

The Day of Reckoning: The Inevitable Application of State Sales Tax to Electronic Commerce

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I. INTRODUCTION

Depleted state coffers, coupled with declining tax revenue following the financial crisis, present a potential national crisis for state governments facing massive budget shortfalls.¹ Seeking alternative methods of raising revenue, states have placed electronic commerce (e-commerce) in their cross-hairs. E-commerce, “[t]he practice of buying

* © 2011 David H. Gershel. J.D. candidate 2012, Tulane University Law School; B.A. History 2009, Colgate University. I would like to thank my family and friends for their support, Professor Shu-Yi Oei for her guidance, and the members of the *Tulane Journal of Technology and Intellectual Property* for their hard work and dedication.

1. ELIZABETH MCNICHOL, PHIL OLIFF & NICHOLAS JOHNSON, STATES CONTINUE TO FEEL RECESSION’S IMPACT, CENTER ON BUDGET AND POLICY PRIORITIES (2011), *available at* <http://www.cbpp.org/files/9-8-08sfp.pdf>.

and selling goods and services through online consumer services on the Internet,”² has seen exponential growth, while remaining relatively free from the obligations of state sales and use taxes. Although this has been a boon to online retailers, e-commerce has become a growing source of concern for cash-strapped state treasuries.³ Facing both budget shortfalls and tax revenues far below prerecession levels, four states (Illinois, New York, North Carolina, and Rhode Island) have recently approved online retail sales taxes.⁴ As of March 2011, thirteen more states had similar bills pending in their respective state legislatures.⁵ Additionally, Colorado, Oklahoma, and South Dakota have enacted reporting and notification requirements to augment use tax compliance by in-state consumers.⁶ The increased number of online transactions benefits retailers without regard to their corporate size or whether they have physical locations in addition to their online presence.⁷

Contrary to common misconception, consumer purchases on the Internet are not generally tax-free. While each state requires their citizens to collect and remit use taxes for purchases made on the Internet, few consumers comply, and even fewer are aware of this legal obligation. Until recently, mandating out-of-state electronic retailers (e-tailers) to collect and remit sales taxes on purchases by in-state citizens perplexed states. For a state to constitutionally require an out-of-state retailer to collect and remit a sales or use tax, the United States Supreme Court mandates that the retailer must have a “substantial nexus” with the taxing

2. BLACK’S LAW DICTIONARY 589 (9th ed. 2009); *see also* U.S. CENSUS BUREAU, 2008 E-COMMERCE MULTI-SECTOR REPORT 3 (2010), *available at* <http://www.census.gov/econ/estats/2008/2008reportfinal.pdf> (“From 2002 to 2008, retail e-sales increased at an average annual growth rate of 21.0 percent, compared with 4.0 percent for total retail sales.”).

3. “State tax collections totaled \$715.2 billion in fiscal year 2009, down 8.5 percent from the \$781.6 billion collected in fiscal year 2008.” U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS IN 2009, at 1 (2010), *available at* <http://www2.census.gov/govs/statetax/2009/stcreport.pdf>; Donald Bruce, William F. Fox & LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, U. TENN. (Apr. 13, 2009), <http://cber.utk.edu/ecommm/ecom0409.pdf>.

4. *See* Dolores W. Gregory, *As States Crank Up Efforts To Force Use Tax Collection, Amazon Threatens To Shutter Operations in Texas and California*, BNA DAILY TAX REPORT, Mar. 11, 2011, at 1.

5. *Id.* Those states are Arizona, Arkansas, California, Connecticut, Hawaii, Maine, Massachusetts, Minnesota, Mississippi, New Mexico, Tennessee, Texas, and Vermont. *Id.*

6. *Id.*

7. “Total e-commerce sales for 2010 were estimated at \$165.4 billion, an increase of 14.8 percent (±2.3%) from 2009. . . . E-commerce sales in 2010 accounted for 4.2 percent of total sales. . . . E-commerce sales in 2009 accounted for 3.9 percent of total sales.” U.S. CENSUS BUREAU NEWS, QUARTERLY RETAIL E-COMMERCE SALES: 4TH QUARTER 2010, at 1 (2011), *available at* <http://www2.census.gov/retail/releases/historical/ecommm/10q4.pdf>.

state.⁸ The Court has enacted a “safe harbor” provision that states 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.”⁹ In other words, some physical presence in the taxing jurisdiction is required before a state can collect sales tax on an out-of-state retailer.¹⁰

Affiliate programs such as Amazon’s “pay an affiliate,” pay a person or company when an internet user clicks a link that directs the user to the affiliate program purveyor’s Web site. Only when a redirected user completes a transaction on that e-tailer’s Web site does the affiliate receive compensation. This “click-through nexus” is sufficient to create a taxing nexus within the State for purposes of satisfying the Due Process and Commerce Clauses of the United States Constitution. Click-through nexus versions of so-called “Amazon laws” were upheld in both instances in which Amazon argued their unconstitutionality in court. These click-through nexus statutes created a rebuttable presumption that in-state affiliates actively solicit sales from in-state residents.

This Comment argues that the three recent decisions challenging the constitutional limits of Amazon laws each arrived at the proper outcome. Further, this Comment argues that, contrary to contemporary scholarly literature,¹¹ the New York Appellate Court correctly held that online affiliates create a substantial nexus for out-of-state electronic retailers. The court rightfully refused Amazon’s argument that affiliates lack the requisite nexus with the taxing jurisdiction to create a sales tax obligation. Amazon tried to reason that affiliates are not akin to employees or in-state sales representatives, which have a more traditional in-state presence. As sales tax jurisprudence has not encountered e-commerce taxation, the courts appropriately applied the Supreme Court’s twentieth-century governing precedent to this twenty-first-century issue. Moreover, courts have properly identified First Amendment privacy issues in North Carolina’s Amazon law’s information requests and undue burdens and also correctly found discrimination against interstate commerce issues in Colorado use-tax-reporting requirements.

8. See U.S. CONST. art. 1, § 8, cl. 3; *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

9. *Quill*, 504 U.S. at 311; see *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753, 758-60 (1967) (holding that a taxpayer must have a physical presence in the taxing jurisdiction in order to satisfy the Commerce Clause and uphold a sales or use tax on an out-of-state retailer).

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

11. Sam Zaprzalka, *New York’s Amazon Tax Not out of the Forest Yet: The Battle over Affiliate Nexus*, 33 SEATTLE U. L. REV. 527 (2010); Daniel Tyler Cowan, *New York’s Unconstitutional Tax on the Internet: Amazon.com v. New York State Department of Taxation & Finance and the Dormant Commerce Clause*, 88 N.C. L. REV. 1423 (2010).

Part II of this Comment will briefly present an overview of sales and use tax jurisprudence from both notable United States Supreme Court decisions, as well as an opinion from the Court of Appeals of New York (New York's highest court). Part III will address the complexities involved in taxing Internet retailers. These complexities will be explored through examining district court decisions and one New York appellate court decision, which challenge the constitutionality of "Amazon laws." Part IV will focus on the implications of affiliate tax liability for states, e-tailers, and consumers. Part IV will discuss the future of the substantial nexus requirement in our rapidly changing technological world as well as address the proposed solutions or outcomes depending on the development of the Amazon law cases, which are pending further review. This Comment will conclude by demonstrating that the click-through nexus laws have a high likelihood of withstanding judicial scrutiny and that a judicial solution is more favorable than a federal or state legislative agenda.

II. SALES AND USE TAX JURISPRUDENCE

The explosive growth of the Internet as an acceptable and increasingly preferred medium to purchase goods only exacerbates the decline in sales and use tax revenue for state treasuries.¹² The dire economic situation coupled with drastic budget shortfalls has increased the pressure on state governments to collect revenue from online retail purchases by in-state citizens. However, constitutional concerns limit the ability of states to implement and collect tax on out-of-state retailer.

State governments rely on sales and use taxes for almost one-third of their annual tax revenue.¹³ A sales tax is "[a] tax imposed on sellers for the privilege of engaging in the business of selling tangible personal property at retail within the state."¹⁴ While the tax burden rests with the consumer, vendors are charged with collecting the tax at the time of sale and remitting the proceeds to the taxing jurisdiction.¹⁵

In contrast, a use tax is levied on a consumer's out-of-state purchases that are brought back into the taxing jurisdiction for in-state use.¹⁶ A use tax is applied to goods which are not subject to a sales tax in

12. "General sales and gross receipts taxes accounted for \$228.1 billion, a decrease of 5.4 percent from 2008." U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS IN 2009, at 1 (Mar. 2010), available at <http://www2.census.gov/govs/statetax/2009stcreport.pdf>.

13. Since 1992, general sales and gross receipts tax revenue averaged 32.6% of total state tax revenue nationwide. *Id.*

14. 67B AM. JUR. 2D *Sales and Use Taxes* § 1 (2011).

15. *Id.*

16. *Id.* § 6.

order to remove the disadvantage to in-state merchants which would result from in-state consumers avoiding taxation by procuring items from outside of the taxing jurisdiction.¹⁷ Thus, sales and use taxes are complementary. While mutually exclusive, sales and use taxes are designed to enact a uniform tax burden on purchased personal tangible property, regardless of the geographic place of the transaction. Unlike a sales tax, a use tax places the responsibility on consumers to accurately report and remit taxes owed for their purchases of personal tangible property.¹⁸ Many consumers are unaware of this obligation. Because of the increased administrative difficulty inherent in enforcing use taxes, states generally favor sales taxes over use taxes.

Remote retailers frequently challenge the application of sales and use taxes on grounds that they violate the Due Process Clause and the Commerce Clause of the United States Constitution. The Supreme Court's 1992 decision in *Quill Corp. v. North Dakota* remains the governing precedent for Due Process and Commerce Clause claims, despite being decided largely before the rise of e-commerce.¹⁹ Accordingly, a court's determination of constitutionality ultimately depends on that jurisdiction's interpretation and application of *Quill*.²⁰ In *Quill*, the Supreme Court clarified that the Due Process Clause and Commerce Clause implicate distinct interests and policies.²¹ The Due Process Clause requires that there is "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." On the other hand, the Commerce Clause operates to "limit the reach of a state's taxing authority to ensure that state taxation does not unduly burden interstate commerce."²²

A. Purposeful Availment Requirement of the Due Process Clause

Two seminal Supreme Court cases govern the Due Process Clause's nexus requirement for imposing a sales or use tax obligation on a remote seller: *National Bellas Hess, Inc. v. Department of Revenue of Illinois*,²³ decided in 1967, and *Quill*, decided in 1992. In *National Bellas Hess*, the Court held that a remote seller "whose only connection with

17. Jennifer Heidt White, *Safe Haven No More: How Online Affiliate Marketing Programs Can Minimize New State Sales Tax Liability*, 5 SHIDLER J. L. COM. & TECH. 21 (2009).

18. See S.D. DEP'T OF REVENUE AND REGULATION, USE TAX (Sept. 11, 2011), <http://www.state.sd.us/drr2/businessstax/st/usetax.htm>.

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

20. *Id.*

21. *Id.*

22. *Id.* at 306, 313.

23. 386 U.S. 753 (1967).

customers in the State is by common carrier or the United States mail” lacked the requisite minimum contacts with the state to be subject to a sales or use tax collection obligation.²⁴ National Bellas Hess, an out-of-state mail-order vendor, refused Illinois’s attempt to require National Bellas Hess to collect and remit sales taxes.²⁵ National Bellas Hess did not maintain a warehouse, office, salesperson, agent or even advertise in Illinois.²⁶ National Bellas Hess’s only contact with Illinois was a biannual catalogue mailing as well as an occasional advertising flyer.²⁷ To pass constitutional muster under either the Due Process or Commerce Clause, the Court held that there must be some “definite link” to, or minimum physical presence in, the taxing jurisdiction.²⁸ The Court noted that it had never upheld the imposition of a tax on a remote seller whose only connection to the State was by common carrier or U.S. mail.²⁹

In *Quill*, the Court reconsidered the minimum physical presence requirement formulated in *National Bellas Hess*.³⁰ The Court struck down a North Dakota statute requiring Quill, and other mail order retailers, to collect and remit a use tax after North Dakota amended the statutory definition “retailer” to include “every person who engages in regular or systematic solicitation of a consumer market in th[e] state.”³¹ Quill had neither real property, employees, nor agents working or residing in North Dakota.³² However, the Supreme Court diverged from *National Bellas Hess* by making a distinction between Due Process Clause and Commerce Clause analyses, noting “[d]ue 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.”³³ This represented a

24. *Id.* at 758.

25. *Id.* at 756. Under the statute, as written, Bellas Hess was required to collect and remit the use tax in Illinois because the tax applied to any “[r]etailer maintaining a place of business in this State,” since that term includes any retailer: “Engaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State.” *Id.* at 755 (quoting ILL. REV. STAT. 105/2 (1965)).

26. *Id.* at 754.

27. *Id.*

28. *Id.* at 756. The Court noted that the two claims were so “closely related” as to permit considering them together. *Id.*

29. *Id.* at 758.

30. *Id.*

31. *Quill Corp. v. North Dakota*, 504 U.S. 298, 302-03 (1992) (quoting N.D. CENT. CODE § 57-40.2-01(6) (1991)).

32. The court found that Quill’s physical presence was “insignificant or nonexistent.” *Id.* at 302.

33. *Id.* at 312.

shift in the Due Process analysis to a “more flexible inquiry,” whereby a foreign corporation may be subject to in personam jurisdiction if it purposefully avails itself of the benefits of an economic market in the forum State.”³⁴ A physical presence was sufficient, but no longer necessary to satisfy the Due Process nexus requirement. Accordingly, the Court held that Quill satisfied the Due Process Clause’s nexus requirement because it had “fair warning” that it may be subject to North Dakota’s jurisdiction by purposefully directing its solicitation activities towards the State’s market for economic benefits.³⁵

B. The Commerce Clause’s Substantial Nexus Requirement

The Commerce Clause on the other hand is concerned with “limiting state burdens on interstate commerce” by prohibiting discrimination against, and undue burdens of, interstate commerce.³⁶ The Supreme Court’s decision in *Complete Auto Transit, Inc. v. Brady*,³⁷ decided after *National Bellas Hess*, set forth a four-part test to determine a tax’s legitimacy. The *Complete Auto* test holds that a tax is valid when it “[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.”³⁸ However, the Court did not elaborate or provide any guidance in interpreting the meaning of the term “substantial nexus.” The vague explanation of the substantial nexus prong in *Complete Auto* created uncertainty throughout the country for courts that lacked jurisprudential guidance on the matter.

The Supreme Court addressed the role of company salespeople in fulfilling the substantial nexus requirement of the Commerce Clause in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*.³⁹ The Court held that the classification of a salesperson as an independent contractor or agent is “without constitutional significance” for substantial nexus purposes.⁴⁰ Rather, the Court determined that “the crucial factor governing nexus is whether the activities performed in th[e] state on

34. *Id.* at 307.

35. *Id.* at 308.

36. *Id.* at 313.

37. 430 U.S. 274 (1977). *Complete Auto* was a Michigan corporation that unloaded cars manufactured by General Motors, outside of Mississippi, off of a freight train in Jackson, Mississippi, and transported them to Mississippi car dealerships. *Id.* at 276.

38. *Id.* at 279 (upholding the tax, noting the plaintiff did not claim the tax violated any of the four parts of the *Complete Auto* test).

39. 483 U.S. 232 (1987).

40. *Id.* at 250.

behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market" for sales in that state.⁴¹ In other words, in-state representatives' activities must be considerable in order to create a taxable nexus in the jurisdiction. They must affect the foreign vendor's ability to consummate sales in the state. Unfortunately, the Court did not stipulate a threshold percentage or any other clear indicator of what satisfies the "significantly associated" standard.⁴²

The Supreme Court most recently addressed the meaning of a "substantial nexus" in *Quill*. However, the Court struggled to more clearly define *Complete Auto's* substantial nexus requirement.⁴³ According to the Court, it is possible for a corporation to have the necessary "minimum contacts" to satisfy the Due Process Clause requirement, but still lack the requisite substantial nexus with the taxing jurisdiction under the Commerce Clause.⁴⁴ This occurred in *Quill*, where the Court struck down a tax for failing to satisfy the Commerce Clause despite being valid under the Due Process Clause.⁴⁵ In the decision, the Court applied the "safe harbor" from the obligation to collect and remit sales and use taxes created in *National Bellas Hess* for vendors "whose only connection with customers in the [taxing] State is by common carrier or the United States mail."⁴⁶ The Court concluded that *Quill* did not satisfy the substantial nexus requirement, because *Quill's* only connection to North Dakota happened to be through common carrier and U.S. mail.⁴⁷ By preserving the bright-line rule of *National Bellas Hess*, the Supreme Court maintained that in order to impose a sales tax obligation on an out-of-state seller, the seller must have a demonstrable, albeit minimal, physical presence in the taxing jurisdiction.⁴⁸ This is the Supreme Court's current standard for determining sales tax liability under the Commerce Clause and whether an independent contractor or salesperson's activities should be attributed to an online retailer for tax purposes.

In *Orvis Co. v. Tax Appeals Tribunal of the State of New York*,⁴⁹ the New York Court of Appeals read the *Quill* decision as not requiring that an out-of-state vendor have a substantial physical presence to satisfy the

41. *Id.* (internal quotation marks omitted).

42. *Id.*

43. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

44. *Id.* at 313.

45. *Id.*

46. *Id.* at 315.

47. *Id.*

48. *Id.*

49. 86 N.Y.2d 165, 177-78 (App. Div. 1995).

substantial nexus requirement.⁵⁰ Orvis, a Vermont-based retailer, sold retail and wholesale goods ordered from its catalogues and then shipped them from Vermont to New York by common carrier or U.S. mail.⁵¹ Orvis maintained no physical presence other than when Orvis's employees occasionally traveled to New York retailers to sell merchandise in person.⁵² Refuting the appellate court's interpretation of *Quill*, the New York Court of Appeals stated that the Supreme Court did not increase the Commerce Clause's threshold for in-state physical presence to a "substantial" amount, but rather held that any measureable amount would satisfy the substantial nexus requirement as long as it was demonstrably more than the "slightest presence."⁵³ The court noted "presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf" would qualify as more than a slight presence.⁵⁴ The court of appeals stated that adopting a substantial physical presence standard would demand a "case-by-case evaluation of the actual burdens imposed" and destroy the bright-line rule preserved in *Quill*.⁵⁵ The court found that Orvis had met the more than a "slightest presence" standard because of the systematic sales calls by its employees and, therefore, the transactions were subject to sales and use tax collection and remittance obligations in New York.⁵⁶

At first glance, it appears that *Quill* logically applies to all remote retailers, including e-tailers. Sales conducted by electronic retailers resemble catalog sales by companies like *Quill*. In both cases, the retailers only maintain a physical presence in a few States, which is where the companies would be subject to state sales tax, if the state has a sales tax. This places online retailers, such as Amazon.com, under the "safe harbor" for vendors in states where they lack a physical presence when their only contact with a taxing state is through common carrier or U.S. mail.

To combat this safe harbor, multiple state legislatures have enacted "Amazon laws" in an attempt to compel online retailers to collect and

50. *Id.*

51. *Id.* at 169. Orvis sold to other states, but the case only concerned the ability of New York to tax Orvis. *Id.*

52. *Id.*

53. *Id.* at 178.

54. *Id.*

55. *Id.* at 177 (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992)). The Court noted, "[S]uch a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." *Id.* (quoting *Quill*, 504 U.S. at 315).

56. *Id.* at 180.

remit sales and use taxes.⁵⁷ These laws target affiliate programs to obtain revenues that would otherwise be required from a brick-and-mortar store. States have attempted this tactic for click-through affiliate programs by amending tax laws to create a substantial nexus and, alternatively, by implementing reporting requirements on e-tailers to ensure use tax compliance with state citizens. Three recent cases, at both the state and federal levels, have addressed the constitutionality of different Amazon laws.

III. AMAZONS LITIGIOUS RESPONSE TO STATES ENACTING AFFILIATE TAXING LAWS

New York became the first state to adopt an affiliate sales tax law in 2008. Many states were inspired to adopt their own versions of New York's Amazon law following a January 2009 New York Supreme Court (trial court) decision upholding the law against Amazon's claims of unconstitutionality.⁵⁸ Since that case was decided, three states have successfully enacted click-through tax nexus legislation, and similar measures have been introduced in at least thirteen states.⁵⁹ On March 10, 2011, North Carolina,⁶⁰ Rhode Island,⁶¹ and most recently Illinois,⁶² enacted click-through nexus laws that are nearly identical versions of New York's law. North Carolina and Illinois require \$10,000 minimum cumulative gross receipts from affiliate sales to be subject to the tax, while Rhode Island only requires \$5,000.

Additionally, Colorado enacted a different type of Amazon tax law, which requires online retailers to report all online purchases by Colorado citizens to the Colorado Department of Revenue in order to properly assess use taxes owed by those consumers.⁶³ Oklahoma in 2010,⁶⁴ and South Dakota in 2011,⁶⁵ enacted versions of Colorado's law. Following

57. Gregory, *supra* note 4, at 1.

58. *Amazon.com, L.L.C. v. N.Y. State Dep't of Tax & Fin.*, 877 N.Y.S.2d 842 (Sup. Ct. 2009).

59. These states include Arizona, California, Connecticut, Hawaii, Illinois, Massachusetts, Maine, Minnesota, Mississippi, New Mexico, South Dakota, Tennessee, Texas, and Vermont. Gregory, *supra* note 4, at 1.

60. N.C. GEN. STAT. § 105-164.8(b)(3) (2009).

61. R.I. GEN. LAWS § 44-18-15 (2010).

62. H.R. 3659, 96th Gen. Assemb., Reg. Sess. (Ill. 2010).

63. COLO. REV. STAT. ANN. § 39-21-112(3.5) (West 2007); 1 COLO. CODE REGS. § 201-1:39-21-112.3.5 (West 2010). The statute contains a \$100,000 minimum gross sales requirement. *Id.*

64. H.R. 2359, 2010 Gen. Assemb., Reg. Sess. (Okla. 2010).

65. H.R. 146, 2011 Gen. Assemb., Reg. Sess. (S.D. 2011); H.R. 147, 2011 Gen. Assemb., Reg. Sess. (S.D. 2011).

the enactment of all of these statutes, Amazon, and other e-tailers, cut their affiliate programs in those states.⁶⁶ Amazon chose not to terminate its affiliate program in New York while litigation continued on the matter.⁶⁷ Furthermore, Amazon threatened to cut ties in California and Hawaii in 2009 which led to Amazon law bill's dying in each state's respective legislature. However, California and Hawaii are considering click-through nexus laws once again.

A. *The New York Statute*

New York enacted the first Amazon law in 2008, which acted as the basis for the three other click-through nexus laws already passed and thirteen pending in various state legislatures. The controversial New York tax law is simply an amendment modifying the term “vendor.” It is codified at New York Tax Law section 1101(b)(8)(vi).⁶⁸ The New York State Department of Taxation and Finance (DTF) subsequently issued two technical service bureau memorandums (TSB-Ms) to clarify the application of the amended definition of “vendor” and how a foreign seller could rebut the presumption of solicitation created under the amendment.⁶⁹

New York tax law requires “every vendor of tangible personal property” to collect sales and use taxes from all sales of tangible personal property.⁷⁰ New York tax law defines “vendor” to include entities that solicit in-state business through paid “employees, independent contractors, agents or other representatives.”⁷¹ The contentious 2008 amendment substantially broadened the legal definition of “vendor” and, therefore, the applicability of tax collection mandates. The amendment modified the definition of “vendor” by creating a rebuttable presumption that an out-of-state retailer was

66. Associated Press, *Amazon and Overstock Cut Ties with Illinois Partners over Sales Tax Legislation*, MYFOXCHICAGO.COM (Sept. 11, 2011), <http://www.myfoxchicago.com/dpp/news/politics/amazon-cuts-business-illinois-online-sales-tax-law-20110311>.

67. Stu Woo, *Amazon Takes Action in Illinois as War on Sales Taxes Continues*, WALL ST. J., Mar. 11, 2011, <http://online.wsj.com/article/SB10001424052748704399804576193212782052704.html>.

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

69. See N.Y. STATE DEP'T OF TAX'N & FIN., NEW PRESUMPTION APPLICABLE TO DEFINITION OF SALES TAX VENDOR (2008) [hereinafter TSB-M-08(3)S]; N.Y. STATE DEP'T OF TAX'N & FIN., ADDITIONAL INFORMATION ON HOW SELLERS MAY REBUT THE NEW PRESUMPTION TO THE DEFINITION OF SALES TAX VENDOR AS DESCRIBED IN TSB-M-08(3)S (2008) [hereinafter TSB-M-08(3.1)S].

70. N.Y. TAX LAW § 1131(1); see also *id.* §§ 1101(b)(8), 1105, 1110, 1132(a).

71. *Id.* § 1101(b)(8)(i)(C)(I).

soliciting business [in New York] through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller, if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods.⁷²

In effect, the amendment imposes sales and use tax collection responsibilities on out-of-state retailers by creating the presumption that those retailers use in-state affiliates to solicit business from New York residents. Under the law, an out-of-state seller can rebut the presumption by presenting evidence that the seller's affiliates "did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question."⁷³

In May of 2008, the DTF issued the first TSB-M in an attempt to clarify two issues.⁷⁴ First, it sought to clarify that the Amazon law applies only to click-through compensation schemes, not pay-per-click or mere advertising compensation schemes.⁷⁵ A click-through compensation scheme is where the two parties, here Amazon and the affiliate, share in the revenue generated by in-state Internet users clicking on the affiliate's link to Amazon on the affiliate's Web site, which redirects the user to buy a specific product on Amazon.⁷⁶ Amazon only compensates an affiliate if the user completes a purchase.⁷⁷ Compensation is based on a percentage of that purchase. Second, the TSB-M provided guidance for a remote retailer to rebut the presumption that its in-state representatives are soliciting sales in New York.⁷⁸ The presumption can be rebutted if the seller can establish that the only activity in-state affiliates engaged in consisted of placing links on their Web sites and passively directing traffic to the out-of-state seller's Web site.⁷⁹ An out-of-state retailer is not considered a vendor when "none of the resident representatives engage in

72. *Id.* § 1101(b)(8)(vi).

73. *Id.*

74. TSB-M-08(3)S, *supra* note 69, at 1-2.

75. *See id.*; *see also id.* at 3-4 examples 2-4. The memorandum also notes a business storing advertising on a server or other computer hardware in state is not considered a vendor. *Id.* at 1.

76. *See id.* at 2-4 examples 1-3.

77. *Id.*

78. *Id.* at 4.

79. *Id.*

any solicitation activity in the state targeted at potential New York State customers on behalf of the seller.”⁸⁰ The retailer must show that every affiliate refrained from the use of any “flyers, newsletters, telephone calls or e-mails,” to rebut the presumption of soliciting business.⁸¹

The DTF then issued a second memorandum in June 2008, which set forth a “safe harbor” procedure to effectively rebut the presumption that the statute applies if, and only if, two conditions are met.⁸² First, every business-referral agreement between a seller and an in-state representative must include a provision prohibiting the affiliate from “engaging in any solicitation activities in New York State that refer potential customers to the seller.”⁸³ Second, each affiliate must annually submit a signed certification to the seller stating that it has not engaged in any prohibited solicitation activities during the year.⁸⁴ If both conditions are met, then the “safe harbor” successfully rebuts the presumption of solicitation. This means that the foreign entity would not be considered a vendor and, therefore, would not be obligated to collect or remit New York State sales or use taxes.⁸⁵

B. Amazon.com v. New York State Department of Taxation and Finance

Amazon.com, joined by Overstock.com, filed suit against the New York State Department of Taxation and Finance claiming that New York’s amended tax statute violates the Due Process and Commerce Clauses both facially and as-applied.⁸⁶ Amazon argued that the statute violates the Due Process Clause by creating an irrational and irrefutable presumption, as well as for being unconstitutionally vague.⁸⁷ In its Commerce Clause challenge, Amazon proclaimed the law unconstitu-

80. *Id.*

81. *Id.* at 4-5.

82. *Id.* at 1.

83. *Id.*

84. *Id.* In the event of a failure to receive a signed certification from all of New York State affiliates, the DTF will weigh the significance of the seller’s reliance on those received in light of the constitutional nexus standard set forth in *Quill* to determine whether such reliance rebuts the presumption or not. *Id.* at 2.

85. *Id.*

86. *Amazon.com, L.L.C. v. N.Y. State Dep’t of Taxation & Fin.*, 913 N.Y.S.2d 129, 133-35 (App. Div. 2010). Amazon also argued that the law violates the Equal Protection Clause by targeting Amazon in bad faith; however, the court found that Amazon failed to establish an equal protection claim. *Id.* at 145. The court held Amazon was not exclusively targeted as Overstock was treated the same way, and Amazon was not treated differently than out-of-state retailers without affiliate programs because of the strong likelihood of per-sale compensation schemes encouraging and causing solicitation. *Id.*

87. *Id.* at 136.

tional because it creates an undue burden on out-of-state retailers that lack a substantial nexus in New York.⁸⁸ Overstock.com joined Amazon in the lawsuit also claiming the statute violated both the Due Process and Commerce Clauses.⁸⁹ The case appealed a January 2009 decision by the New York Supreme Court, which issued a declaratory judgment in favor of the DTF, finding the law constitutional on all accounts.⁹⁰ On appeal, the appellate court upheld the lower court's ruling that, on its face, the statute violated neither the Due Process Clause nor the Commerce Clause.⁹¹ However, citing a lack of evidence, the court remanded the case back to the trial court for further discovery before a proper determination of the as-applied Due Process and Commerce Clause claims could be rendered.⁹²

Amazon's affiliate program enables thousands of third parties located within New York to place "Amazon.com" advertisements on their own Web sites, in the form of hyperlinked text, in order to direct Web site visitors to Amazon.com.⁹³ If, and only if, a visitor consummates a transaction on Amazon.com does the affiliate receive a commission.⁹⁴ Amazon explicitly disavows any control over its affiliates' activities in the standard operating agreement governing the relationship between itself and its affiliates, other than prohibiting misrepresentation or embellishment of the nature of the relationship between the two parties.⁹⁵ Overstock.com's affiliate program operated in the same way, however, Overstock.com has terminated its affiliate program in New York following the enactment of the new tax law, while Amazon has not.⁹⁶ Neither company maintains retail stores or warehouses in New York, nor did any of their employees or company representatives live in the state to create a physical presence, other than their affiliates.⁹⁷

The court found that the statute did not facially violate the Due Process Clause on the claims of creating an irrational and irrebuttable presumption, or for vagueness. The statute presumes an in-state solicitation occurs when an New York State affiliate is compensated on a per-sale basis for sales made by New York residents who visit the

88. *Id.*

89. *Id.*

90. *Id.* at 146.

91. *Id.* at 145.

92. *Id.*

93. *Id.* at 134.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 133-34.

representative's Web site, "click-through" to the online retailer's Web site, and make a purchase of the product from the redirected link.⁹⁸ The presumption relies on the probable scenario of affiliates engaging in more than simple advertising to generate greater click-through sales and therefore increase their compensation.⁹⁹ Additionally, the statute permits online retailers to offer proof that their affiliates did not engage in solicitation to rebut the statute's presumption.¹⁰⁰ Thus, the court found that the statute contained a rational and rebuttable presumption rooted in notions of capitalism and the entrepreneurial spirit affiliates likely possess to increase their personal income. The court held the vagueness claim lacked substance as the contested words and phrases in the statute were entitled to their ordinary meaning which did not create any confusion.¹⁰¹

The court remanded the as-applied Due Process Clause challenge for further discovery giving the two e-tailers the opportunity to provide evidence that their in-state contractors only advertised and did not solicit sales in New York.¹⁰² This will give Amazon and Overstock the possibility to prove their argument: they cannot possibly control or monitor whether the "hundreds of thousands" of New York affiliates solicit in-state business.¹⁰³ However, the court notes that the fact that each out-of-state vendor has a contract with each in-state representative, presumably with their addresses, belies that argument.¹⁰⁴ The court noted that the existence of Amazon's local nonprofit affiliate programs present evidence that the presumption of soliciting local consumers is valid; however, the court felt it would be premature to dismiss the as-applied Due Process Clause challenge before the parties conduct further discovery.¹⁰⁵ Amazon and Overstock did not challenge the threshold issue of whether the e-tailers satisfied the Due Process purposeful-avilment requirement for the statute to impose the sales tax collection obligation on them. This may be a concession by the two companies and the reason why they brought claims of an irrebuttable presumption and vagueness. Like the catalogues mailed to North Dakota residents in *Quill*, there is the strong likelihood that Amazon and Overstock purposefully availed themselves of benefits of the economic market in

98. *Id.* at 140.

99. *Id.*

100. *Id.*

101. *Id.* at 141.

102. *Id.* at 144.

103. *Id.*

104. *Id.*

105. *Id.*

New York through their affiliate programs and therefore had the requisite minimum contacts to satisfy the Due Process Clause.

In dismissing the facial Commerce Clause challenge to New York's affiliate tax law, the court noted that the two companies satisfied the substantial nexus requirement to constitutionally allow New York to levy the affiliate sales tax on them.¹⁰⁶ The statute does not target out-of-state affiliates' sales but rather "imposes a tax collection obligation on an out-of-state vendor only where the vendor enters into a business-referral agreement with a New York State resident, and only when that resident receives a commission based on a sale in New York."¹⁰⁷ Furthermore, the statute differentiates between solicitation and passive advertising.¹⁰⁸ Passive advertising is not within the scope of the tax.¹⁰⁹ Companies have the ability to invoke the safe harbor outlined in the statute and TSB-Ms.¹¹⁰ Certifying that in-state representatives did not engage in solicitation activities, but merely acted as "conduit[s] for linkage with the out-of-state vendor" would prevent those retailers from being subject to the sales tax collection obligation.¹¹¹ Because neither company complied with the safe harbor's provisions, the presumption of solicitation stands in light of the fact that "[t]he higher your referrals, the greater your earnings will be." This leads the court to conclude that neither affiliate program was designed for passive advertisers.¹¹² Consequently, the facial challenge to the statute under the Commerce Clause failed.¹¹³ The court held that "the representative has an in-state presence sufficient to satisfy the substantial nexus test," thereby upholding the presumption that the affiliates engaged in proactive solicitation.¹¹⁴

The court remanded the as-applied Commerce Clause challenge because, once again, the lack of discovery on the issue precluded the court from reaching a conclusion as a matter of law on whether the "plaintiffs' in-state representatives are engaged in sufficiently meaningful activity so as to implicate the State's taxing powers."¹¹⁵ Furthermore, the sparse record prevented the court from making a determination on whether the in-state affiliates' activities were "significantly associated"

106. *Id.* at 138.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 139.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.* at 143.

with Amazon's and Overstock's ability to conduct business in New York under the *Tyler Pipe* standard.¹¹⁶ Finally, the court noted that neither company took solace in the statute's safe harbor as to remove the specter of the law's presumption of solicitation.¹¹⁷

C. Colorado's Affiliate Tax: Direct Marketing Ass'n v. Huber

On January 26, 2011, the United States District Court of the District of Colorado granted a motion for a preliminary injunction enjoining the application of Colorado's Amazon law to retailers with a connection to Colorado only through common carrier or U.S. Mail.¹¹⁸ The plaintiff, the Direct Marketing Association (DMA), "is an association of businesses and organizations that market products directly to consumers via catalogs, magazine and newspaper advertisements, broadcast media, and the internet."¹¹⁹ DMA sought to enjoin Colorado from enforcing its Amazon law's notice and reporting obligations on out-of-state vendors.¹²⁰ The Act and its accompanying regulations require out-of-state retailers, not otherwise required to collect and remit a sales tax, to identify and submit an annual purchase summary of each Colorado customer to the Colorado Department of Revenue (DOR).¹²¹ Additionally, foreign vendors must inform their consumers of their obligation to pay a use tax to the DOR.¹²² Failure to comply would result in significant civil penalties.¹²³ Upon enactment of the law, Amazon terminated its affiliate program in Colorado.¹²⁴

The DMA sought a preliminary injunction against Colorado, based on a discrimination claim and undue burden claim under the Commerce Clause.¹²⁵ The DMA first alleged that the Act and regulations discriminated against out-of-state vendors, and therefore interstate commerce itself, because in-state retailers are required to collect and remit sales tax, but are not subject to the notice and reporting requirements imposed by

116. *Id.* at 143-44.

117. *Id.*

118. Direct Mktg. Ass'n v. Huber, No. 10-CV-01546-REB-CBS, 2011 WL 250556, at *7-8 (D. Colo. Jan. 26, 2011).

119. *Id.* at *1.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. John Schroyer, *State GOP Aim To Repeal 'Amazon Tax' in Wake of Judge's Ruling*, GAZETTE, Jan. 27, 2011, <http://www.gazette.com/articles/state-111921-repeal-judge.html>.

125. *Direct Mktg.*, No. 10-01546-REB-CBS, 2011 WL 250556, at *1-5.

the Act and Regulations.¹²⁶ Out-of-state vendors are classified under Colorado law as any retailer not statutorily obliged to collect and remit Colorado sales tax.¹²⁷ The court found the Colorado Amazon law discriminatory because “in practical effect, [it] impose[s] a burden on interstate commerce that is not imposed on in-state commerce.”¹²⁸

In its second claim for relief, the DMA relied on *Quill* to allege that the Amazon law is unconstitutionally burdensome and an improper regulation of interstate commerce.¹²⁹ Because this was a motion for a preliminary injunction, the court did not conduct a full substantial-nexus analysis, but did conclude that “the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in *Quill*.”¹³⁰ Thus, the court found the DMA likely to succeed in its undue burden claim, because they are protected by the *Quill* safe harbor.¹³¹ The court granted the preliminary injunction and enjoined the DOR from enforcing the Act and Regulations, but only against retailers whose sole connection to Colorado is through common carrier or U.S. mail.¹³²

D. North Carolina’s Law Tax Collection Refined: Amazon.com v. Lay

*Amazon.com v. Lay*¹³³ arose from an audit of Amazon’s transactions occurring between August 1, 2003, and February 28, 2010. The DOR conducted the audit to determine the tax liability of Amazon, not its customers, in North Carolina.¹³⁴ Additionally, the ACLU intervened, filing amicus briefs supporting Amazon on both motions.¹³⁵ The DOR requested “all information for all sales to customers with a North Carolina shipping address,” including “Bill to Name; Bill to Address (Street, City, State, and Zip); Ship to Name; Ship to Address [and] Product/item code or description.”¹³⁶ Amazon filed a complaint stating it

126. *Id.* at *3 (noting only retailers who defy their obligations to collect and remit sales taxes would be subject to the reporting requirements, in addition to civil penalties for failure to comply with sales tax requirements).

127. *Id.* at *4.

128. *Id.*

129. *Id.*

130. *Id.* at *5.

131. *Id.*

132. *Id.* at *7-8. One of the bills pending in the Colorado state Senate is looking to eliminate the use tax separating requirements that were the basis for Direct Marketing Association’s discrimination and undue burden claims. S.B. 11-073, 86th Gen. Assem., Reg. Sess. (Co. 2011).

133. *Amazon.com v. Lay*, 758 F. Supp. 2d 1154 (W.D. Wash 2010).

134. *Id.* at 1159.

135. *Id.* at 1161.

136. *Id.*

did not want to disclose any personal identifiers for fear of violating its customers' privacy rights.¹³⁷ The DOR maintained that it needed the information to calculate the proper aggregate sales tax owed by Amazon, including exemptions; otherwise, it would charge Amazon at the highest tax rate, leaving it to challenge the assessment and establish applicable exemptions.¹³⁸

The United States District Court for the Western District of Washington granted Amazon.com's request for summary judgment, holding that information requests for detailed customer purchase records by the North Carolina Department of Revenue (DOR) violated the First Amendment, but denied Amazon's motion to dismiss.¹³⁹ The court stressed the importance of one's ability to access information anonymously. The disclosure of personal identifiers in the information requests would enable the DOR to determine the expressive content of a buyer's purchases, raising fears of government tracking and censoring. The court stated that compliance with the requests would chill individual exercises of First Amendment rights, noting, "[S]ome will fear to read what is unpopular, what the powers-that-be dislike. When the light of publicity may reach any student, any teacher, inquiry will be discouraged."¹⁴⁰ The court found that the DOR lacked a persuasive governmental interest in calculating Amazon's tax exemptions to warrant forcing Amazon to provide the detailed personal information.¹⁴¹ Amazon provided all of the necessary data to calculate its tax liability.¹⁴² In fact, "[t]he DOR concede[d] [at trial] that it has no legitimate need or use for having details as to North Carolina Amazon customers' literary, music, and film purchases."¹⁴³ Therefore, the court granted the declaratory judgment, but only to the extent of the unnecessary information.¹⁴⁴ The holding did not bar the DOR from issuing new, less specific requests; nor did it strike down North Carolina's click-through nexus law as invalid.¹⁴⁵

137. *Id.*

138. *Id.* at 1160.

139. *Id.* at 1171-72. Amazon also brought a claim under the Video Privacy Protection Act (VPA), but that is superfluous to the discussion of the law's constitutionality and outside of the scope of this Comment.

140. *Id.* at 1168.

141. *Id.* at 1169.

142. *Id.*

143. *Id.* The court also found that the DOR lacked a convincing need for the identities and detailed information about Amazon customers to avoid violating the VPA. *Id.* at 1170.

144. *Id.* at 1171.

145. *Id.*

Subsequently, on January 28, 2011, Amazon.com and the North Carolina Department of Revenue reached a settlement.¹⁴⁶ In exchange for the DOR no longer requesting the controversial information and destroying information that it already had received from Amazon, Amazon and the ACLU agreed to drop the lawsuit.¹⁴⁷ Furthermore, the DOR agreed not to appeal the ruling of *Amazon.com v. Lay*, but retained the right to pursue the tax obligations owed by Amazon and its customers for online sales to in-state residents.¹⁴⁸ Notably, neither the lawsuit nor the settlement overturned the law, enabling North Carolina to continue collecting sales tax from Amazon as of the time of this Comment's writing.

IV. E-COMMERCE TAXATION EFFECTS AND THE FUTURE OF AFFILIATE TAX LIABILITY

Taxation of electronic commerce is a double-edged sword for states. They can be the beneficiary of increased tax revenue, but they may see jobs or other sources of income for residents (i.e., affiliate programs) flee their state. This creates a paradoxical situation where each state must conduct a cost-benefit analysis weighing the benefits of the projected tax revenue increase against the burdens of enacting such a law on the State's economy and citizens. However, enacting these laws to level the playing field is also advantageous to states that are looking to protect brick-and-mortar stores already existing in their state which create and maintain meaningful jobs with benefits.

Upon the enactment of the New York statute, Overstock.com and other e-tailers eliminated their affiliate programs to sever their "ties" with New York.¹⁴⁹ It is debatable whether this represents a concession by these electronic retailers that there is more than the slightest presence in New York or that they simply wished to avoid the risk of incurring tax liabilities for affiliate programs if the New York law withstands judicial scrutiny. Either way, e-tailers have cut those programs. While this has led to a lost source of income for some New York State citizens, according to the New York State Department of Taxation and Finance,

146. *Amazon Lawsuit Against North Carolina Department of Revenue Settled*, SALES TAX INST., http://www.salestaxinstitute.com/amazon_lawsuit_against_north_carolina_department_of_revenue_settled (last visited Nov. 18, 2011).

147. Associated Press, *NC Tax Man Drops Bid To See Amazon Buyers' Data*, ABCNEWS.COM (Feb. 10, 2011), <http://abcnews.go.com/Technology/wireStory?id=12882899>.

148. *Id.*

149. Saul Hansell, *Overstock.com Throws New York Affiliates Overboard To Avoid Sales Tax*, N.Y. TIMES, <http://bits.blogs.nytimes.com/2008/05/14/overstockcom-throws-new-york-affiliates-overboard-to-avoid-sales-tax/> (last modified May 14, 2008, 6:28 PM).

the State “collected \$70 million in sales tax from online retailers, including Amazon, for fiscal year 2009-10.”¹⁵⁰ However, unlike in New York, upon the enactment of affiliate tax laws in Colorado, North Carolina, and Rhode Island, Amazon cut its affiliate programs in all of those states to avoid being subjected to sales taxes.¹⁵¹ Currently, Amazon has not reinstated their affiliate program in Colorado following the settlement of claims concerned in *Direct Marketing Association*. On its Web site, Amazon stipulates that “[i]tems sold by Amazon.com LLC, or its subsidiaries, and shipped to [customer] destinations in the states of Kansas, Kentucky, New York, North Dakota, or Washington are subject to tax”;¹⁵² this is because of its physical presence in those states and continued compliance with New York’s law while the case is being litigated.¹⁵³

As a corporation, Amazon has a responsibility to its shareholders to maximize profits. As such, tax avoidance has proved to be a visibly significant motivation behind some recent business decisions made by Amazon. On February 10, 2011, following an assessment of \$269 million in back taxes owed in Texas, Amazon notified the Texas Workforce Commission of its intention to close its Texas Facility.¹⁵⁴ According to the notice, Amazon would close the facility, lay off all 119 employees by April 13, 2011, and not build a proposed second warehouse.¹⁵⁵ Amazon maintains that it does not have a physical presence in Texas because the warehouse is owned by a separately incorporated entity.¹⁵⁶

In Tennessee, Amazon’s proposal to build two distribution centers is contingent on Amazon receiving an exemption from collecting and remitting sales taxes to Tennessee once a physical presence, and therefore substantial nexus, is created.¹⁵⁷ This special treatment being considered to entice Amazon to build the distribution centers, and provide the jobs

150. Verne G. Kopytoff, *Amazon Pressured on Sales Tax*, N.Y. TIMES, Mar. 13, 2011, <https://www.nytimes.com/2011/03/14/technology/14amazon.html?pagewanted=2>.

151. Gregory, *supra* note 4, at 1.

152. *Sales Tax Requirements*, AMAZON.COM, <http://www.amazon.com/gp/help/customer/display.html?nodeId=468512> (last visited Sept. 10, 2011).

153. Gregory, *supra* note 4, at 1.

154. Nancy J. Moore, *Amazon.com To Close Texas Facility in Dispute over State’s Tax Demand*, Sales and Use Tax Monitor Online (BNA) (Feb. 22, 2011).

155. *Id.* Under the federal Worker Adjustment and Retraining Notification Act, employers must provide 60 days’ notice of the intention to lay off 100 or more employees. 29 U.S.C. § 2101 (2006).

156. Gregory, *supra* note 4, at 1, 3.

157. Bonna Johnson, *Tenn. Retailers Oppose Amazon Sales Tax Pass*, USA TODAY, Jan. 29, 2011, http://www.usatoday.com/money/companies/2011-01-29-amazon-sales-tax_N.htm.

accompanying it, is opposed by retailers of all sizes.¹⁵⁸ Not just mom-and-pop retailers, but the Retailer Industry Leaders Association, which also represents large corporate rivals such as “Best Buy, Target, Wal-Mart, Dollar General and Home Depot,” which has joined local Tennessee businesses in protesting the proposal to grant Amazon preferential treatment.¹⁵⁹ One estimate projects lost sales tax revenue at \$35 million annually if the Tennessee legislature concedes to Amazon.¹⁶⁰ Competitors complain against the preferential treatment, especially considering that any other company maintaining a physical presence in any form, whether a warehouse or retail outlet, has to pay sales tax.¹⁶¹

Similarly, in South Carolina, Amazon is negotiating for a sales tax exemption in exchange for “building a \$100 million warehouse facility and creating 1,249 permanent jobs to handle orders from around the region.”¹⁶² Again, retailers large and small are arguing against the validity of the tax break, which would exempt Amazon from having to collect a sales tax once it has a physical presence in the State.¹⁶³ The State’s Commerce Department promised Amazon it would get the preferential tax treatment on the books.¹⁶⁴ A decision is yet to be made as the politicians in South Carolina weigh the lost tax revenue and unfair competitive advantage the exemption would provide against the desire to create jobs and, according to South Carolina Governor Nikki Haley, the desire not to be known “as the state that doesn’t keep [its] promises.”¹⁶⁵ If either Tennessee or South Carolina yields, it is more than likely that Amazon will continue to pursue advantageous and preferential treatment prompting others to follow Amazon’s lead of leveraging jobs and direct investment to gain the same competitive advantage.

The potential revenue that taxation of electronic retailers may generate is a source of debate, but one estimate holds that, depending on the growth rate of e-commerce, aggregate lost sales and use tax revenue nationally for state and local governments will be between \$11.4 billion and \$12.65 billion for 2012.¹⁶⁶ Forty-five states and the District of

158. *Id.*

159. *Id.*

160. *Critics Cry Foul on Amazon Tax Advantage*, CHATTANOOGA TIMES FREE PRESS, Feb. 26, 2011, <http://www.timesfreepress.com/news/2011/feb/26/critics-cry-foul-amazon-tax-advantage/>.

161. Johnson, *supra* note 157.

162. Jim Davenport, *Amazon Tax Break Questioned: Haley Checking into Sales Tax Promises for Distribution Center Set To Open Later This Year*, POST & COURIER (Mar. 1, 2011), <http://www.postandcourier.com/news/2011/mar/01/amazon-tax-break-questioned/>.

163. *Id.*

164. *Id.*

165. *Id.*

166. Bruce, Fox & Luna, *supra* note 4.

Colombia are projecting budget shortfalls for fiscal year 2012 that will total \$125 billion.¹⁶⁷ The struggle to find additional sources of revenue is compounded by spending cuts and falling tax revenues experienced since the financial crisis. The attractiveness of taxing online sales cannot be overstated, as evidenced by the estimates above. Before the internet, the vast majority of those sales would have been conducted through a physical store in a state subjecting them to sales taxes. Not only would taxation of companies, such as Amazon.com or Overstock.com, aid the government's coffers, but it would level the playing field by removing a significant price advantage that these companies are privy to at the expense of the companies that maintain brick-and-mortar stores, which are obligated to charge sales tax. For example, Borders, the national chain-bookstore, filed for bankruptcy on February 16, 2011, citing its delay in adapting to consumer tendencies which are shifting away from brick-and-mortar stores to online retail and the e-book markets.¹⁶⁸

As other states consider enacting affiliate taxing laws, and Amazon continues to oppose any such legislation, Amazon's competitors are jumping on what may be a golden opportunity to garner future sales. The first to act was Barnes & Noble, which recently invited Amazon's affiliates to join its own affiliate program.¹⁶⁹ Barnes & Noble willfully collects and remits sales taxes owed to states that have a sales tax from both its online and in-store sales.¹⁷⁰ Barnes & Noble issued an "open letter" on February 14, 2011, to persuade Amazon affiliates to defect to Barnes & Noble or to join Barnes & Noble's affiliate program in addition to Amazon's.¹⁷¹ Best Buy, Sears, and Wal-Mart quickly followed suit just weeks after.¹⁷² Amazon's brash decisions have potentially become its competitors' gains. Each of these four retailers are already obligated to pay state sales taxes due to their in-state physical presences. Therefore, they are not fighting the Amazon laws, but rather, they endorse them as a

167. McNichol, Olift & Johnson, *supra* note 1.

168. Peter Gorenstein, *Borders Goes Bust: Are There Too Many Stores in America?*, YAHOO! FIN. (Feb. 16, 2011), <http://finance.yahoo.com/tech-ticker/borders-goes-bust-are-there-too-many-stores-in-america-535936.html>.

169. See Associated Press, *Barnes & Noble Lures Spurned Amazon Affiliates*, SEATTLE TIMES, Feb. 14, 2011, <http://seattletimes.nwsourc.com/html/business/20110214amazon15.html>; *General Tax Info*, BARNES AND NOBLE, <http://www.barnesandnoble.com/help/cds2.asp?PID=8115> (last visited Sept. 10, 2011).

170. *General Tax Info*, *supra* note 169.

171. John Foley, *Barnes & Noble Issues Open Letter to Amazon Affiliates* NEW YORK, BARNES & NOBLE (Feb. 14, 2011), http://www.barnesandnobleinc.com/press_releases/2011_feb_14_amazon_affiliates.html.

172. Sandra M. Jones, *Sears Dangles Carrot to Amazon's Skittish Affiliates*, CHI. TRIB., Mar. 3, 2011, http://articles.chicagotribune.com/2011-03-03/business/ct-biz-0304-sears-amazon-20110303_1_state-sales-sales-tax-amazon-business.

matter of “fairness” in their quest to create an equal and competitive environment by removing the price advantage granted to online retail sales that lack sales tax.¹⁷³ These other retailers provide certainty by complying with state sales tax laws. This is important, not just for affiliates in those states where affiliate programs were terminated by Amazon and other e-tailers, but for any individual who resides in a state where their legislatures enact an affiliate taxing law. Affiliates are at the mercy of those e-tailers, but guaranteed tax compliance by big-box retailers means that they will not unexpectedly terminate their affiliates in response to state enacting affiliate taxing laws.

Operating in the same manner as affiliate programs for Amazon, the affiliate programs of these other retailers pay compensation for purchases made after an internet user clicks on the sponsored link and subsequently makes a purchase on the retailer’s Web site. Therefore, this system naturally encourages those affiliates to generate greater sales. In *Amazon.com v. New York*, the court noted the likelihood of such a compensation structure leading an affiliate to solicit purchases, and therefore business in New York, to earn greater compensation from an affiliate program.¹⁷⁴ However, the solicitation of business by an affiliate of these other retailers is not an issue since they are already collecting and remitting sales taxes. If these big-box competitors are successful in drawing customers away from Amazon or other e-commerce firms, affiliates that were terminated or are fearful of being terminated, it makes the argument against State, enacting Amazon laws because of lost affiliate income for State citizens largely moot. However, as Barnes & Noble issued the first open letter on February 14, 2011,¹⁷⁵ the results of big-box retailers’ efforts to lure Amazon affiliates away and the subsequent personal income and tax revenue consequences are yet to be seen. If substantial defections from Amazon do occur, it will force Amazon to reevaluate its business tactic of fighting affiliate taxing laws through litigation and termination of affiliate programs.

The pace at which other states have enacted affiliate tax laws, and the number of click-through nexus bills currently pending in state legislatures, suggests that online retailers will continue to be targeted regardless of the speed or size of the economic recovery.¹⁷⁶ With the unprecedented multibillion-dollar budgetary shortfalls, states cannot

173. Kopytoff, *supra* note 150.

174. *Amazon.com, L.L.C. v. N.Y. State Dep’t of Taxation & Fin.*, 913 N.Y.S. 2d 129 (App. Div. 2010).

175. Foley, *supra* note 171.

176. Gregory, *supra* note 4, at 1.

afford to ignore the indefinite loss of sales tax revenue as individuals continue to migrate to internet retailers for more and more purchases. There are a few likely outcomes, all of which remain largely contingent upon one another.

First, as states wish to “level the playing field” for brick-and-mortar retailers residing within their boundaries, while increasing tax revenue, momentum may be building for the seemingly defunct Streamlined Sale and Use Tax Agreement (SSUTA).¹⁷⁷ The SSUTA intends to reduce the cost, and increase the ease, of doing business as well as facilitate compliance with tax obligations in multiple taxing jurisdictions. The SSUTA removes the need for each entity to consider whether it is subject to sales or use taxes in a State and avoids the administrative cost and burdens to comply with the particular tax laws of each local and state jurisdiction. Amazon itself supports a streamlined system for those efficiency reasons.¹⁷⁸ There are forty-four member states and the District of Columbia, of which twenty-four have passed legislation confirming the SSUTA.¹⁷⁹ As the Supreme Court indicated in *Quill*, Congress retains the power to overturn *Quill* and regulate the tax burdens on interstate commerce.¹⁸⁰ Therefore, the SSUTA requires congressional legislative action to grant the states remote sales tax collection authority. However, the SSUTA has languished as the efforts for federal adoption have thus far proved futile.¹⁸¹ Furthermore, the new Republican majority in the House of Representatives, elected partly on a platform of preventing new taxes, does not bode well for an adoption of the SSUTA in the near future. This political reality will likely continue the shift towards states adopting variations of New York’s Amazon law to reach the same end by alternative means.

Other than the seven states mentioned previously who have enacted some version of an affiliate tax law, thirteen other states have introduced bills that create a click-through nexus to target out-of-state e-commerce affiliate programs.¹⁸² This is the logical course of action for states seeking to obtain tax revenue from online retailers such as Amazon, given that New York’s affiliate tax law has survived judicial scrutiny thus far and seems poised to pass constitutional muster on the as-applied claims. Furthermore, the Western District of Washington did not hold

177. *Frequently Asked Questions*, STREAMLINEDSALESTAX.ORG, <http://www.streamlinedsalestax.org/index.php?page=faqs> (last visited Sept. 10, 2011).

178. Kopytoff, *supra* note 150.

179. *Frequently Asked Questions*, *supra* note 177.

180. *Quill*, 504 U.S. at 318.

181. BNA DAILY TAX REPORT, Nov. 24, 2010, at 1.

182. Gregory, *supra* note 4, at 1.

North Carolina's law, nearly identical to New York's, unconstitutional, but rather found that North Carolina's information requests to determine tax liability violated the First Amendment.¹⁸³ These two decisions imply that the click-through nexus laws are constitutional and will continue to withstand legal challenges. Because Colorado's Amazon law did not survive constitutional scrutiny, it would behoove other states to model their own affiliate taxing law on New York's rather than Colorado's, like all of the currently pending bills already do.¹⁸⁴

However, states must consider online retailers' defensive tactics to such laws. As noted, in the wake of the enactment of Amazon laws in various states, Amazon and other e-tailers, terminated affiliate programs in those states to avoid tax liability.¹⁸⁵ Other online retailers cut ties with affiliates in New York.¹⁸⁶ New York collected a substantial sum of internet sales tax revenue in fiscal year 2009-2010 totaling \$70 million.¹⁸⁷ With the large number of states considering adopting click-through nexus provisions to tax online retailers with affiliate programs in their respective states, the growing momentum may pressure Congress to act, or lead online retailers to congregate their affiliate programs in a few safe harbor states. The e-tailers will use their concentration of affiliate programs to guarantee those states will not enact affiliate tax laws. Where a traditional physical presence is already established such as by a warehouse, the company will pay the sales tax. Such a decision would largely rest upon the applicable sales tax in each state, favoring states with the lowest or no applicable rates.¹⁸⁸ Alternatively, the outcome of litigation likely to ensue over Texas's \$269 million assessment of Amazon's tax liability may provide yet another method for e-tailer to pursue. If subsidiaries are not found to create a physical presence for online retailers such as Amazon.com and Overstock.com, this loophole would assuredly be exploited by e-tailers to refrain from incurring tax liability for warehouses or distribution centers. However, this will not cure the click-through nexus problems affiliate programs pose if Amazon laws are upheld.

183. *Amazon.com, v. Lay*, 758 F. Supp. 2d 1154, 1172 (2010).

184. *See White*, *supra* note 17, at 5.

185. Zachary Colman, *Online Retailers Dump Ill. Partners Over Tax Law*, BLOOMBERG BUSINESSWEEK, Mar. 11, 2011, <http://www.businessweek.com/ap/financialnews/D9LTAR2G3.htm>.

186. Woo, *supra* note 67.

187. Kopytoff, *supra* note 150.

188. Alaska, Delaware, Montana, New Hampshire, and Oregon do not collect sales taxes. *Taxes By State*, RETIREMENT LIVING INFO. CENTER, <http://retirementliving.com/RLtaxes.html> (last modified Jan. 2011).

Therefore, Amazon and other online retailers will continue to threaten termination of affiliate programs, jobs, and tax revenues in states considering click-through nexus legislation. While this may seem unscrupulous, it is in the best interests of e-tailers and their shareholders to refrain from paying taxes in order to maintain a competitive price advantage. In addition, note that while big-box brick-and-mortar retailers comply with applicable state sales tax on customer purchases,¹⁸⁹ smaller competitors benefit as well from not collecting and remitting sales taxes, provided they do not maintain affiliate programs in those states. Amazon's tactic of cutting ties with affiliates and threatening to do so for states considering adopting click-through nexus measures, is geographically limited. In the unlikely event that all, or nearly all, of the fifty states enact click-through nexus laws, it will remove any sort of a "safe haven" for online retailers to avoid sales tax liability. This coordinate legislative action would leave e-tailers nowhere to hide other than in states where they willingly pay sales tax, due to their physical presences in those states. Congress would be sure to act if the situation approached this sort of a national consensus. More likely some states will see this as an opportunity to recruit online retailer affiliate business for their state's citizens by refusing to enact an Amazon law. The highly frayed and volatile current political environment presents the most obvious obstacle to congressional adoption of the SSUTA, but the budget crises facing the vast majority of states presents common ground to further a goal of adopting such measures in every state. Furthermore, the Internet's universality and lack of physical or geographic boundaries means, in essence, that Amazon could use affiliates in other countries to provide the same services, and depending on local tax law, even encourage active solicitation of business on behalf of Amazon.¹⁹⁰

V. CONCLUSION

Courts upholding the click-through nexus Amazon laws of New York and North Carolina, and the significant value of tax revenue at stake, lends credibility to the prediction that this legal conflict will be

189. See *General Tax Info*, BARNES & NOBLE, <http://www.barnesandnoble.com/help/cds2.asp?PID=8115> (last visited Mar. 21, 2011); *Help: Sales Tax*, WALMART, <http://www.walmart.com/cp/Sales-Tax/538379> (last visited Mar. 21, 2011); *Conditions of Use—Sales Tax Policy*, BEST BUY, http://www.bestbuy.com/site/Help-Topics/Conditions-of-Use/pcmcat204400050067.c?id=pcmcat204400050067#use_tax (last visited Mar. 21, 2011); *Terms of Use—Placing an Order*, SEARS, http://www.sears.com/shc/s/nb_10153_12608_NB_CTermssofservice?adCell=W3 (last visited Sept. 9, 2010).

190. Contingent on whether those foreign affiliates or Web sites would be subject to U.S. sales taxes.

subject to an eventual hearing at the United States Supreme Court. Regardless, the New York law and its progeny are grounded in the legal precedent of *Quill*. None of the three Amazon law cases adjudicated directly challenged the physical presence standard espoused in *Quill*. It is obvious that the twentieth century *Quill* standard is outdated in the face of twenty-first century e-commerce. The failure of the law to track economic developments foreshadows an eventual legal challenge to address and clarify the physical presence standard in the Internet era or, alternatively, congressional action to amend or affirm the standards espoused in *Quill*. The click-through nexus laws appear to be in constitutional compliance as an ingenious and legal way to adapt to the limitations set by *Quill* in the age of e-commerce.

Whether Congress, in the form of overruling *Quill*'s physical presence standard or enacting legislation such as the Streamlined Sales and Use Tax Agreement, or the Supreme Court hearing an appeal of a case such as *Amazon.com v. New York* and providing the solution, states will continue to enact click-through nexus laws to tax e-commerce as lost tax revenues continue to grow as internet sales increase. Even if Amazon and other e-tailers lose this fight, they can continue to employ the evasive tactics to paying sales taxes noted in this Comment. In the end, it will not matter if Amazon loses its sales tax advantage on product pricing. Without the costs of building, maintaining, stocking, and employing people at brick-and-mortar stores, Amazon retains the low-cost advantage of being a purely online marketplace. For brick-and-mortar retailers, a sales tax levied on Amazon will not necessarily put their prices on par with Amazon, but will certainly help reduce the gap. The ability to capture terminated affiliates and potentially be the beneficiaries of the sales they generate, which Amazon therefore loses, may be a boon for those retailers such as Barnes & Noble and Wal-Mart. If the magnitude of this problem for e-tailers escalates to a situation where lost affiliate-generated sales noticeably hurts their bottom line or helps their competitors too much, this would ultimately force online retailers to reform their business strategies to recapture their lost affiliates or poach their competitors'. Either way, the validity of the New York statute, as evidenced by the *Amazon.com v. New York* decision, will continue to entice more states to follow New York's lead, up until the point a definitive solution is crafted.

Whether Congress or the Supreme Court creates the standard for the legality of click-through nexus laws, the building momentum behind this tax-on-technology movement means the issue cannot be ignored for much longer. For the law itself, the legal precedent of *Quill* permits

states to find a substantial nexus under the Commerce Clause for in-state representatives or independent contractors which the in-state affiliates qualify as when they solicit in-state sales. Therefore, I believe that should *Amazon.com v. New York* reach the United States Supreme Court, New York's Amazon law will be found constitutional. And then the Court will finally update the analysis of the Due Process and Commerce Clauses to take into account the advances of the Internet and other media and communication forums while altering the precedent set by *Quill* almost twenty years ago. Affiliate programs benefit both the e-tailer and the affiliate. Accordingly, the increased sales garnered by e-tailers on the efforts of their affiliates should create a taxable nexus under the reasonable and rebuttable presumption of solicitation. Without targeting passive advertising methods, the law is not discriminatory to electronic commerce and seeks to close a gaping tax loophole created not by law, but rather by the unforeseeable advances in technology accompanying the rise of the Internet.