compensating, Sales, or Use Tax—Post-Complete Auto Transit Cases*, 71 A.L.R. 5th 671, 671 (1999) (“The validity of a tax imposed by a state on an out-of-state entity is determined by, among other factors, whether the taxpayer’s activity has a sufficient nexus or connection with the state.”).

33. *Quill*, 504 U.S. at 311; *Nat’l Bellas Hess v. Dep’t of Revenue*, 386 U.S. 753, 758 (1966), *overruled in part by Quill*, 504 U.S. 298; *see also* Schwartz, *supra* note 5, at 485

Taxing states have had particular trouble establishing a substantial nexus when dealing with Internet retailers.³⁴ Internet retailers have a huge virtual presence throughout the entire United States,³⁵ yet their headquarters and workforce typically are located in only one state.³⁶ Since these Internet retailers have a physical presence in only one or two states, legislatures in the remaining states have had a difficult time creating the requisite substantial nexus to impose a sales and use tax.³⁷ While States try to enforce a use tax directly on their residents,³⁸ most citizens fail to self-report their out-of-state purchases. Consequently, States are unable to realize a large amount of tax revenue from Internet transactions.³⁹

(“[*Bellas Hess* and *Quill*] require some nexus between a company and the taxing state above and beyond the common carrier[s] such as phones, roads, and the mails which provide merely the simple links by which commerce takes place.” (internal quotation marks omitted)).

34. See Julie M. Buechler, Note, *Virtual Reality: Quill’s “Physical Presence” Requirement Obsolete when Cogitating Use Tax Collection in Cyberspace*, 74 N.D. L. REV. 479, 479–80, 483 (1998). As a result, many state courts have attempted to circumvent or minimize the scope of the *Quill* holding. See Mark Alan McGinnis, Comment, *Marching to the Beat of the Itinerant Drummer: States Increasingly Refuse to Get Physical Before Finding Nexus*, 32 CAP. U. L. REV. 149, 199–200 (2003).

35. See Carl Bialik, *Numbers Show China Beats U.S. in Net Use, but Which Numbers?*, WALL ST. J., Mar. 28, 2008, at B1 (specifying that in 2007 the United States had over two hundred million Internet users and “71% of heads of households use[d] the Internet”).

36. For example, Amazon.com is headquartered in Seattle, Washington. See AMAZON.COM, INC., 2008 AMAZON.COM ANNUAL REPORT 3 (2009), available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjAyN3x0aGlsZEIEP50xfr5cGU9Mw==&t=1>. eBay is headquartered in San Jose, California. See EBAY INC., 2007 EBAY INC. ANNUAL REPORT 1 (2007), available at <http://files.shareholder.com/downloads/ebay/839786756x0x192977/08EAA22C-C31C-41AD-B4D3-0A954354566F/ar2007.pdf>. And Overstock.com is headquartered in Salt Lake City, Utah. See Overstock.com, *Who We Are*, <http://www.overstock.com/about> (last visited Apr. 14, 2010).

37. See Wendy Trahan, *The Future of Sales and Use Tax on Electronic Commerce: Promoting Uniformity After Quill*, 21 VA. TAX REV. 101, 107 (2001); Seth Cooper & Jonathan Williams, *An Unconstitutional Interstate Sales Tax*, FORBES, May 14, 2008, http://www.forbes.com/2008/05/13/amazonlaw-states-rights-oped-cx_scjw_0514amazonlaw.html. Compare this situation to Apple, Inc. As Apple opens more retail stores throughout the country, residents in these states are required to pay sales tax on their purchases, even if the purchases are made online. In other words, Apple has a substantial nexus with every state in which it opens a retail store. See Trahan, *supra*, at 113–14 (citing Michael J. McIntyre, Commentary, *Taxing Electronic Commerce Fairly and Efficiently*, 52 TAX L. REV. 625, 640–41 (1997)); Andrew B. Lustigman, Amazon, or Online, Tax Will Hurt Small Businesses, *The Lustigman Firm*, Feb. 12, 2004, http://www.lfirm.com/CM/Publications-Internet/small_business.asp. See generally *Borders Online, LLC v. State Bd. of Equalization*, 29 Cal. Rptr. 3d 176 (Cal. Ct. App. 2005) (holding that there was a substantial nexus between the state and Borders Online).

38. See, e.g., N.C. GEN. STAT. §§ 105-164.6(b), 105-164.16(d) (2009).

39. See Groves, *supra* note 5, at 310; see also John C. Blase & John W. Westmoreland, *Quill Has Been Plucked! MTC Sales Are Slowly Eroding the Substantial Nexus Standard*,

As a result, States have recently begun to experiment with new ways to satisfy statutorily the substantial nexus requirement and force out-of-state Internet retailers to collect taxes from their customers. New York was the first state in the country to impose a sales and use tax on Internet companies such as Amazon.com and Overstock.com by attempting to create a substantial nexus based on the companies' marketing affiliates living and working in New York.⁴⁰ At present, no fewer than sixteen other states either have considered passing or have passed the so-called Amazon tax: California,⁴¹ Colorado,⁴² Connecticut,⁴³ Hawaii,⁴⁴ Illinois,⁴⁵ Iowa,⁴⁶ Maryland,⁴⁷ Minnesota,⁴⁸ Mississippi,⁴⁹ New Mexico,⁵⁰ North Carolina,⁵¹ Rhode Island,⁵² Tennessee,⁵³ Vermont,⁵⁴ Virginia,⁵⁵ and Wisconsin.⁵⁶ Despite these

73 N.D. L. REV. 685, 685 (1997) ("[T]he use tax is normally self-assessed (i.e., voluntarily paid to the state by the purchaser), and the purchaser is primarily responsible for paying the tax.").

40. See N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney Supp. 2010).

41. See Assem. 178, 2009–10 Leg., Reg. Sess. (Cal. 2009). Debate on the bill has been postponed for one year. See Bendele, *supra* note 1.

42. See 2010 Colo. Sess. Laws 54, 54–55.

43. See S. 806, 2009 Gen. Assem., Jan. Sess. (Conn. 2009).

44. See H. 1405, 25th Leg., Reg. Sess. (Haw. 2009). Although the Hawaii Legislature passed the bill, Hawaiian Governor Linda Lingle vetoed it. See Mike Sachoff, *Hawaii Governor Vetoes Amazon Tax Law*, WEB PRO NEWS, July 2, 2009, <http://www.webpronews.com/topnews/2009/07/02/hawaii-governor-vetoes-amazon-tax-law>.

45. See S. 3353, 96th Gen. Assem., Reg. Sess. (Ill. 2010).

46. See H. File 2510, 83d Gen. Assem., Reg. Sess. (Iowa 2010).

47. See S. 1071, 2009 Gen. Assem., Reg. Sess. (Md. 2009). The bill failed to make it out of committee. See Missy Ward, *Maryland Advertising Tax SB 1071 Gets Squashed*, MISSYWARD.COM, Apr. 14, 2009, <http://missyward.com/2009/04/14/maryland-advertising-tax-sb-1071-gets-squashed/>.

48. See S. 282, 2009–10 Leg., 86th Sess. (Minn. 2009).

49. See S. 2927, 2010 Leg., Reg. Sess. (Miss. 2010). The bill died in Committee on February 2, 2010. See Mississippi Legislature 2010 Regular Session, Senate Bill 2927, <http://billstatus.ls.state.ms.us/2010/pdf/history/SB/SB2927.xml> (last visited Apr. 14, 2010).

50. See H. 50, 49th Leg., 2d Sess. (N.M. 2010).

51. North Carolina's Amazon tax was included in the state's budget for Fiscal Year 2009–11. See 2009–4 N.C. Adv. Legis. Serv. 503 (LexisNexis).

52. Rhode Island's Amazon tax was included in the most recent state budget. See R.I. Gen. Laws § 44-18-15 (Supp. 2009); Neil Downing, *R.I.'s Amazon Law Gets Support*, PROVIDENCE JOURNAL, July 25, 2009, <http://www.povertyinstitute.org/matriarch/documents/7.25.09%20Providence%20Journal%20RI%20Amazon%20Law%20Gets%20Support.pdf>.

53. See H. 1947 / S. 1741, 106 Gen. Assem., Reg. Sess. (Tenn. 2009).

54. See H. 661, 2010 Leg., Reg. Sess. (Vt. 2010).

55. See S. 660, 2010 Gen. Assem., Reg. Sess. (Va. 2010).

56. While members of the Wisconsin General Assembly have considered the Amazon tax, they have yet to introduce any specific legislation to change the state's tax code. See Joseph Henchman, *"Amazon Tax" Laws Signal Business Unfriendliness and Will Worsen*

States' efforts, the constitutionality of the Amazon tax remains contentious.

II. BACKGROUND LAW: *QUILL CORP. V. NORTH DAKOTA*

The constitutionality of taxing out-of-state Internet retailers hinges on the interpretation and application of the Supreme Court's decision in *Quill*.⁵⁷ "Quill was a Delaware corporation with offices and warehouses in Illinois, California, and Georgia."⁵⁸ The company solicited business in North Dakota and other states "through catalogs and flyers, advertisements in national periodicals, and telephone calls."⁵⁹ Of its nearly \$200 million in sales, "almost \$1 million [were] made to about 3,000 customers in North Dakota."⁶⁰ Before 1987, Quill was not considered a "retailer" under North Dakota's use statute—North Dakota required " 'every retailer maintaining a place of business in' the State to collect the tax from the consumer and remit it to the State."⁶¹ In 1987, however, the definition of "retailers" was expanded to include " 'every person who engages in regular or systematic solicitation of a consumer market in th[e] state.' "⁶² This change forced Quill to collect a use tax on all orders it received from North Dakota residents.⁶³

Quill challenged North Dakota's use tax on both Due Process Clause and Commerce Clause grounds,⁶⁴ relying heavily on the Supreme Court's decision in *Bellas Hess*.⁶⁵ Before analyzing the validity of these claims, the *Quill* Court made clear that the "nexus"

Short-Term Budget Problems, TAX FOUND., Mar. 8, 2010, <http://www.taxfoundation.org/publications/show/25949.html>.

57. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 314–15 (1992); see also Buechler, *supra* note 34, at 485, 488–91 (arguing that substantial nexus law related to mail-order companies will likely apply to cyberspace commerce as well); McGinnis, *supra* note 34, at 161–67 (arguing that *Quill* remains the modern test for substantial nexus analysis).

58. *Quill*, 504 U.S. at 302.

59. *Id.*

60. *Id.*

61. *Id.* (quoting N.D. CENT. CODE § 57-40.2-07 (Supp. 1991)).

62. *Id.* at 302–03 (quoting N.D. CENT. CODE § 57-40.2-01(6) (Supp. 1991)). "Regular or systematic solicitation" meant "three or more advertisements within a 12-month period." *Id.* at 303 (quoting N.D. ADMIN. CODE 81-04.1-01-03.1 (1988)).

63. *Id.* at 303. The statute was specifically "crafted to allow for the taxation of mail-order companies that maintained no property or personnel in the state." McGinnis, *supra* note 34, at 161–62.

64. *Quill*, 504 U.S. at 303–04.

65. "In this case . . . we must either reverse the State Supreme Court or overrule *Bellas Hess*. While we agree with much of the state court's reasoning, we take the former course." *Id.* at 301–02; see also McGinnis, *supra* note 34, at 165 (arguing that reliance on *Bellas Hess* was proper and such reliance furthered the goals of the Commerce Clause).

analyses under the Due Process Clause and Commerce Clause are distinct.⁶⁶ The two clauses concern different values and governmental interests:

Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, 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.⁶⁷

First, the Court considered the Due Process Clause nexus requirement. In order for a state to tax out-of-state companies, the "Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax . . . and that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State."⁶⁸ Building on its landmark decision in *International Shoe Co. v. Washington*,⁶⁹ the Court's analysis shifted from an examination of physical presence of the company within the state to "a more flexible inquiry,"⁷⁰ which examines whether an out-of-state company has "purposefully avail[ed] itself of the benefits of an economic market in the forum State."⁷¹ As a result of the evolving Due Process Clause jurisprudence, the *Quill* Court overruled the portion of the *Bellas Hess* decision that held such physical presence was required to establish minimum contacts under the Due Process

66. *Quill*, 504 U.S. at 305–07 ("Thus, although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct.").

67. *Id.* at 312.

68. *Id.* at 306 (citations and quotations omitted).

69. 326 U.S. 310 (1945). In *International Shoe*, the Court explained that due process requires that a defendant have minimum contacts with the forum "such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." *Id.* at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)).

70. *Quill*, 504 U.S. at 307.

71. *Id.*; see also *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985) ("So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.").

Clause.⁷² Furthermore, the Court found that Quill purposefully availed itself of North Dakota's market and thus satisfied the minimum contacts requirement under the Due Process Clause.⁷³

Second, the Court addressed the separate "nexus" inquiry under the dormant Commerce Clause. Applying the four-part test from *Complete Auto Transit, Inc. v. Brady*,⁷⁴ the *Quill* Court held that courts should

sustain a tax against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."⁷⁵

The Court's decision in *Complete Auto* "emphasized the importance of looking past 'the formal language of the tax statute [to] its practical effect,'"⁷⁶ and overruled prior cases that attempted to distinguish between "direct" and "indirect" taxes.⁷⁷ *Bellas Hess* concerned the first prong of the *Complete Auto* test and "stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."⁷⁸ In other words, the dormant Commerce Clause substantial nexus test requires some physical presence in the taxing state before the state can require an out-of-state retailer to collect taxes.⁷⁹

72. *Quill*, 504 U.S. at 319 (Scalia, J., concurring in part and concurring in the judgment) ("I agree with the Court that the Due Process Clause holding of *Bellas Hess* should be overruled."); see also *id.* at 307 (majority opinion) ("[T]he Court suggested that such [physical] presence was not only sufficient for jurisdiction under the Due Process Clause, but also necessary.").

73. *Id.* at 308 (majority opinion).

74. 430 U.S. 274 (1977).

75. *Quill*, 504 U.S. at 311 (alteration in original) (quoting *Complete Auto*, 430 U.S. at 279).

76. *Id.* at 310 (quoting *Complete Auto*, 430 U.S. at 279).

77. *Id.* at 309–11 (specifying that *Complete Auto* overruled *Freeman v. Hewitt*, 329 U.S. 249 (1946), and its progeny).

78. *Id.* at 311. Furthermore, "the substantial nexus requirement is not, like due process' minimum contacts requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Id.* at 313 (quotations omitted). Indeed, "the 'substantial nexus' requirement has evolved into more than a mere proxy for notice, like the due process 'minimum contacts' requirement, and now acts as a sword against states seeking to gratuitously impose their taxes on interstate commerce." McGinnis, *supra* note 34, at 165.

79. *Quill*, 504 U.S. at 315 ("Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office.").

Despite the push for pragmatism over formalism in Commerce Clause jurisprudence,⁸⁰ the *Quill* Court maintained the bright-line rule articulated in *Bellas Hess*.⁸¹ Accordingly, the Court found that the North Dakota tax imposed on Quill was unconstitutional⁸² because Quill did “no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.”⁸³

As a result of the Supreme Court’s decisions in *Bellas Hess* and *Quill*, courts must analyze taxes on out-of-state corporations under both the Due Process Clause and the Commerce Clause. While most out-of-state corporations will satisfy the weakened Due Process Clause requirement of purposeful availment, it remains difficult for states to establish the sufficient nexus between itself and the out-of-state corporation necessary to satisfy the Commerce Clause requirement. These difficulties led to the passage of New York’s Amazon tax, which attempts to ease the process and statutorily create the requisite substantial nexus.

III. *AMAZON.COM V. NEW YORK STATE DEPARTMENT OF TAXATION & FINANCE*

Since it is difficult for states to establish a substantial nexus with out-of-state corporations, New York attempted to create statutorily the necessary nexus with the passage of its Amazon tax.⁸⁴ As this Recent Development argues, however, New York’s attempt fails to satisfy the requirements of *Quill*.

80. *Id.* at 314–15. Many legal scholars have denounced the formalistic approach of *Quill* because “the nexus tests in *Quill* are vulnerable to manipulation by a seller engaging in an electronic commerce transaction.” Trahan, *supra* note 37, at 112. For example, the physical presence test can be avoided with entity isolation or by manipulating relationships with telecommunications providers. *Id.* at 113–17; see also John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. CAL. L. REV. 419, 473 (2002) (“[S]ales tax equity can be fully achieved only if *Quill*’s anachronistic physical presence test is either judicially or legislatively overruled.”).

81. *Quill*, 504 U.S. at 311–12, 314. Justice White, however, dissented from this portion of the Court’s opinion. *Id.* at 333 (White, J., concurring in part and dissenting in part).

82. *Id.* at 301–02 (majority opinion). The Court went to great lengths to explain why *Bellas Hess* and its bright-line rule remain good law. While the Court agreed with much of the North Dakota Supreme Court’s decision, it ultimately determined that a bright-line rule in this area is beneficial. *Id.* at 312–18. Justices Scalia, Kennedy, and Thomas, on the other hand, would declare the North Dakota tax unconstitutional on *stare decisis* grounds and not “revisit the merits of [the *Bellas Hess*] holding.” *Id.* at 320 (Scalia, J., concurring in part and concurring in the judgment).

83. *Id.* at 311 (majority opinion).

84. N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney Supp. 2010).

A. *The Amazon Tax and Amazon's Associates*

Less than a month after New York's Amazon tax was passed, Amazon filed suit challenging its constitutionality.⁸⁵ Amazon argued, inter alia, that the tax—on its face and as applied—violated the dormant Commerce Clause.⁸⁶ The New York trial court, relying heavily on *Scripto, Inc. v. Carson*⁸⁷ and *Orvis Co. v. Tax Appeals Tribunal of New York*⁸⁸ and marginalizing *Quill*, ruled in favor of New York and upheld the Amazon tax.⁸⁹

Before analyzing the trial court's decision, it is important to understand fully the agreement between Amazon and its associates⁹⁰ and the role these associates play for Amazon. While *Quill* dealt with traditional mail-order companies, Amazon is the quintessential twenty-first century mail-order company.⁹¹ Amazon's Web site reaches millions of Internet users every day both in New York and around the world. These consumers purchase items from Amazon's Internet "catalog," and Amazon in turn ships these items by mail or common carrier to the consumers. Amazon has no employees or property located in New York.⁹²

Amazon Associates are part of a new wave of online advertising called the performance marketing approach ("PMA").⁹³ The PMA is based on the business model first employed by catalog retailers who used print advertising to communicate with potential customers and then took and shipped orders from a central location.⁹⁴ The Internet-based PMA is based on two steps: (1) "the retailer [i.e., Amazon]

85. Saul Hansell, *Amazon Sues New York over Tax*, SEATTLE TIMES, May 3, 2008, http://seattletimes.nwsources.com/html/business/technology/2004389623_amazon03.html.

86. *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842, 846 (N.Y. Sup. Ct. 2009).

87. 362 U.S. 207 (1960).

88. 654 N.E.2d 954 (N.Y. 1995).

89. *Amazon.com*, 877 N.Y.S.2d at 846–47.

90. As explained more fully *infra*, the fact that Amazon called its associates "independent contractors" in its Operating Agreement was an important factor in the court's decision. See *infra* Parts III.B–C.

91. See CHRIS ANDERSON, *THE LONG TAIL: WHY THE FUTURE OF BUSINESS IS SELLING LESS OF MORE* 47–49 (1st paperback ed. 2008) (describing the ascension of online retailers, such as Amazon.com, who effectively utilize the barrier-free infrastructure of online retail).

92. Amazon's Memorandum of Law in Support of its Cross-Motion for Summary Judgment and in Opposition to the State's Motion to Dismiss at 19, *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 601247/08).

93. See Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants at 3–4, No. 601247/08 (N.Y. App. Div. filed Sept. 2, 2009). For a more detailed discussion of performance-based marketing, see *id.* at 3–10.

94. *Id.* at 4.

signs a standardized agreement with various entities that run websites, known in the industry as ‘affiliates,’ to publish and display an electronic advertisement for the retailer on their websites,”⁹⁵ and then (2) “the visitor to the affiliate’s website . . . may, without any involvement by or notice to the affiliate, view the advertiser’s electronic ad and decide to click through to the advertiser’s website.”⁹⁶ Other than placing the advertisement on its Web site, the affiliate has no “direct involvement” in the transaction between the customer and the Internet retailer.⁹⁷ Thus, unlike independent contractors, the role played by affiliates is minimal.⁹⁸

More specifically, Amazon’s Associate Program “allows participants . . . to maintain links to Amazon.com on their own websites and compensates them by paying a percentage of the proceeds of the sale.”⁹⁹ Before approving an associate application, Amazon reviews the applicant’s Web site to ensure that it does not promote sexually explicit materials, violence, illegal activities, or the like.¹⁰⁰ Web site owners who are accepted are granted “a revocable, non-exclusive, worldwide, royalty-free license . . . solely for purposes of facilitating referrals from [their site] to the Amazon Site”¹⁰¹ and enter into an “independent contractor” relationship with Amazon.¹⁰² Associates receive a referral fee of varying percentages based on the

95. *Id.*

96. *Id.* at 5.

97. *Id.* at 6. For example, the affiliate “functions exclusively as a publisher of an electronic advertisement” and does not (1) “directly sell any product to any Web User and does not have a sales force that affirmatively solicits potential customers for the retailer,” (2) “receive payment from the Web Users who purchase an advertiser’s products or services,” (3) “deliver a product or service to any person,” (4) “know the identity of the visitors to its website, if any, who click through from its website to that of the retailer and whether those visitors ultimately purchase a product from the advertiser,” and (5) have “involvement in the final sales transaction between the Web User and the retailer through the retailer’s website.” *Id.*

98. *Id.*

99. *Amazon.com v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842, 845 (N.Y. Sup. Ct. 2009) (quotations omitted); see AMAZON.COM, ASSOCIATES PROGRAM OPERATING AGREEMENT ¶ 1 (Jan. 18, 2010) [hereinafter OPERATING AGREEMENT], <https://affiliate-program.amazon.com/> (select “Operating Agreement” under “Customer Support”).

100. OPERATING AGREEMENT, *supra* note 99, ¶ 1. A typical Amazon Associate Web site might be a Web site that reviews GPS devices. Interested buyers would then be directed to GPS devices for sale on Amazon by clicking on a link on the GPS-reviewing Web site. Amazon “authorizes Associates to place different types of links from their websites to its own.” *Amazon.com*, 877 N.Y.S.2d at 845.

101. *Amazon.com*, 877 N.Y.S.2d at 845; OPERATING AGREEMENT, *supra* note 99, ¶ 2.

102. *Amazon.com*, 877 N.Y.S.2d at 845; OPERATING AGREEMENT, *supra* note 99, ¶ 14.

type of product sold on Amazon.com or its affiliate Web sites.¹⁰³ New York argued that Amazon's Operating Agreement ("Operating Agreement") created a substantial nexus between Amazon and New York.¹⁰⁴ The New York trial court conducted its dormant Commerce Clause analysis and agreed that the Operating Agreement created the requisite nexus between Amazon and New York.¹⁰⁵

B. The Complete Auto Test and the Substantial Nexus Prong

The New York trial court began its dormant Commerce Clause analysis by laying out the four-part *Complete Auto* test¹⁰⁶ and recognized that the decision in *Amazon.com* hinged on the interpretation of the first prong—whether a substantial nexus exists between New York and Amazon.¹⁰⁷ The trial court's legal analysis under the substantial nexus prong, however, is flawed in several respects.

Under *Quill*, the Supreme Court held that a substantial nexus does not exist between a retailer and a state when the retailer's only connection with the state is by mail or common carrier.¹⁰⁸ The *Quill* Court was clear: physical presence, in the form of "a small sales force, plant or office"¹⁰⁹ is required.¹¹⁰ By requiring this substantial nexus, the *Quill* Court was "limiting state burdens on interstate commerce"¹¹¹ and helping to foster economic growth in interstate commerce.¹¹²

Instead of relying on *Quill*, however, the New York trial court followed two prior New York state court decisions, *Scripto* and *Orvis*,¹¹³ and maintained that even the slightest physical presence is

103. *Amazon.com*, 877 N.Y.S.2d at 845; OPERATING AGREEMENT, *supra* note 99, ¶¶ 4–5.

104. See Reply Memorandum of Law in Further Support of Defendants' Motions to Dismiss and in Opposition to Plaintiffs' Cross-Motions for Summary Judgment at 10–13, *Amazon.com*, 877 N.Y.S.2d 842 (No. 601247/08).

105. See *Amazon.com*, 877 N.Y.S.2d at 849.

106. *Id.* at 847 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

107. *Id.*

108. *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

109. *Id.* at 315.

110. See McGinnis, *supra* note 34, at 199. For a summary of the current state of the law related to substantial nexus and physical presence, see *In re Appeal of InterCard, Inc.*, 14 P.3d 1111, 1122 (Kan. 2000).

111. *Quill*, 504 U.S. at 313.

112. *Id.* at 316.

113. As one author has argued, "Courts, like the *Orvis* Court, have ignored the root physical presence requirement that is the foundation of the establishment of nexus for taxation purposes." McGinnis, *supra* note 34, at 199–200. Instead, state courts, like the

enough to create a substantial nexus.¹¹⁴ According to the trial court, this physical presence requirement “can be actual or imputed based on the in-state solicitation of sales by an employee, agent, or independent contractor of the retailer on its behalf.”¹¹⁵ The trial court failed to address Amazon’s argument that while its associates were labeled “independent contractors” in the Operating Agreement their role is more akin to that of an advertiser, and instead concluded that the substantial nexus prong had been satisfied primarily because Amazon did not discourage its New York associates from soliciting within the state.¹¹⁶ As this Recent Development argues, the trial court failed to analyze properly the role an Amazon Associate plays for Amazon—that of an advertiser and not of an independent contractor.

The failure of the New York trial court to examine properly the activities of Amazon’s associates enabled the court to uphold the tax. Examining the actual functions performed by the associates should have led the trial court to determine that Amazon’s associates are merely advertisers and not “independent contractors”—despite the boilerplate language in the Amazon Operating Agreement.¹¹⁷ This

Orvis court, have relied on a company’s economic presence in the taxing state. *Id.* at 200. This can likely be explained by the desire to uphold the large revenue sources these taxes produce. *See id.* (“Although *Orvis* was but one example of the blatant disregard of Supreme Court jurisprudence, state courts have found it to be a fruitful revenue source and frequently rely upon its faulty reasoning.”); *see also* *Borders Online, LLC v. Cal. Bd. of Equalization*, 29 Cal. Rptr. 3d 176, 190 (Cal. Ct. App. 2005) (following the approach taken by the New York court in *Orvis*).

114. *Amazon.com v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842, 847 (N.Y. Sup. Ct. 2009). Although state courts have reinterpreted this physical presence requirement to include a “slightest physical presence,” manifested by economic activities within the taxing state, this interpretation misstates the core requirement of *Quill*. *See* McGinnis, *supra* note 34, at 201 (“[I]t is also established that a slightest presence will also not create nexus. States, not surprisingly, have sought to impose the tax when a business has little more than a slightest presence. Rather, to comply with *Quill*, the physical presence requirement should hinge on the presence [with]in the taxing state of a small sales force, plant, or office.” (quotations omitted)); *see also In re Appeal of Intercard*, 14 P.3d at 1119 (“The *Orvis* court ignores the *Quill* holding that sufficient physical presence is a necessary element of the nexus required for a state to impose a use tax collection duty. Economic presence cannot negate this requirement.”).

115. *Amazon.com*, 877 N.Y.S.2d at 847.

116. *Id.* at 848–49.

117. While it is unclear why the New York trial court did not examine more closely the actual functions performed by Amazon’s associates, it is important to note that many state courts have attempted to ignore *Quill* and its substantial nexus requirement, in order to uphold the ability of states to tax out-of-state retailers. *See* McGinnis, *supra* note 34, at 199–200. *Compare* *Magnetek, Inc. v. Treasury Dep’t*, 562 N.W.2d 219, 223 (Mich. Ct. App. 1997) (following the broad interpretation of “physical presence” from *Orvis*), *with* *Fla. Dep’t of Revenue v. Share Int’l, Inc.*, 676 So. 2d 1362, 1363 (Fla. 1996) (following the more demanding interpretation of “physical presence” from *Quill*).

would have allowed the trial court to rely on *Quill*, rather than *Scripto* and *Orvis*, and hold that a substantial nexus does not exist between Amazon and New York.¹¹⁸ Furthermore, had the New York trial court examined more fully the role of Amazon's associates, it would have found that Amazon does not substantially rely on the advertising its associates provide to establish and maintain a market in New York.¹¹⁹ The "crucial factor governing nexus is whether the activities performed [in the taxing state] on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales."¹²⁰ This is not the case for Amazon and its associates. Amazon's advertising activity in New York through the use of marketing affiliates is not equivalent to the Internet retailer maintaining a sales force, office, or plant in the state. As a result, Amazon's connection with New York does not satisfy the substantial nexus prong.

C. *Application of Quill Is Proper in Amazon.com*

The New York trial court held that Amazon's associates were independent contractors soliciting orders on behalf of Amazon,¹²¹ but this holding misconstrues the role the associates played. As articulated in more detail above,¹²² the associates are "independent third parties . . . only in the business of generating their own content and displaying it on their own websites, while also publishing electronic advertisements for Amazon and other Internet retailers."¹²³ After an Internet viewer clicks on an Amazon link, "the [associate] has no further connection with or knowledge of the communications between the potential customer and Amazon concerning a transaction or its fulfillment The [associate] also has no ability to insert itself in the sales transaction and influence the customer to make a purchase."¹²⁴ Amazon and the consumer enter into a transaction; Amazon receives payment from the consumer; Amazon

118. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 & n.6 (1992).

119. See *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250–51 (1987).

120. *Id.* at 250. "[D]e minimis local activities or proof that the local activities do not generate any significant proportion of local sales" will not satisfy the substantial nexus requirement. *Borders Online, LLC v. State Bd. of Equalization*, 29 Cal. Rptr. 3d 176, 191 (Cal. Ct. App. 2005). This is a question of fact determined by the court. *Id.*

121. *Amazon.com*, 877 N.Y.S.2d at 845.

122. See *supra* Part III.A.

123. Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 16.

124. *Id.* As the Performance Marketing Alliance Amicus Brief illustrates, it is more beneficial to examine what the affiliates *cannot* do. *Id.* at 16–17.

ships the product to the consumer—it is only after the transaction is completed that the associate receives payment for the “click through.”¹²⁵ This is not the role of an independent contractor but rather an advertiser.

Furthermore, by upholding the constitutionality of the Amazon tax, the New York trial court implied that there is a distinction between an in-state versus an out-of-state Web site owner.¹²⁶ As a result, New York is able to impose a sales and use tax on the happenstance that some of Amazon’s marketing associates live in New York.¹²⁷ The residency of the associates, however, should have no bearing on the substantial nexus between New York and Amazon. There should be no constitutional distinction based on the fact that one Web site owner lives in New York, while another lives just across the border in Pennsylvania.¹²⁸ The location of a server or Web site owner is irrelevant to the average Internet user.¹²⁹ The focus must be

125. *Id.* at 12.

126. Imagine, for example, a Web site that discusses the many places to hike in the Adirondack Mountains. This particular Web site owner is an Amazon Associate and has Amazon.com links on his site that visitors can click on if they are interested in buying hiking boots or camping equipment. The Web site will undoubtedly attract visitors who live in New York. Under the New York trial court’s reasoning, if the Web site owner happens to live in New York, then a substantial nexus has been created between New York and Amazon. *See Amazon.com*, 877 N.Y.S.2d at 847. But it is just as likely that this Web site owner will live in Pennsylvania, New Jersey, or Delaware. If that is the case, no substantial nexus will be created between New York and Amazon, even though the Web site is still attracting New York residents and resulting in sales on Amazon.com from New York residents. Such logic simply does not make sense.

127. *See* Walter J. Baudier, iBrief, *Internet Sales Taxes from Borders to Amazon: How Long Before All of Your Purchases Are Taxed?*, 2006 DUKE L. & TECH. REV. 0005, ¶ 2, (2006), <http://www.law.duke.edu/journals/dltr/articles/pdf/2006dltr0005.pdf> (noting that states and sometimes local jurisdictions have the power to impose sales and use taxes and to define what is subject to their tax).

128. *See generally* McGinnis, *supra* note 34 (arguing that substantial nexus requires a small workforce, plant, or office). Advertisers who happen to live in the taxing state will not satisfy this physical presence requirement. *Id.* at 197–203.

129. In fact, many Web sites are stored on multiple servers in multiple locations; thus, the average Internet user likely does not know where the Web site he is viewing is actually located. *See* 1-800 Contacts, Inc. v. WhenU.com, 309 F. Supp. 2d 467, 475 n.14 (S.D.N.Y. 2003) (“Given that a single website contains text and information located on multiple servers, when a user’s computer accesses a single website, the computer may be receiving information from several different servers.”); *see also* Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 26 (“The state of incorporation or physical location of a website’s server is irrelevant to the Web User’s decision whether to visit a website.”). If this were the case, Amazon simply could screen Web site applications and reject those Web site owners who lived in New York. This would not hurt Amazon’s ability to advertise in New York or receive “click throughs” from New York residents—it would only hurt the potential associates denied from the program. Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 26.

on Amazon and its physical presence within New York—does Amazon have “a small sales force, plant, or office” located in the state?¹³⁰ The associates and their advertising activities in New York are not enough to create a physical presence for Amazon in New York.¹³¹ Thus, Amazon has not satisfied the substantial nexus prong.

The role Amazon’s associates play is more similar to the role “the publishers of the ‘national periodicals’ that contained print advertisements played in the catalog marketing program that was held in *Quill* not to create a ‘substantial nexus’ with the taxing state.”¹³² The associates passively display advertisements for Amazon on their Web sites and nothing more. The PMA is an innovative new advertising tool, which allows companies to reach potential customers more effectively and help small Internet companies develop their own Web sites more quickly¹³³—but it is simply advertising. The Amazon tax “improperly singles out and discriminates against advertisers that use the performance marketing channel, as opposed to other, more traditional forms of advertising.”¹³⁴ Thus, the New York trial court exaggerated and misinterpreted the role played by Amazon’s associates and their advertising function.

Even assuming that a court could find that Amazon’s associates created a “physical presence” for Amazon in New York, the trial court failed to examine the importance of these associates to Amazon’s overall ability to operate in New York.¹³⁵ The court concluded that the associates are independent contractors¹³⁶ without

130. *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).

131. See Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 16–18 (analyzing the activities of Amazon’s affiliates and stating that they do not, “under *Quill*, create a ‘physical presence’ in New York”); McGinnis, *supra* note 34, at 199–200.

132. Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 18 (citing *Quill*, 504 U.S. at 302).

133. *Id.* at 2; see also *Am. Library Ass’n v. United States*, 201 F. Supp. 2d 401, 416 (E.D. Pa. 2002) (“Unlike television, cable, radio, newspapers, magazines or books, the Internet provides an opportunity for those with access to it to communicate with a worldwide audience at little cost.”).

134. Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93, at 2. “Affiliates are content providers whose principal mission is to attract users to their own websites to review the information and content that they create and display. They do not drum up business for Amazon or other companies.” *Id.* at 17.

135. See *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987).

136. *Amazon.com v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842, 845 (N.Y. Sup. Ct. 2009). The court reached this conclusion based on the fact that Amazon’s Operating Agreement with associates defines the relationship between Amazon and the

also examining whether “ ‘the activities performed in [New York] on behalf of [Amazon] are significantly associated with [Amazon]’s ability to establish and maintain a market in [New York] for the sales.’ ”¹³⁷ Because of the court’s reliance on the phrase “independent contractor” from Amazon’s Operating Agreement, the court was able to marginalize the decision in *Quill* and place its reliance, instead, on *Scripto*¹³⁸ and *Orvis*. Such reliance, however, is improper because in both cases the independent contractors were essential to the companies’ ability to maintain a market in the taxing state. This is not the case for Amazon and its associates.

In *Scripto*, the Supreme Court upheld the constitutionality of a Florida sales and use tax on *Scripto*, a Georgia corporation.¹³⁹ *Scripto* established an “advertising specialty division trading under the name of Adgif Company,”¹⁴⁰ which employed ten salesmen in Florida that marketed and sold *Scripto*’s products in the state.¹⁴¹ In each written contract with the salesmen, *Scripto* made clear that the relationship between the parties was that of “independent contractors;”¹⁴² however, each salesman “actively engaged in Florida as a representative ‘of *Scripto* for the purpose of attracting, soliciting and obtaining Florida customers.’ ”¹⁴³

Reliance on *Scripto* is inapt for several reasons. As a threshold matter, *Scripto* arguably was not decided under the dormant

associates as one of “independent contractors.” OPERATING AGREEMENT, *supra* note 99, ¶ 14.

137. *Tyler Pipe*, 483 U.S. at 250 (quoting *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 715 P.2d 123, 126 (Wash. 1986), *vacated*, 483 U.S. 232 (1987)); *see also* *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960) (“The formal shift in the contractual tagging of the salesman as ‘independent’ neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida.”); Brief of the Tax Foundation as Amicus Curiae in Support of Plaintiffs-Appellants, *supra* note 18, at 9 (“The trial court . . . did not conduct any evaluation in regard to whether [Amazon’s] ‘local function’ [was] significantly associated with maintenance or establishment of [their] sales market in New York.” (citing *Amazon.com*, 877 N.Y.S.2d at 849)); Sam Zaprzalka, Note, *New York’s Amazon Tax Not Out of the Forest Yet: The Battle over Affiliate Nexus*, 33 SEATTLE U. L. REV. 527, 539 (2010) (“The Court held that whether or not a salesperson was classified as an independent contractor was not determinative for nexus purposes.”).

138. *Scripto* is an example of attributional nexus, which “takes the physical presence of an in-state entity and attributes that presence to the out-of-state retailer in order to subject the remote retailer to taxation.” Andrew W. Swain & Nathaniel T. Trelease, *Taxing Time for the Internet?*, BUS. L. TODAY, Nov.–Dec. 2005, at 11, 13.

139. *Scripto*, 362 U.S. at 213.

140. *Id.* at 208.

141. *Id.* at 209.

142. *Id.*

143. *Id.* (emphasis added) (citation omitted in original).

Commerce Clause. While the *Scripto* Court relied on cases dealing with the Commerce Clause,¹⁴⁴ the *Quill* Court—in clarifying the distinction between the Due Process and Commerce Clause “nexus” tests—classified *Scripto* as a Due Process Clause case.¹⁴⁵

Even if *Scripto* could be classified as a dormant Commerce Clause case, a substantial nexus linked Florida and *Scripto* because *Scripto* relied on its salesmen to maintain a market in Florida.¹⁴⁶ This was not the case in *Amazon.com*. The salesmen in *Scripto* were actively involved in soliciting sales for the company—they received “catalogs, samples, and advertising material” and the “[o]rders for such products [were] sent by these salesmen directly to the Atlanta office for acceptance or refusal.”¹⁴⁷ Amazon’s associates, on the other hand, are not involved in the actual sale between Amazon and its customers. Rather, the associates are similar to advertisers who essentially act as electronic billboards, passively displaying links on their Web sites that point customers to items they may wish to purchase from Amazon. Thus, the facts in *Amazon.com* are substantially different from those in *Scripto*. It appears that the New York trial court placed constitutional significance on the magic words “independent contractors” and determined that these words created a substantial nexus between New York and Amazon. The trial court should not have relied on the way these associates were characterized, but rather on the practical significance of their activities vis-à-vis Amazon.

The New York trial court’s dependence on *Orvis* is misguided for these same reasons. In *Orvis*, the court found that both *Orvis* and Vermont Information Processing (“VIP”) had a substantial nexus with New York because both companies’ activities in New York

144. See *id.* at 212 (stating that *General Trading Co. v. State Tax Commission*, 322 U.S. 335 (1944), served as the basis for the holding).

145. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306–07 (1992) (“These cases all involved some sort of physical presence within the State, and in *Bellas Hess* the Court suggested that such presence was not only sufficient for jurisdiction under the Due Process Clause, but also necessary.”). While the Court went on briefly to discuss *Scripto* under its dormant Commerce Clause analysis, the Court viewed *Scripto* as an extension of its Due Process Clause jurisprudence. *Id.* It is, therefore, improper to rely on *Scripto* after *Quill* as anything other than a Due Process Clause case.

146. See *Scripto*, 362 U.S. at 210–12; *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987) (emphasizing the importance of the relationship between the behavior in question and the maintenance of a sales market in the state).

147. *Scripto*, 362 U.S. at 207.

“were an essential part of [their] ability to do business in the state.”¹⁴⁸ Orvis’s salesmen made systematic visits “to all of its as many as 19 wholesale customers on the average of four times a year,” while VIP’s “visits to New York vendees and its assurances to prospective customers that it would make such visits enhanced sales and significantly contributed to VIP’s ability to establish and maintain a market for the computer hardware and software it sold in New York.”¹⁴⁹ Without Orvis’s and VIP’s salesmen visiting customers in New York, neither company would have been able to maintain a market in the state. That was not the case in *Amazon.com* because “click-through” advertising was not necessary for Amazon to maintain a market in New York.¹⁵⁰ Thus, the facts in *Amazon.com* are substantially different from those in *Orvis*.

If the New York trial court had properly relied on *Quill*’s substantial nexus bright-line rule, the court would have held the New York tax unconstitutional. Invalidating the New York tax would have confirmed that the “settled expectations” applicable to mail-order companies also applied to Internet retailers.¹⁵¹ Instead, the trial court has opened the door to thousands of new taxes levied on these Internet retailers. As one court has aptly noted, “[w]ithout the limitation’s [sic] imposed by the Commerce Clause, . . . inconsistent regulatory schemes could paralyze the development of the Internet altogether.”¹⁵² If other courts adopt the *Amazon.com* reasoning, the “freedom” of the Internet will be further reduced.

After receiving the decision from the New York trial court, Amazon appealed the ruling on July 13, 2009,¹⁵³ to the New York Supreme Court Appellate Division, First Judicial Department. A five-judge panel of the Appellate Division, First Judicial Department heard oral arguments for the appeal on October 29, 2009.¹⁵⁴ Several

148. Amazon’s Reply Memorandum of Law in Further Support of its Cross-Motion for Summary Judgment at 13, *Amazon.com v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 601247/08).

149. *Orvis Co. v. Tax Appeals Tribunal of New York*, 654 N.E.2d 954, 962 (N.Y. 1995).

150. See Henchman, *supra* note 56 (noting that the referrals from Amazon’s New York affiliates contribute to “only 1.5 percent of Amazon.com’s sales in New York”).

151. *Quill Corp. v. North Dakota*, 504 U.S. 298, 316 (1992).

152. *Am. Libraries Ass’n v. Pataki*, 969 F. Supp. 160, 181 (S.D.N.Y. 1997).

153. *Tag Team: PMA Backs Amazon in New York Tax Legal Fight*, REVE NEWS, Sept. 9, 2009, <http://www.revenews.com/admin/tag-team-pma-backs-amazon-in-new-york-tax-legal-fight/>.

154. Jeffrey S. Reed, *Court Hears Oral Argument in Amazon, Overstock Appeals*, 54 ST. TAX NOTES 369, 369 (2009), available at <http://www.mwe.com/info/pubs/TaxAnalysts1109.pdf>. The appeal was a consolidation of the *Amazon.com* and the *Overstock.com* cases. See *id.*

trade groups filed amicus briefs supporting Amazon's position.¹⁵⁵ A decision is expected sometime in 2010.

IV. THE FUTURE OF *QUILL* AND THE SUBSTANTIAL NEXUS REQUIREMENT

The *Amazon.com* decision raises new questions as to the continuing vitality of *Quill* and its bright-line substantial nexus rule. The *Quill* Court argued that "a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals."¹⁵⁶ For over fifteen years, Internet retailers have relied on *Quill* and its bright-line rule.¹⁵⁷ The decision in *Amazon.com*, however,¹⁵⁸ blurs the rule and further jeopardizes the expectations of Internet retailers. Other states—and perhaps even local jurisdictions, such as counties and towns—will begin experimenting with and implementing new sales and use taxes, and Internet retailers will be forced to divert time and resources away from business operations to lobby against these taxes and argue their constitutionality in court.¹⁵⁹ Furthermore, judicial resources (limited as they are) will be expended adjudicating these cases, since simple reliance on *Quill* is no longer possible.¹⁶⁰ As a result, this Recent

155. See, e.g., Brief of the Tax Foundation as Amicus Curiae in Support of Plaintiffs-Appellants, *supra* note 18; Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants, *supra* note 93.

156. *Quill*, 504 U.S. at 316. But see *id.* at 329–31 (White, J., concurring in part and dissenting in part) (arguing that the majority's bright-line rule will not achieve its goal of reducing litigation and criticizing the majority for imposing its own economic preference under the guise of encouraging settled business expectations).

157. See Baudier, *supra* note 127, ¶ 9 ("After *Quill*, the law appeared settled, but new technological developments along with the Internet boom have posed new questions for courts relying on the *Quill* decision."). Nevertheless, state courts continue to chip away at the "brightness" of *Quill*'s holding and make the area of Internet taxation all the more murky. See McGinnis, *supra* note 34, at 199–200 ("[State courts] have ignored the root physical presence requirement that is the foundation of the establishment of nexus for taxation purposes." (citing *In re Appeal of InterCard, Inc.*, 14 P.3d 1111, 1119 (Kan. 2000))).

158. See *In re Appeal of InterCard, Inc.*, 14 P.3d 1111, 1119 (Kan. 2000) ("The *Orvis* court ignores the *Quill* holding that sufficient physical presence is a necessary element of the nexus required for a state to impose a use tax collection duty.").

159. See Le, *supra* note 20, at 423. Le also argues that it is "time for Congress . . . [to] take a permanent stance on Internet taxation and provide clear guidance to states and e-commerce businesses." *Id.*

160. Despite *Quill*'s arguably clear holding, the application of *Quill* has varied widely among state courts. See *In re Appeal of InterCard*, 14 P.3d at 1118–23 (summarizing various state courts' analyses of *Quill*). The *Amazon.com* decision allows for more cutting away at the bright-line rule. Furthermore, courts are not well-suited to deal with dormant Commerce Clause issues. See McGinnis, *supra* note 34, at 201 (explaining that courts only have the power to invalidate laws which violate the Commerce Clause).

Development proposes two alternative solutions to help truly settle the business expectations of Internet retailers: (1) if the Supreme Court has an opportunity to grant certiorari in *Amazon.com* or a similar case, it should do so and reaffirm *Quill*'s bright-line rule with the caveat that Congress is free to regulate in this area,¹⁶¹ or (2) Congress should pass uniform, national legislation governing the imposition of sales and use taxes on Internet retailers.¹⁶²

While it is possible the Supreme Court would grant certiorari in a case addressing the continued strength of *Quill*, the *Quill* Court itself believed that interstate taxation of mail-order companies (or Internet retailers) was a matter better resolved in the halls of Congress.¹⁶³ Under dormant Commerce Clause jurisprudence, Congress always remains free to disagree with the Court and "overrule" cases by passing national legislation.¹⁶⁴ This Recent Development nevertheless proposes that the Supreme Court should reaffirm *Quill*'s bright-line test if it has the opportunity to do so, albeit with the caveat that Congress is free to regulate in this area.¹⁶⁵ This would allow Congress

161. The Supreme Court appears reluctant to address again the issue of Internet taxation. See Joseph Henchman, *Why the Quill Physical Presence Rule Shouldn't Go the Way of Personal Jurisdiction*, 46 ST. TAX NOTES 387, 394 (2007) ("The Supreme Court's decision not to accept the *MBNA [America Bank N.A. v. Tax Commissioner of the State of West Virginia]* appeal [in June 2007] suggests that the Court prefers that Congress give the next word on the physical presence rule after *Quill*.").

162. For an examination of two possible congressional solutions, see Baudier, *supra* note 127, ¶¶ 22–28. The first proposal is for a "single nationwide flat tax on sales collectible by the state where the goods are used." *Id.* ¶ 22. The second proposal would leave the taxation power in the hands of the individual states. *Id.* ¶ 24. The states could participate in the Streamlined Sales Tax Project, which "is endeavoring to develop computer software which would automatically calculate taxes for any given jurisdiction, thereby eliminating much of the burden on retailers' crossing multiple states' boundaries." *Id.*

163. *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992) ("This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.").

164. *Id.* For example, after the passage of New York's Amazon tax, New York Senator Charles Schumer and New York Representatives Anthony Weiner and Gregory Meeks co-sponsored federal legislation that would have effectively repealed the Amazon tax and prohibited other states from passing similar taxes. Russell Berman, *Amazon Tax Battle Rages in the Capital: Schumer, Weiner, Meeks Line Up Against Paterson*, N.Y. SUN, July 17, 2008, <http://www.nysun.com/new-york/schumer-weiner-meeks-side-against-paterson/82086/>.

165. See Henchman, *supra* note 161, at 392, 395 (noting that Congress is the final authority over issues of interstate commerce). Several of the Justices, while they likely would uphold the *Quill* decision, are hesitant in extending the Court's dormant Commerce Clause jurisprudence. Thus, it would be wiser for Congress to deal with the situation than to rely on the Supreme Court changing the decision. See *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 348 (2007) (Scalia, J., concurring in

to pass legislation, in order to settle officially the expectations of out-of-state Internet retailers.¹⁶⁶ Ultimately, whether Internet retailers are allowed to operate freely without paying sales and use taxes or are forced to collect a national Internet sales tax is a decision better left to Congress, where retailers and interest groups are free to lobby congressional leaders.¹⁶⁷

CONCLUSION

The New York trial court's decision in *Amazon.com* exaggerated the passive role Amazon's associates play in New York and failed to give necessary weight to the Supreme Court's decision in *Quill*. As a result, Internet retailers across the country now face an uncertain future. Amazon and other Internet retailers represent the modernization of the mail-order business in today's technologically driven society. Thus, the question remains: what rules should courts apply to these modern day mail-order retailers? The *Amazon.com* court, similar to the North Dakota Supreme Court when it upheld the tax on *Quill*,¹⁶⁸ decided that *Quill*'s bright-line rule should not be applied in today's modern society.¹⁶⁹ However, the rationales articulated by the Supreme Court in *Quill* for maintaining such a bright-line rule apply with equal force to today's Internet retailers.¹⁷⁰

part) ("I write separately to reaffirm my view that 'the so-called negative Commerce Clause is an unjustified judicial invention, not to be expanded beyond its existing domain.'" (quoting *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 312 (1997) (Scalia, J., concurring))); *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting) ("The negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application.")). Furthermore, reaffirmation of *Quill* and its bright-line rule would prevent state courts from marginalizing the decision in order to uphold state taxes. See McGinnis, *supra* note 34, at 199–200 (discussing the reliance on the faulty reasoning of *Orvis* as a means to protect state tax revenues).

166. For an example of a proposed law that would legislatively overrule the substantial nexus requirement of *Quill* and likely satisfy the minimum contacts requirement of the Commerce Clause, see Groves, *supra* note 5, at 312–13; see also Trahan, *supra* note 37, at 112, 117–20 (examining the ways in which Congress could change legislatively the physical presence test, including the passage of a uniform sales and use tax act); Buechler, *supra* note 34, at 497–500 (arguing that Congress should take the lead in regulating cyberspace commerce).

167. See *Quill*, 504 U.S. at 318–19 ("In this situation, it may be that 'the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.'" (quoting *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 637 (1981) (White, J., concurring))).

168. *Quill*, 504 U.S. at 303–04, 314.

169. *Amazon.com v. N.Y. State Dep't of Taxation & Fin.*, 877 N.Y.S.2d 842, 846–47 (N.Y. Sup. Ct. 2009).

170. *Quill*, 504 U.S. at 315–16 (outlining the benefits of a bright-line rule).

It is thus crucial either for the Supreme Court to reaffirm that its bright-line rule, first articulated in *Bellas Hess* and reaffirmed in *Quill*, remains good law and applies to Internet retailers, or for Congress to pass uniform, national legislation regulating taxation of Internet retailers. Without such assurance, the area of Internet taxation will remain complicated and unclear.

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