

"Amazon Laws" and Taxation of Internet Sales: Constitutional Analysis

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Summary

As more and more purchases are made over the Internet and states experience more and more fiscal distress, states are looking for new ways to collect taxes for sales generated online. There is a common misperception that states cannot tax Internet sales; however, the reality is that they may impose sales and use taxes on such transactions, even when the retailer is outside of the state. However, if the seller does not have a constitutionally sufficient connection ("nexus") to the state, then the seller is under no enforceable obligation to collect a use tax. The purchaser, on the other hand, is still generally responsible for paying the use tax, but the rate of compliance is low.

Recent laws, often called "Amazon laws" in reference to the large Internet retailer, represent fresh attempts by the states to capture taxes on Internet sales. States enacting these laws have used two basic approaches. The first is to impose the responsibility for collecting use tax on those retailers who compensate state residents for placing links to the retailer's website on the state residents' websites (i.e., online referrals or "click-throughs"). The other is to require remote sellers to provide information about sales and taxes to the state and/or the in-state customers. New York was the first state to enact click-through legislation. Colorado was the first to pass a notification law. These laws have received significant publicity, in part due to questions about whether they impermissibly impose duties on remote sellers who do not have a sufficient nexus to the state.

Under Supreme Court jurisprudence, nexus is required by two provisions of the U.S. Constitution: the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. The Court has held that, under the dormant Commerce Clause, a state may not impose tax collection responsibilities on an out-of-state seller that does not have a physical presence in the state. Importantly, physical presence is only required by the dormant Commerce Clause, which is subject to congressional regulation, while the Fourteenth Amendment imposes a lesser requirement. This means Congress may choose a different standard under its power to regulate interstate commerce, so long as such standard is consistent with due process.

In both the 113th and 112th Congresses, legislation has been introduced to address the issue of Internet commerce and sales and use taxes. The Main Street Fairness Act (112th Congress) would have authorized states to impose tax collection responsibilities on remote sellers once the act's requirements relating to state adoption of the multistate Streamlined Sales and Use Tax Agreement (SSUTA) were met. The Marketplace Equity Act of 2011 (112th Congress) would have allowed a state to impose tax collection responsibilities on large remote sellers once it implemented a simplified tax administration system. The Marketplace Fairness Act of 2013 (H.R. 684 and S. 336) represents a hybrid approach in that it would allow a state to impose sales and use tax collection duties on remote sellers if the state (1) was a member under the SSUTA or (2) had adopted minimum simplification requirements, as provided under the act. Similar legislation was introduced in the 112th Congress.

Until Congress decides otherwise, physical presence remains the standard used to determine the constitutionality of states' "Amazon laws." Both the Colorado and New York laws have been challenged on constitutional grounds. Colorado's notification law appears to be the more constitutionally problematic approach—it was recently struck down by a federal district court. So far, the New York click-through law has been upheld.

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Recently, several states have enacted legislation intended to capture use taxes on sales made by out-of-state sellers to in-state customers. These laws are commonly referred to as "Amazon laws," in reference to the large Internet retailer.

A use tax is the companion to a sales tax—the sales tax is imposed on the sale of goods and services within the state's borders, while the use tax is imposed on purchases made by the state's residents from out-of-state (remote) sellers.[1] The purpose of the use tax is to dissuade residents from purchasing goods and services from out-of-state merchants in order to avoid the sales tax.[2]

Two common misconceptions exist about the ability of states to impose sales and use taxes on Internet sales. The first is that the Internet Tax Freedom Act, enacted in 1998, prevents such taxation.[3] This is not the case. The act contains a moratorium[4] only on state and local governments imposing "multiple or discriminatory taxes on electronic commerce," as well as new taxes on Internet access services. As a result of this law, a state may not, for example, impose a tax on electronic commerce that is not imposed on similar transactions made through other means (such as traditional "brick and mortar" stores).[5] It remains permissible, however, for a state to impose a sales or use tax that is administered equally without regard to whether the sale was face-to-face, mail order, or Internet.[6]

The second misperception is that the U.S. Constitution prohibits states from taxing Internet sales. States have the power to tax their residents, even when the seller is located outside of the state and has no real connection with the state. There are, however, constitutional restrictions on the state's power to require an out-of-state seller to collect use tax from the purchaser on behalf of the state. This does not exempt the purchaser from the duty to pay use tax on items purchased from out of state sellers who have no nexus with the purchaser's state. The purchaser remains responsible for paying the use tax; however, the rate of purchaser compliance is low. As a result of this low compliance rate and increasing Internet commerce, states are attempting to develop new ways in which they can capture the use taxes that are going uncollected on Internet sales. This report focuses on the ways in which the states' efforts to impose requirements on out-of-state

[1] For information on state sales and use taxes, see CRS Report R41853, *State Taxation of Internet Transactions*, by Steven Maguire.

[2] *See* Miller Bros. Co. v. Maryland, 347 U.S 340, 343 (1954)("The use tax, not in itself a relatively significant revenue producer, usually appears as a support to the sales tax in two respects. One is protection of the state's revenues by taking away from inhabitants the advantages of resort to untaxed out-of-state purchases. The other is protection of local merchants against out-of-state competition from those who may be enabled by lower tax burdens to offer lower prices.").

[3] P.L. 105-277, Div. C, Title XI, 112 Stat. 2681-719, *found at* 47 U.S.C. §151 note (hereinafter *Internet Tax Freedom Act*). For more information on the act, see CRS Report RL33261, *Internet Taxation: Issues and Legislation*, by Steven Maguire and Nonna A. Noto.

[4] The moratorium, which was originally set to expire in 2001, has been extended several times and is now in effect until November 1, 2014. P.L. 107-75, §2, 115 Stat. 703 (the Internet Tax Nondiscrimination Act of 2001 extended the moratorium through November 1, 2003); P.L. 108-435, §§2, 8, 118 Stat. 2615 (the Internet Tax Nondiscrimination Act extended the moratorium retroactively from November 1, 2003, to November 1, 2007); P.L. 110-108, §2, 121 Stat. 1024 (the Internet Tax Freedom Act Amendments Act of 2007 extended the moratorium to November 1, 2014).

[5] *See Internet Tax Freedom Act*, *supra* note 3, at §1105(2) (definition of "discriminatory tax").

[6] *See id.* at §1101(b) ("Except as provided in this section [imposing the moratorium] nothing in this title shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act.").

retailers are limited by the Constitution. The report discusses recent state legislation as well as legislation introduced in the two most recent Congresses.

Constitutional Requirements

As discussed below under "Recent State Legislation," several states have enacted legislation aimed at collecting taxes from Internet sales by imposing tax collection or notification requirements on Internet retailers. These laws potentially implicate two provisions of the U.S. Constitution: the Fourteenth Amendment's Due Process Clause[7] and the dormant Commerce Clause.[8] The clauses have different purposes, and a state's imposition of tax liability on a retailer may be acceptable under one and not the other.[9] The concern under the Due Process Clause is whether imposition of the liability is fair; while the concern under the dormant Commerce Clause is whether it unduly burdens interstate commerce. Together, these clauses impose two requirements relevant for analyzing the states' "Amazon laws": (1) each requires that there be some type of nexus between the state and the remote vendor before the state can impose the liability; and (2) the dormant Commerce Clause prohibits states from discriminating against out-of-state sellers. An important point to emphasize at the outset is that Congress has the authority under its commerce power to permit state taxation that would otherwise violate the dormant Commerce Clause.[10]

Nexus

Before a state may impose tax liability on an out-of-state business, a constitutionally sufficient connection or "nexus" must exist between the state and business. Nexus is required by both the Due Process Clause and the dormant Commerce Clause. Due process requires there be a sufficient nexus between the state and the seller so that (1) the state has provided some benefit for which it may ask something in return and (2) the seller has fair warning that its activities may be subject to the state's jurisdiction.[11] The dormant Commerce Clause, meanwhile, requires a nexus

[7] U.S. CONST. Amend. 14, §1 ("nor shall any State deprive any person of life, liberty, or property, without due process of law ... ").

[8] U.S. CONST. art. 1 §8, cl.3 ("The Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."). The Supreme Court has long held that because the Constitution grants Congress the authority to regulate interstate commerce, the states may not unduly burden such commerce—this is known as the dormant, or negative, Commerce Clause. *See* Okla. Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 180 (1995) (dormant Commerce Clause "reflect[s] a central concern of the Framers" that "the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.") The dormant Commerce Clause "prevent[s] a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Id*.; Southern Pacific Co. v. Arizona, 325 U.S. 761, 768 (1945)(further rationale is that out-of-state entities subject to any burden are likely not in a position to use the state's political process to seek relief).

[9] *See* Quill v. North Dakota, 504 U.S. 298, 312 (1992).

[10] *See id*. at 318 ("[O]ur 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. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions ... Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.").

[11] *See id.* at 308.

in order to ensure that the state's imposition of the liability does not impermissibly burden interstate commerce.[12]

The nexus standard is not the same under both clauses. The Supreme Court has ruled that, absent congressional action, the standard required under the dormant Commerce Clause is the seller's physical presence in the state,[13] while due process imposes a lesser standard under which the seller must have directed purposeful contact at the state's residents.[14]

This was not always the case. In 1967, the Court first articulated the physical presence requirement in *National Bellas Hess v. Dept. of Revenue of Illinois,*[15] grounding the requirement in both the Due Process and Commerce Clauses. The Court noted that each required a similar connection between the state and seller liable for the tax: due process required that "the state has given anything for which it can ask return," while state taxes on interstate commercial transactions were permissible when they represented "a fair share of the cost of the local government whose protection [the seller] enjoys."[16] The Court held these requirements meant that a state's authority to impose tax collection responsibility was limited to when the merchant had a physical presence in the state.[17] The Court also noted that imposition of the tax liability would be an unacceptable burden on interstate commerce due to the significant number of taxing jurisdictions across the country and the complexity of their administrative and collection requirements.[18]

By the late 1980s, it seemed possible that physical presence was no longer the rule because the Court had modified its analysis of both the Due Process and Commerce Clauses. The Due Process Clause was no longer interpreted to require an individual or entity's physical presence in a state before that state could exercise authority over the individual or entity; instead, liability could be imposed when the individual or entity intentionally made a sufficient level of contact with the state.[19] Additionally, rather than enforcing bright-line prohibitions against certain types of taxation on interstate commerce, the Court developed a test to determine whether a tax placed an unacceptable burden on interstate commerce.[20] The burden that the use tax responsibility imposed on out-of-state vendors had been a reason for such an imposition to be deemed unconstitutional.

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

[13] *See* National Bellas Hess Inc. v. Dep't. of Rev. of Illinois, 386 U.S. 753 (1967); *Quill*, 504 U.S. at 317-18.

[14] *See Quill*, 504 U.S. at 308.

[15] National Bellas Hess v. Dep't. of Revenue of Illinois, 386 U.S. 753 (1967); *see also* Miller Bros. Co. v. Maryland, 347 U.S. 340, 347 (1954) (finding insufficient nexus, based solely on due process grounds, when the seller's activities did not involve the "invasion or exploitation of the consumer market in" the taxing state, with the Court contrasting "active and aggressive operation within a taxing state" with the seller's "occasional delivery of goods sold at an out-of-state store with no solicitation other than the incidental effects of general advertising").

[16] *Bellas Hess*, 386 U.S. at 756.

[17] *Id*. at 758.

[18] *Id*. at 759-60.

[19] Many of these cases addressed whether an individual or entity could be subject to suit in a state court. For example, in *Burger King v. Rudzewicz*, 471 U.S. 462 (1985), the Court held that a Michigan franchisee without any contacts with Florida could be subject to suit in Florida court after entering into a contract with a Florida corporation. The Court wrote, "So long as a commercial actor's efforts are 'purposefully directed' towards residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there [citations omitted]." *Id.* at 476.

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

Some thought that technological advances might have sufficiently reduced the complexity of collecting use taxes that the burden would not be considered unacceptable under the new test.

However, in the 1992 case *Quill v. North Dakota*,[21] the Supreme Court rejected the idea that physical presence was no longer required. It held that, absent congressional action, the dormant Commerce Clause still prevented a state from imposing use tax collection liability on a mail-order seller that had no physical presence in the state. Although the Court affirmed the holding in *Bellas Hess*, it did not entirely adopt the same rationale. As in *Bellas Hess*, the Court found that collecting the tax would be an impermissible burden on interstate commerce, noting again the magnitude of the potential burden of such tax in light of the numerous taxing jurisdictions across the country.[22] The Court, however, altered its reasoning from *Bellas Hess* by expressly rejecting the idea that *due process* requires physical presence. The Court, noting that the two clauses served different purposes, found that its due process analysis had evolved so that physical presence was not necessary so long as the seller had directed sufficient action toward the state's residents.[23] The Court found such purposeful contact existed in *Quill* since the seller had "continuous and widespread solicitation of business" within the state.[24]

The Supreme Court has not revisited the issue since *Quill*. Nonetheless, several pre-*Quill* cases provide guidance on determining when a state may impose tax collection responsibilities on out-of-state retailers. Clearly, a state can impose such responsibilities on a company with a "brick and mortar" retail store or offices in the state.[25] This seems to be the case even if the in-state offices and the sales giving rise to the tax liability are unrelated to one another. For example, the Court has held that a state could require a company to collect use taxes on mail order sales to in-state customers when the company maintained two offices in the state that generated significant revenue, even though the offices were used to sell advertising space in the company's magazine and had nothing to do with the company's mail-order business.[26] The Court firmly rejected the argument that there needed to be a nexus not only between the company and the state, but also between the state and the sales activity. It reasoned that there was a sufficient connection between the state and company as the two in-state offices had enjoyed the "advantage of the same municipal services" whether or not they were connected to the mail-order business.[27]

Absent some type of physical office or retail space in the state, it also seems that having in-state salespeople or agents is sufficient contact. In several cases pre-dating *Bellas Hess* and *Quill*, the Court upheld the power of the state to impose use tax collection liabilities on remote sellers when the sales were arranged by local agents or salespeople.[28] In *Scripto, Inc. v. Carson*,[29] the Court

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

[22] *Id*. at 313.

[23] *See id*. at 308.

[24] *Id.* ("In 'modern commercial life' it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State.").

[25] *See* Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941)(upholding imposition of state use tax collection liability on mail order sales when company had retail stores in the state); Nelson v. Montgomery Ward, 312 U.S. 373 (1941) (same); *see also* D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24, 32-33 (1988)(upholding imposition of use tax on company with 13 stores in the state).

[26] Nat'l Geographic Soc. v. California Bd. of Equalization, 430 U.S. 551 (1977).

[27] *Id*. at 561.

[28] *See* Scripto, Inc. v. Carson, 362 U.S. 207, 211 (1960)(discussed *infra*); Felt & Tarrant Co. v. Gallagher, 306 U.S. 62 (1939) (upholding state imposition of use tax collection liability on company with two agents in the state); General (continued...)

held that a state could impose use tax collection liability on an out-of-state company that had no presence in the state other than 10 "independent contractors" who solicited business for the company. These individuals had limited power. They had no authority to make collections or incur debts on behalf of the company. They merely forwarded the orders they solicited to the company's out-of-state headquarters, where the decision to fill the order was made. Their status as independent contractors rather than employees was deemed constitutionally insignificant,[30] and the Court held that there was a constitutionally sufficient nexus between the company and the state—the individuals had conducted "continuous local solicitation" in the state on behalf of the company.[31] The Court later described the case as "represent[ing] the furthest constitutional reach to date" of a state's ability to impose use tax collection duties on a remote seller.[32]

Discriminatory Taxes

In addition to requiring nexus, the Commerce Clause prohibits state laws that discriminate against interstate commerce.[33] A state law that "regulates even-handedly to effectuate a legitimate local public interest" and has "only incidental" effect on interstate commerce is constitutionally permissible "unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[34] On the other hand, state law that, on its face, discriminates against out-of-state sellers is "virtually *per se* invalid."[35] Traditionally, such laws have only been permissible if they meet the high standard of "advanc[ing] a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[36] Thus, a state law that subjected remote sellers to tax-related burdens not imposed on in-state sellers would appear to be facially discriminatory and, therefore, subject to a high level of judicial scrutiny.

Congressional Authority to Act

The fact that the Supreme Court in *Quill* separated the nexus analysis under the Due Process Clause from that under the dormant Commerce Clause has important ramifications for Congress. Under its authority to regulate commerce, Congress has the power to authorize state action that would otherwise be an unconstitutional burden on interstate commerce, so long as it is consistent with other provisions in the Constitution.[37] When the Court held in *Bellas Hess* that both the Due

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Trading Co. v. Tax Comm'n, 322 U.S. 335 (1944) (upholding state imposition of use tax collection liability on company with salespeople in the state).

[29] 362 U.S. 207.

[30] *Id.* at 211.

[31] *Id.*

[32] *Bellas Hess*, 386 U.S. at 757.

[33] *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977); *see also* Oregon Waste Systems, Inc. v. Dep't of Environmental Quality, 511 U.S. 93, 98 (1994)(dormant Commerce Clause "denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce").

[34] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

[35] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 575 (1997) (internal citations omitted); *see also* Hughes v. Oklahoma, 441 U.S. 322, 336 (1979).

[36] New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 278 (1988); *see also* Hughes v. Oklahoma, 441 U.S. 322, 336-37 (1979)(imposing same test).

[37] *See* Northeast Bancorp v. Board of Governors of Fed. Reserve Sys., 472 U.S. 159, 174 (1985)("state actions [that (continued...)

Process and Commerce Clauses required physical presence, Congress could not have used its commerce power to impose a lesser standard that did not require physical presence. Under the Court's Fourteenth Amendment Due Process analysis, physical presence was still required. However, since the *Quill* Court held that the nexus standard for due process was less than that required by the dormant Commerce Clause, Congress may be able to permit state taxation without physical presence, assuming the minimum connection necessary to satisfy the Due Process Clause is met.[38]

Thus far, Congress has not defined a standard for nexus. Legislation to do so has been introduced in both the 113th and 112th Congresses as well as in earlier Congresses. Some, but not all, of this legislation has been linked in some way to the Streamlined Sales and Use Tax Agreement (SSUTA).[39]

113th Congress

Thus far, only the Marketplace Fairness Act of 2013[40] has been introduced in the 113th Congress. It represents a hybrid approach that would allow states to require remote vendors to collect sales or use taxes in two situations: (1) the state is a member of the SSUTA or (2) the state, although not a member of the SSUTA, has adopted minimum simplification requirements. Either the simplification requirements or the terms of the SSUTA would mitigate much of the burden that collection of the taxes might otherwise impose on remote vendors.

The legislation is similar to the Marketplace Fairness Act introduced in the 112th Congress.[41] A notable difference is the sales threshold that triggers the tax collection requirement. The earlier legislation would have required collection if the seller's gross remote sales in the previous calendar year exceeded $500,000. That figure was raised to $1 million in the 2013 bills.

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burden interstate commerce] which [Congress] plainly authorizes are invulnerable to constitutional attack under the Commerce Clause. [citations omitted]"); *see also* Prudential Insurance Co. v. Benjamin, 328 U.S. 408, 434 (1946) (describing Congress's Commerce Clause power as plenary and limited only by other constitutional provisions).

[38] *See Quill*, 504 U.S. at 318 ("[O]ur 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. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions ... Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.").

[39] The Streamlined Sales and Use Tax Agreement (SSUTA) is a product of the Streamlined Sales Tax Project, which was formed by state tax administrators in 2000 in order to simplify and make uniform the administration of sales and use taxes among the states. *See* STREAMLINED SALES TAX GOVERNING BOARD INC., *Frequently Asked Questions*, http://www.streamlinedsalestax.org/index.php?page=faqs [hereinafter *Streamlined Sales Tax FAQ*]. In 2002, member states adopted the Streamlined Sales and Use Tax Agreement (SSUTA). Efforts are now aimed at each state's adoption of changes to its taxing scheme in order to come into compliance with the agreement. According to the project's website, 44 states and the District of Columbia participate in the project, and 24 states have enacted conforming legislation. These 24 states are Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin and Wyoming. *See Streamlined Sales Tax FAQ*. For discussion of the agreement, see CRS Report R41853, *State Taxation of Internet Transactions*, by Steven Maguire.

[40] H.R. 684 and S. 336.

[41] S. 1832 (112th Cong.).

112th Congress

The Main Street Fairness Act,[42] the Marketplace Equity Act of 2011,[43] and the Marketplace Fairness Act[44] were introduced in the 112th Congress.

The Main Street Fairness Act

As with previous legislation,[45] the Main Street Fairness Act was linked to the SSUTA. It would have authorized each SSUTA member state to impose sales and use tax collection responsibilities on remote sellers (other than small sellers)[46] for sales sourced to that state under the agreement. The authorization would have become effective when (1) 10 states comprising at least 20% of the population of all states with a sales tax became members under the SSUTA; (2) various operational aspects of the agreement had been implemented; and (3) each member state had met requirements relating to databases and taxability matrices. Additionally, the SSUTA would have been required to meet specified minimum simplification requirements (e.g., multistate registration system; uniform definitions and rules for sourcing; single state-level administration of state and local sales and use taxes). It appears at least one of the criteria—the population requirement—has been met.[47]

The Marketplace Equity Act of 2011

The Marketplace Equity Act of 2011 was not tied to the SSUTA. It would have authorized a state to impose tax collection responsibilities on large remote sellers once it had implemented a simplified tax administration system. The state's sales and use tax system would have been required to meet minimum requirements relating to streamlined return filing; uniform tax base and exemptions throughout the state; and the sales and use tax rate structure. A state meeting the requirements would have been able to begin requiring remote sellers to collect the taxes on the first day of the calendar year that was at least six months after the state published a public notice regarding the collection responsibilities. Information that would have been required in the notice included (1) the state law requiring remote sellers to collect the taxes; (2) the criteria under which the taxes must be collected; (3) the tax rate(s); (4) the beginning date for collection of taxes; and (5) the requirements for tax return filing and compliance. The act would have provided an exemption from the tax collection requirement for remote sellers with less than $1 million in total remote sales within the United States. Remote sellers with less than $100,000 in sales in a given state would have been exempted from the collection requirement for that state.

[42] H.R. 2701 and S. 1452 (112th Cong.).

[43] H.R. 3179 (112th Cong.).

[44] S. 1832 (112th Cong.).

[45] Similar legislation has been introduced in prior Congresses. *See, e.g.*, S. 1736 and H.R. 3184 (108th Cong.) (allowing states to impose sales and use tax collection liability on large remote vendors once 10 states with at least 20% of the total population of all states with a sales tax became member states compliant with the Streamlined Sales and Use Tax Agreement (SSUTA) and any necessary operational aspects of the Agreement were implemented).

[46] The bill limited its application to businesses that are "sufficiently large," but did not define that term.

[47] According to the project's website, the 24 states that have enacted conforming legislation comprise 33% of the U.S. population. *See id.*

The Marketplace Fairness Act

Finally, the Marketplace Fairness Act represents a hybrid approach. It would have authorized states to impose sales and use tax collection responsibilities on sales sourced to that state if the state had adopted the SSUTA or implemented minimum simplification requirements, as provided in the act. The bill included an exception for "small sellers," which it defines as having gross annual remote sales of $500,000 or less.

Recent State Legislation

Facing the ongoing economic recession, many states have considered legislation designed to raise revenue by increasing the collection of use taxes from Internet sales. Two primary approaches have developed: "click-through nexus" and notification requirements. This section examines these approaches by focusing on the laws in the first states to enact legislation: New York's click-through nexus statute and Colorado's required notification law.

Click-Through Nexus

One approach adopted by some states is "click-through nexus." This term arises from the "click-throughs"—online referrals—that Internet retailers solicit through efforts such as Amazon's "Amazon Associates" program.[48] In this type of program, an individual or business that operates a website places a link on that website that directs Internet users to a different website that offers products or services from an online retailer such as Amazon. In Amazon's program, these "associate" individuals or businesses receive, as compensation for their referral, a percentage of the income Amazon realizes when an Internet user "clicks through" from one of these links and purchases Amazon goods and services.

"Click-through nexus" statutes require an online retailer to collect use taxes on sales to customers located in the taxing state based on the physical presence in that state of the retailer's "associates." An example of such a law is the one enacted by New York in 2008.

Under New York law, vendors are required to collect sales and use taxes, with vendors defined to include any entity which "solicits business" through "employees, independent contractors, agents or other representatives."[49] The 2008 law added a statutory presumption that sellers of taxable property and services meet this requirement "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."[50]

[48] *See* AMAZON ASSOCIATES, https://affiliate-program.amazon.com/gp/associates/join/landing/main.html. Overstock has a similar program.

[49] N.Y. TAX LAW §1101(b)(8)(i)(C)(I) (McKinney 2013).

[50] N.Y. TAX LAW §1101(b)(8)(vi) (McKinney 2013). For the presumption to apply, the cumulative gross receipts from sales by the seller to in-state customers as a result of all referrals must exceed $10,000 during the preceding four quarterly sales tax periods.

According to guidance issued by the state's tax agency, the presumption is not triggered by placing an advertisement.[51] For these purposes, advertising does not include placing a direct or indirect link to the seller's website if the consideration for such placement is based on the sales generated by the link.[52] Finally, the presumption may be rebutted by proof that the resident "did not engage in any solicitation in the state on behalf of the seller that would satisfy the [Constitution's] nexus requirement" during the preceding four sales and use tax quarterly periods.[53]

New York's statute tries to capture more remote sellers in the gap between those that fall within the *Bellas Hess/Quill* safe harbor, who clearly cannot be compelled to collect use taxes, and those that maintain property or direct employees in the taxing state, which Amazon and other Internet retailers have taken great care not to do. On the one hand, it might be argued that the law complies with the Supreme Court's jurisprudence by targeting only Internet retailers whose "affiliate" programs create some degree of physical presence in the state and whose "affiliates" solicit (i.e., do more than merely advertise) on the retailer's behalf. Examined in this light, the law might be characterized as similar to the one at issue in *Scripto*, where the Court upheld the power of the state to require use tax collection by a remote seller whose sales were arranged by local "independent contractors" who forwarded the orders they solicited to the company's out-of-state headquarters.[54] In that case, the Court made clear that the individuals' title was unimportant, as was the fact that they had no authority over the sales (e.g., could not approve them).[55] Rather, the key factor in the Court's decision was that the individuals had conducted "continuous local solicitation" in the state on behalf of the company.[56] By targeting those affiliates that solicit in the state, it seems the argument could be made that the New York law is within the Court's *Scripto* holding and, therefore, is constitutional with respect to affiliates with sufficient solicitation activities.

On the other hand, it might be argued there is reason to question whether linking on a website is substantively similar to the "continuous local solicitation" conducted by the salespeople in *Scripto*. It might be argued that the *Scripto* salespeople's on-going activities are distinguishable from the one-time action of placing a link on a website. A court examining whether this difference is constitutionally significant might be particularly hesitant about extending *Scripto's* holding since the *Bellas Hess* Court referred to it as "represent[ing] the furthest constitutional reach to date" of a state's ability to require use tax collection by a remote seller.[57] Another question may be whether a court would find the New York law to be unconstitutionally

[51] New York State Dept. of Taxation and Finance, Office of Tax Policy Analysis, Taxpayer Guidance Division, *TSB-M08(3)S: New Presumption Applicable to Definition of Sales Tax Vendor* (May 8, 2008), available at http://www.tax.ny.gov/pdf/memos/sales/m08_3s.pdf.

[52] *See id.*

[53] N.Y. TAX LAW §1101(b)(8)(vi) (McKinney 2013).

[54] Scripto, Inc. v. Carson, 362 U.S. 207, 211 (1960). *See also* Felt & Tarrant Co. v. Gallagher, 306 U.S. 62 (1939) (upholding state imposition of use tax collection liability on company with two agents in the state); General Trading Co. v. Tax Comm'n, 322 U.S. 335 (1944) (upholding state imposition of use tax collection liability on company with salespeople in the state).

[55] *See Scripto,* 362 U.S. at 211.

[56] *Id*.

[57] *Bellas Hess*, 386 U.S. at 757.

burdensome by requiring remote sellers to potentially monitor thousands of affiliates in order to determine whether the nexus requirement has been met.[58]

Whether New York's strategy of taxing Internet retailers based on the presence in the taxing state of "affiliates" or "associates" will survive constitutional scrutiny and prove to be what some have called the "Holy Grail of remote taxation"[59] remains to be seen. Amazon filed suit in New York state court, alleging both facial and as-applied invalidity under, among other things, the Commerce Clause and Due Process Clause. The company argued that the Supreme Court's jurisprudence stands only for the proposition that substantial nexus can be created by "active solicitation" in the taxing state on behalf of an out-of-state retailer, a standard which "click-through" referrals do not meet.[60] After the trial court dismissed the case,[61] the state appellate court rejected the facial challenges under both clauses, but remanded the case with respect to the claim of as-applied invalidity under both clauses.[62] When rejecting the facial challenge under the Commerce Clause, the appellate court found "the nexus requirement is satisfied" because the law imposes tax collection responsibility on remote vendors "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" and "does not target the out-of-state vendor's sales through agents who are not New York residents."[63] With respect to the facial due process challenge, the appellate court rejected the claims that the law's presumption was irrational and irrebuttable and that the law was unconstitutionally vague.[64]

With virtually parallel timing, Overstock.com, Inc., sought both declaratory and injunctive relief from the newly enacted New York statute. It experienced essentially the same results as had Amazon in its case.[65] Subsequently, both Overstock and Amazon appealed, asserting that the New York law "is unconstitutional on its face because it violates the Commerce Clause by subjecting online retailers, without a physical presence in the State, to New York sales and compensating use taxes."[66] The two also alleged that the law creates "an irrational irrebuttable presumption of solicitation of business within the state,"[67] and, thereby, violates the Due Process Clause.

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[58] *Cf. Quill,* 504 U.S. at 313 (imposing use tax collection liability was an impermissible burden on interstate commerce due to potential burden of such tax in light of the numerous taxing jurisdictions across the country).

[59] *See Amazon Laws: The Rise of "Click-thru Nexus" for Sales Tax Collection*, CBIZ (January 2011), available at http://www.cbiz.com/page.asp?pid=9111.

[60] Brief of Plaintiffs-Appellants, Amazon.com, LLC v. New York State Dep't of Taxation and Finance, 913 N.Y.S.2d 129 (N.Y. App. Div. 2010) (Nos. 1534, 1538), 2009 WL 7868633 at *24-25.

[61] Amazon.com, LLC v. New York State Dep't of Taxation and Finance, 877 N.Y.S.2d 842, 846 (N.Y. Sup. Ct. 2009).

[62] Amazon.com, LLC v. New York State Dep't of Taxation and Finance, 913 N.Y.S.2d 129, 143, 144 (N.Y. App. Div. 2010) ("Inasmuch as there has been limited, if non-existent, discovery on issue we are unable to conclude as a matter of law that plaintiffs' in-state representatives are engaged in sufficiently meaningful activity [under the Commerce Clause] so as to implicate the State's taxing powers, and thus find that they should be given the opportunity to develop a record which establishes, actually, rather than theoretically, whether their in-state representatives are soliciting business or merely advertising on their behalf," and "we conclude that it would be premature to find that even as applied the due process challenges are unavailing, whether because they create an illegal and irrebuttable presumption, or because the language of the statute is so vague that plaintiffs cannot ascertain which transactions give rise to their obligations to collect the sales tax" and therefore "we remand for further discovery so that plaintiffs can make their record that all their in-state representatives do is advertise on New York-based Web sites.").

[63] *Id*. at 138.

[64] *See id.* at 139-40.

[65] *See* Br. for Pl.-Appellant Overstock.com, Inc., 2009 Amazon.com, LLC v. New York State Dep't of Taxation and Finance, 913 N.Y.S.2d 129 (N.Y. App. Div. 2010) (No. 1535), 2009 WL 7868638 at *12.

[66] Overstock.com, Inc. v. New York Dep't of Taxation and Finance, __ N.E. 2d __, 2013 WL 1234823 (N.Y. March (continued...)

The New York Court of Appeals rejected the facial challenges. It noted that the Department of Taxation and Finance had issued two memoranda providing guidance for rebutting the solicitation presumption that would oblige a remote seller to collect taxes on remote sales. If the contract with the resident website owner contains a prohibition on solicitation on behalf of the remote seller and the resident certifies, annually, that the resident has not engaged in such solicitation, the "click-through" link would not be deemed to be evidence of sufficient direct activity to establish nexus between the remote seller and the state.

Required Notification

The second approach adopted by some states requires Internet retailers to provide information to the state and/or customer, rather than requiring Internet retailers to collect the use taxes themselves. This approach is illustrated by Colorado's law, which was enacted in 2010.

Among other things, Colorado's law imposes three duties on any "retailer that does not collect Colorado sales tax."[68] Retailers must (1) inform Colorado customers that a sales or use tax is owed on certain purchases and that it is the customer's responsibility to file a tax return; (2) send each Colorado customer a year-end notice of the date, amount, and category of each purchase made during the previous year, as well as a reminder that the state requires taxes be paid and returns filed for certain purchases; and (3) provide an annual statement to the Colorado department of revenue for each in-state customer showing the total amount paid for purchases during the year. Unless the retailer can show reasonable cause, each failure to notify a customer about the duty to file a state use tax return carries a $5 penalty, while each failure of the other two duties carries a $10 penalty.[69]

The notification requirements apply only to companies that do not collect Colorado sales and use taxes, which would appear to be primarily those retailers without a substantial nexus to the state. In other words, the law applies to companies that do not have a physical presence in the state. The

(...continued)

28, 2013).

[67] *Id.*

[68] COLO. REV. STAT. ANN. §39-21-112(3.5). "Retailer" is defined as "a person doing business in this state, known to the trade and public as such, and selling to the user or consumer, and not for resale." COLO. REV. STAT. ANN. §39-26-102(8). "Doing business in this state" is defined as "the selling, leasing, or delivering in this state, or any activity in this state in connection with the selling, leasing, or delivering in this state, of tangible personal property by a retail sale as defined in this section, for use, storage, distribution, or consumption within this state. This term includes, but shall not be limited to, the following acts or methods of transacting business:(a) The maintaining within this state, directly or indirectly or by a subsidiary, of an office, distributing house, salesroom or house, warehouse, or other place of business; (b)(I) The soliciting, either by direct representatives, indirect representatives, manufacturers' agents, or by distribution of catalogues or other advertising, or by use of any communication media, or by use of the newspaper, radio, or television advertising media, or by any other means whatsoever, of business from persons residing in this state and by reason thereof receiving orders from, or selling or leasing tangible personal property to, such persons residing in this state for use, consumption, distribution, and storage for use or consumption in this state. (II) Commencing March 1, 2010, if a retailer that does not collect Colorado sales tax is part of a controlled group of corporations, and that controlled group has a component member that is a retailer with physical presence in this state, the retailer that does not collect Colorado sales tax is presumed to be doing business in this state ... This presumption may be rebutted by proof that during the calendar year in question, the component member that is a retailer with physical presence in this state did not engage in any constitutionally sufficient solicitation in this state on behalf of the retailer that does not collect Colorado sales tax." COLO. REV. STAT. ANN. §39-26-102(4).

[69] COLO. REV. STAT. ANN. §39-21-112(3.5)(c)(II), (d)(III)(A) and (B).

first question is whether this violates due process. While the law targets companies without physical presence in the state, it applies to "retailers" who, by definition, must be "doing business" in the state.[70] This means the notification law applies only to retailers who have some type of contact with the state. However, there may be retailers for whom the "doing business" standard would not result in the requisite minimum connection with the state.

Additionally, the Colorado statute raises two issues under the Commerce Clause. First, since the law applies to companies that do not have a physical presence in the state, it would appear that the notification requirements would have to be distinguishable from use tax collection responsibilities in order to be permissible. On the one hand, some might distinguish between them since the notification law does not actually impose any tax collection liability on remote sellers, unlike the laws at issue in *Bellas Hess* and *Quill*. On the other hand, some might characterize the laws as functionally similar since all are intended to increase use tax collection, in which case it might be argued that the notification requirements are at least as burdensome as tax collection responsibilities since both require similar types of recordkeeping and, unlike collection responsibilities, the notification law also involves reporting information to the consumer. A court adopting this characterization of the notification duties would likely find them to be an impermissible burden on interstate commerce.

Second, by targeting remote sellers that do not have a physical presence in the state, the law imposes duties on out-of-state business that are not similarly imposed on Colorado businesses. Thus, it appears to be a facially discriminatory law. Under the Supreme Court's jurisprudence, facially discriminatory laws are "virtually *per se* invalid."[71] In order to be upheld against constitutional challenge, they generally must meet the high standard of "advanc[ing] a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[72] Whether the Colorado law would meet this high standard is open to question. While collecting use tax on purchases made to in-state customers seems an obvious legitimate government purpose, some might argue that there are other alternatives, such as collecting use tax from state residents on the state income tax form.

The constitutionality of the Colorado law has already been challenged. In March 2012, a federal district court held that the law violates the dormant Commerce Clause.[73] First, the court found that the state law impermissibly discriminated against out-of-state vendors. The court explained the only way a discriminatory law could be saved was if the state were able to show that its legitimate interests could not be served by reasonable nondiscriminatory alternatives, which the court found the state had completely failed to do.[74] Second, the court found the notification requirements were "inextricably related in kind and purpose" to the tax collection responsibilities at issue in *Quill* and therefore subject to the physical presence standard.[75] Since the Colorado requirements applied to retailers without a physical presence in the state, the court concluded they were in violation of the protections established by *Quill* and therefore unconstitutional.[76]

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[70] *See* definitions *supra note* 59.

[71] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 575 (1997) (internal citations omitted).

[72] New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 278 (1988).

[73] Direct Mktg. Ass'n v. Huber, Civil Case No. 10-cv-01546-REB-CBS, 2012 U.S. Dist. LEXIS 44468 (D. Colo. March 30, 2012) (granting plaintiff's motion for summary judgment).

[74] *See id.* at *17-*20.

[75] *Id*. at 26.

[76] *See id.* at *26-*27.

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