

Fordham Intellectual Property, Media and Entertainment Law Journal

Volume 24 *Volume XXIV*
Number 1 *Volume XXIV Book 1*

Article 6

2013

Much Ado About Nexus: The States Struggle to Impose Sales Tax Obligations on Out-of-State Sellers Engaged in E-Commerce

Sara Shoenfeld
Fordham University School of Law

Follow this and additional works at: <https://ir.lawnet.fordham.edu/iplj>



Part of the [Intellectual Property Law Commons](#)

Recommended Citation

Sara Shoenfeld, *Much Ado About Nexus: The States Struggle to Impose Sales Tax Obligations on Out-of-State Sellers Engaged in E-Commerce*, 24 *Fordham Intell. Prop. Media & Ent. L.J.* 260 (2015).
Available at: <https://ir.lawnet.fordham.edu/iplj/vol24/iss1/6>

This Note is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in *Fordham Intellectual Property, Media and Entertainment Law Journal* by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

Much Ado About Nexus: The States Struggle to Impose Sales Tax Obligations on Out-of-State Sellers Engaged in E-Commerce

Cover Page Footnote

J.D. Candidate 2014, Fordham University School of Law; B.S., 2011 Yeshiva University. Thank you to Professor Elizabeth Maresca for her valuable guidance throughout this process and for her ongoing support and mentoring.

Much Ado About Nexus: The States Struggle to Impose Sales Tax Obligations on Out-of-State Sellers Engaged in E-Commerce

Sara Schoenfeld*

INTRODUCTION	263
I. CAN IT BE SOLVED? NEW LEGAL ISSUES ARISING FROM A CHANGING E-COMMERCE SALES TAX ENVIRONMENT AND RECENT ATTEMPTS BY THE STATES AND CONGRESS TO FIND THE SOLUTION	266
A. <i>The Forces Limiting State Power to Impose Sales Tax Obligations on Out-of-State Sellers</i>	266
1. The Dormant Commerce Clause Limits State Ability to Regulate and Tax Interstate Commerce	267
2. Pre- <i>Quill</i> Supreme Court Limits on State Power to Impose Sales Tax Obligations on Out-of-State Sellers—The <i>National Bellas Hess</i> Exception, the <i>Complete Auto</i> Four-Step Test, and the Market Maintenance Theory	268
3. The <i>Quill</i> Limitation—The Supreme Court Upholds the Commerce Clause “Substantial Nexus” Requirement and Attempts to Explain the Required Physical Presence	270
B. <i>The Practical Limitations of State Sales Tax</i>	

* J.D. Candidate 2014, Fordham University School of Law; B.S., 2011 Yeshiva University. Thank you to Professor Elizabeth Maresca for her valuable guidance throughout this process and for her ongoing support and mentoring.

<i>Collection in an Unlimited Online World</i>	272
1. The Evolution of the Internet into an Online Marketplace Transformed the Way We Shop ..	273
2. The States Look to Sales Tax Expansion to Solve a Bad Economic Situation	275
a) E-Commerce Poses Additional Obstacles to the Imposition of Sales Tax Obligations on Out-of-State Sellers	279
<i>C. Legal Interpretations and Complications—The State Courts Attempt to Interpret Quill and Apply its Mail Order Transaction Holding to Modern Internet Sales</i>	281
1. The “More Than the Slightest Presence” Standard Emerges.....	282
2. Is There a Physical Presence Requirement in Substantial Nexus?	283
3. The “Isolated, Sporadic, and Insufficient” Standard.....	284
4. The <i>Scripto</i> and <i>Tyler Pipe</i> Market Maintenance Factor Meets the <i>Orvis</i> Standard.....	284
5. The Remaining Grey Areas—Slightest Presence? Substantial Nexus?	285
<i>D. Recent Attempts by the States and Congress to Solve the Nexus Problem</i>	286
1. Forty-Four States Join Together to Simultaneously Simplify and Expand Sales Tax Collection Through the Streamlined Sales and Use Taxation Agreement.....	286
2. Congress Attempts to Solve State Sales Tax Collection Woes Through Federal Legislation	289
a) The Main Street Fairness Act.....	290
b) The Marketplace Fairness Act.....	291
c) The Marketplace Equity Act	292
II. IN AN EFFORT TO IMPROVE SALES AND USE TAX COLLECTION, THE STATES ENACT LEGISLATION THAT VIOLATES THE CONSTITUTION.....	293

A. <i>The States Enact Nexus Laws Using Four Main Approaches</i>	294
1. New York and Other States Argue They Can Assert Nexus Under the Click-Through Nexus Approach.....	294
2. Many States Argue They Can Enact Affiliate Nexus Statutes Under the Unitary Business Theory	297
3. Colorado and Oklahoma Argue They Can Impose Notice and Information Reporting Requirements on Out-of-State Sellers.....	299
4. Oklahoma Argues <i>Quill</i> is No Longer Relevant to its Statute.....	301
B. <i>Each Approach to State Nexus Legislation Individually Conflicts with the Constitution</i>	302
1. The Click-Through Nexus Approach Disregards Supreme Court Precedent.....	302
2. The Affiliate Nexus Approach is Unconstitutional Because it Misapplies the Unitary Nexus Theory and Imputes Nexus on the Wrong Business.....	304
3. Notice and Information Reporting Requirements are Unconstitutional Because They Disregard Supreme Court Precedent and are Discriminatory and Unduly Burdensome.....	305
4. State Declaration that <i>Quill</i> is No Longer Relevant to its Statute Violates <i>Quill</i> and its Protection of the Commerce Clause.....	306
C. <i>The Varying State Nexus Statutes Collectively Violate the Commerce Clause</i>	307
III. IT IS TIME FOR CONGRESS TO ACT TO PERMANENTLY REJECT THE CONCEPT OF NEXUS	310
A. <i>Current State Legislative Approaches are Unconstitutional on their Own and Collectively</i>	311
B. <i>The SSUTA is a Step in the Right Direction but Lacks the Necessary Nexus Uniformity</i>	312
C. <i>The Best Solution is for Congress to Solve the Nexus Problem, But Not with the Acts Currently</i>	

<i>Pending in Congress</i>	313
CONCLUSION.....	315

INTRODUCTION

E-commerce allows sellers to conduct business online and reach customers all over the nation. However, a seller engaging in e-commerce must be aware that it is obligated to collect and remit state sales taxes to each state with which the seller establishes “substantial nexus.”¹ This term, “substantial nexus,” is not well defined.² While it is clear that physical presence within a state establishes “substantial nexus,” it remains unclear what in-state activities establish physical presence within a state.³ Must a seller collect and remit sales taxes to each state in which it has customers? To each state in which the seller has affiliates?

Imagine you are a business, trying to keep up with modern demands and stay afloat in a struggling economy. In good faith, you try to comply with every law you may be subject to. That good faith compliance may cost you more than you expected. The real issue is that nexus statutes vary from state to state.⁴ These varying state nexus statutes particularly burden businesses engaged in e-commerce. Online sellers must figure out with which states they have established nexus, which of their products are subject to sales tax in each of those states, how to comply with each state’s nexus laws where they do qualify, and then implement some

¹ *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–12 (1992).

² *Compare Koch Fuels, Inc. v. Clark*, 676 A.2d 330, 333 (R.I. 1996) (finding that the Supreme Court in *Quill* did in fact require “a physical presence in the taxing state” before that state can constitutionally impose a sales tax burden upon a seller), *with Orvis Co., Inc. v. Tax Appeals Tribunal of New York*, 86 N.Y.2d 165, 177–78 (N.Y. 1995) (“[T]he Supreme Court never intended to elevate the nexus requirement to a substantial physical presence of the vendor.”).

³ *See Orvis*, 86 N.Y.2d at 177–78.

⁴ *Compare* ARK. CODE ANN. § 26-52-117(d) (West 2013) (using the Click Through Nexus approach), *and* R.I. GEN. LAWS ANN. § 44-18-15(a) (West 2012) (using the Click Through Nexus approach), *with* ALA. CODE § 40-23-190 (2013) (using the Affiliate Nexus approach), *and* WIS. STAT. ANN. § 77.51(13g) (West 2013) (using the Affiliate Nexus approach).

system for continued compliance. A business engaged in e-commerce cannot assume they have nexus only where they have warehouses, stores or employees—that is, where they may have true physical presence. While true physical presence in a state establishes nexus, state legislatures employ varying approaches to expand the definition of nexus, allowing for further confusion.⁵ Businesses engaged in e-commerce must endure the headache of nationwide compliance requiring thorough analysis of each individual state’s sales tax laws.

Not only do varying state nexus statutes place practical burdens on sellers, such legislation also raises constitutional concerns. Modern nexus statutes pose two constitutional problems: (1) the individual statutes exceed the constitutional limit imposed by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady* and *Quill Corp. v. North Dakota*, that an out-of-state seller must have “substantial nexus” with a state before that state can force the seller to collect and remit state sales taxes;⁶ and (2) the combination of varying nexus statutes unduly burdens businesses engaged in interstate commerce and therefore violates the dormant Commerce Clause.⁷

The Supreme Court most recently articulated the “substantial nexus” requirement in the 1992 *Quill* case.⁸ This outdated standard, which the Court applied to sales made through mail order catalogs in *Quill*, must somehow be applied to the complex and ubiquitous online marketplace.⁹ Through its reliance on this vague nexus standard, the Supreme Court indirectly delegates its interpretive power to the states and allows the states to interpret the concept of “nexus” liberally, especially when applying it to

⁵ See *supra*, note 4.

⁶ See *Quill*, 504 U.S. at 311–12 (1992); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274, 279 (1977).

⁷ See U.S. CONST. art. I, § 8, cl. 3 (“The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes”); *Quill*, 504 U.S. at 312 (1992) (“[T]he Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy.”).

⁸ *Quill*, 504 U.S. at 311–12.

⁹ See *id.* at 302.

businesses engaged in e-commerce.¹⁰ Driven by their desire to collect the billions of dollars of uncollected sales tax revenue, many states embrace their interpretive power to construe their own limitations and enact unconstitutional nexus statutes.¹¹

With unconstitutional state nexus statutes in place, it is now time for change. This Note will proceed in three parts. Part I will identify the legal issues arising from the changing e-commerce sales tax environment and the recent attempts by the states and by Congress to solve such issues. Part II will discuss the current strategies adopted by states to collect Internet sales tax, and explain how the strategies are unconstitutional both individually and collectively. Part III will analyze the current state nexus strategies as well as current state and federal legislative attempts to solve the nexus problem. Ultimately, in Part III, this Note will argue that “substantial nexus” is an antiquated standard and that to best solve the ongoing e-commerce nexus problem, Congress should act to abolish the entire concept of nexus as it applies to sales taxes. If Congress does not enact legislation, the alternative constitutional option is for the states to amend the Streamlined Sales and Use Tax Agreement (“SSUTA”), an agreement entered into by forty-four states in an attempt to simplify sales tax collections,¹² to include a uniform nexus statute.

¹⁰ See *infra* Part II.B–C.

¹¹ See Scott Peterson, *Streamlined Sales Tax Master Presentation August 1, 2011*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=governing-board-presentation> (follow “Streamlined Sales Tax Master Presentation August 1, 2011” hyperlink) (last visited Sept. 26, 2013) (“By 2012 the projected loss for state and local governments is \$23.3 billion, including \$11.4 billion from remote electronic commerce, \$6.8 billion from business-to-consumer catalog sales, and \$5 billion from business-to-business catalog sales.”) [hereinafter *Streamlined Sales Tax Master Presentation*]; see also *infra* Part II.B–C (explaining how current state nexus approaches violates the Constitution).

¹² See *Frequently Asked Questions*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=faqs> (last visited Jan. 1, 2013) [hereinafter *Frequently Asked Questions*]. See generally *Streamlined Sales and Use Tax Agreement Adopted November 12, 2002 and Amended through May 24, 2012*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=modules> (follow “SSUTA as amended 5/24/2012” hyperlink) (last visited Sept. 26, 2013) [hereinafter *Streamlined Sales and Use Tax Agreement*].

I. CAN IT BE SOLVED? NEW LEGAL ISSUES ARISING FROM A CHANGING E-COMMERCE SALES TAX ENVIRONMENT AND RECENT ATTEMPTS BY THE STATES AND CONGRESS TO FIND THE SOLUTION

State action is limited by the dormant Commerce Clause and the Supreme Court's interpretations of the dormant Commerce Clause.¹³ Since the latest Supreme Court nexus case in 1992, the online marketplace has grown and a new commercial landscape has arrived.¹⁴ States, suffering from a bad economy and losing revenue to sales conducted over the Internet by out-of-state sellers, are enacting aggressive nexus statutes to increase sales and use tax collection.¹⁵ Meanwhile, state courts are struggling to interpret Supreme Court precedent and the states and Congress are attempting to solve the problem posed by e-commerce sales.¹⁶

A. *The Forces Limiting State Power to Impose Sales Tax Obligations on Out-of-State Sellers*

The Commerce Clause grants Congress the right to regulate interstate commerce and simultaneously limits the ability of the states to regulate and burden interstate commerce.¹⁷ This limit on the states is attributed to the dormant Commerce Clause, also known as the "negative Commerce Clause."¹⁸ Further, the states are bound by Supreme Court interpretations of the dormant Commerce Clause.¹⁹ Through 1992, the states' ability to regulate interstate commerce, including their ability to tax and burden interstate commerce, can be explained in three parts: (1) the

¹³ See U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . .").

¹⁴ See *infra* Part I.B.1.

¹⁵ See *infra* Part I.B.2.

¹⁶ See *infra* Part I.C–D.

¹⁷ See *infra* notes 20–25 and accompanying text.

¹⁸ See U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . ."); Robert D. Plattner, *Quill: 10 Years After*, 25 ST. TAX NOTES 1017, 1017–18 (2002), available at <http://taxadmin.org/fta/meet/09am/papers/nexus/Plattner.pdf>.

¹⁹ See Plattner, *supra* note 18, at 1017–18.

dormant Commerce Clause, (2) pre-*Quill* Supreme Court precedent, and (3) the *Quill* decision.²⁰

1. The Dormant Commerce Clause Limits State Ability to Regulate and Tax Interstate Commerce

The Constitution explicitly grants Congress the right to regulate interstate commerce.²¹ However, the Commerce Clause is silent on the ability of individual states to regulate interstate commerce carried on within their borders where Congress has not acted to preempt the field.²² As a result, where Congress is silent, the reviewing state court may determine the limits on state power to regulate and tax interstate commerce.²³

In *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, the United States Supreme Court explained that the dormant Commerce Clause “prohibit[s] certain state taxation even when Congress has failed to legislate on the subject.”²⁴ The Court explained:

[T]his construction [] serve[s] the Commerce Clause’s purpose of preventing a State from . . . jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the

²⁰ See U.S. CONST. art. I, § 8, cl. 3; *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–12 (1992); *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); *Nat’l Geographic Soc’y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977); *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753, 758–59 (1967); *Scripto, Inc. v. Carson*, 362 U.S. 207, 209 (1960).

²¹ U.S. CONST. art. I, § 8, cl. 3 (“The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . .”).

²² See U.S. CONST. art. I, § 8, cl. 3; Plattner, *supra* note 18, at 1017–18.

²³ See Plattner, *supra* note 18, at 1017–18.

²⁴ *Okl. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995) (“Despite the express grant to Congress of the power to ‘regulate Commerce . . . among the several States,’ U.S. Const., art. I, § 8, cl. 3, we have consistently held this language to contain a further, negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject.”); see also *Quill*, 504 U.S. at 309; *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

flow of commerce across its borders that commerce wholly within those borders would not bear.²⁵

The prevailing interpretation of the dormant Commerce Clause is that the power of the states to regulate interstate commerce lies between a total prohibition to regulate interstate commerce and permission to regulate wherever Congress is silent.²⁶

In modern transactions, the ability of states to force out-of-state vendors to collect state sales taxes is governed by the dormant Commerce Clause.²⁷ In *Complete Auto*, the Supreme Court ruled that a seller must have “substantial nexus” within a state before that state can force the seller to collect state sales tax.²⁸ While the typical example of nexus is true physical presence within a state, a seller may establish nexus within a state in a variety of other ways.²⁹

2. Pre-*Quill* Supreme Court Limits on State Power to Impose Sales Tax Obligations on Out-of-State Sellers—The *National Bellas Hess* Exception, the *Complete Auto* Four-Step Test, and the Market Maintenance Theory

The earliest relevant nexus case is the 1967 Supreme Court case, *National Bellas Hess, Inc. v. Department of Revenue*.³⁰ In *National Bellas Hess*, the Supreme Court explained that Congress alone has the power to regulate interstate commerce to “ensure a national economy free from . . . unjustifiable local

²⁵ *Jefferson Lines, Inc.*, 514 U.S. at 179–80.

²⁶ See Plattner, *supra* note 18, at 1017–18.

²⁷ See *Jefferson Lines, Inc.*, 514 U.S. at 179; *Quill*, 504 U.S. at 309.

²⁸ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274, 279 (1977); see also *Quill*, 504 U.S. at 311–12 (1992); 43 RESEARCH INST. OF AM., TAX ADVISORY PLANNING SYS. §4.01 (2012).

²⁹ See, e.g., WASH. ADMIN. CODE § 458-20-193 (2013) (“‘Nexus’ means the activity carried on by the seller in Washington which is significantly associated with the seller’s ability to establish or maintain a market for its products in Washington”); see also David Hardesty, *Future Taxation of E-Commerce*, SMARTPROS (July 19, 1999), <http://accounting.smartpros.com/x13424.xml> (“For instance, the use of a Web server in another state, trade show attendance in another state, agents or employees in another state, plus a variety of other circumstances, can result in nexus for sales and use tax. However, a taxpayer that is aware of the nexus traps can easily avoid them.”).

³⁰ *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753 (1967).

entanglements.”³¹ The Court explained that interstate commerce is burdened by varying state and local tax rates, allowable exemptions, and administrative and record-keeping requirements.³² Therefore the Court reasoned that mail-order sellers who only communicate with customers in a particular state by mail or common carrier could not be forced to collect and remit sales taxes to that state.³³

Perhaps the most significant ruling prior to *Quill* was the 1977 case *Complete Auto Transit, Inc. v. Brady*.³⁴ Modern dormant Commerce Clause jurisprudence is guided by the four-part test enunciated in *Complete Auto*.³⁵ Under this test, a state may tax an out-of-state seller where the tax: (1) is “applied to an activity with a substantial nexus with the taxing State;” (2) is “fairly apportioned;” (3) “does not discriminate against interstate commerce;” and (4) is “fairly related to the services provided by the State.”³⁶

The Supreme Court has also indicated that the effect of an in-state representative’s activities on the out-of-state seller’s ability to maintain an in-state market is significant to a determination of nexus.³⁷ In 1960, in *Scripto Inc. v. Carson*, the Supreme Court held that the presence of ten independent contractors in a state was sufficient to establish nexus because the contractors were the out-of-state seller’s primary means of “attracting, soliciting, and

³¹ *Id.* at 760.

³² *Id.* (involving an out-of-state mail-order vendor whose only connection with customers in the state of Illinois was by common carrier or United States mail).

³³ *Id.* at 758–59 (“[There is a] sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.”).

³⁴ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (enunciating the four-part test).

³⁵ *Id.*

³⁶ *Id.* (ruling that a tax imposed by the state upon a transportation company for the “privilege of doing business” within the state was not in violation of the Commerce Clause simply because the corporation was engaged in interstate commerce); *see also* *Lamtec Corp. v. Dep’t of Revenue*, 170 Wash. 2d 838, 844 (2011).

³⁷ *See* *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250–52 (1987); *Nat’l Geographic Soc’y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977); *Scripto Inc. v. Carson*, 362 U.S. 207, 208–10 (1960).

obtaining” in-state customers.³⁸ Similarly in 1977, in *National Geographic v. California Board of Equalization*, the Supreme Court determined that two small offices in a state established “nexus” with that state even where the activities were limited to soliciting and advertising.³⁹ Then in 1987, in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, the Supreme Court explained, “the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are *significantly associated* with the taxpayer’s ability to *establish and maintain a market* in this state for the sales.”⁴⁰ The *Tyler* Court held that an out-of-state seller established nexus with a state where in-state sales representatives acted daily to improve in-state name recognition, market share, goodwill, and individual customer relations.⁴¹

Finally, in 1992, the Supreme Court decided *Quill v. North Dakota*.⁴² The Court decided *Quill* using the *National Bellas Hess* exception for sellers communicating with in-state customers through mail or common carrier,⁴³ the *Complete Auto* four-part test requiring “substantial nexus,”⁴⁴ and a consistent emphasis on in-state market maintenance.⁴⁵

3. The *Quill* Limitation—The Supreme Court Upholds the Commerce Clause “Substantial Nexus” Requirement and Attempts to Explain the Required Physical Presence

In *Quill*, the Supreme Court addressed the ability of North Dakota to impose a sales tax duty on an out-of-state seller who conducted business within the state through “catalogs and flyers,

³⁸ *Scripto*, 362 U.S. at 209.

³⁹ *Nat’l Geographic*, 430 U.S. at 556 (“Appellant’s maintenance of two offices in the State and solicitation by employees assigned to those offices of advertising copy in the range of \$1 million annually . . .”).

⁴⁰ *Tyler Pipe*, 483 U.S. at 250 (emphasis added).

⁴¹ *Id.* at 249–51.

⁴² *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁴³ *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753, 758–59 (1967).

⁴⁴ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

⁴⁵ *See Tyler Pipe*, 483 U.S. at 250–52; *Nat’l Geographic Soc’y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977); *Scripto Inc. v. Carson*, 362 U.S. 207, 208–10 (1960).

advertisements in national periodicals, and telephone calls.”⁴⁶ Quill Corporation was North Dakota’s sixth largest provider of office supplies with about 3,000 in-state customers.⁴⁷ Quill Corporation had over \$200 million worth of national sales with almost \$1 million from North Dakota sales.⁴⁸ Significantly, all of the merchandise was delivered to North Dakota customers by mail or common carrier.⁴⁹

The *Quill* Court first distinguished the requirements of the Due Process Clause from that of the Commerce Clause.⁵⁰ The Court explained that “[d]ue process concerns the fundamental fairness of governmental activity, and the touchstone of due process nexus analysis is often identified as ‘notice’ or ‘fair warning.’”⁵¹ The Court continued, “[i]n contrast, the Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy.”⁵² The Court maintained that while the Due Process Clause does not “require a physical presence in a State,” the Commerce Clause does require a minimum level of in-state presence.⁵³ Therefore, the *Quill* majority reaffirmed the *Bellas Hess* physical presence requirement.⁵⁴ The Court held that Quill Corporation lacked the

⁴⁶ *Quill*, 504 U.S. at 302.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at 308, 312.

⁵¹ *Id.* at 312.

⁵² *Id.*

⁵³ *Id.* at 308 (concluding that the Due Process Clause does not bar enforcement of the use tax against Quill because it was beyond dispute that “Quill ha[d] purposefully directed its activities at North Dakota residents, that the magnitude of those contacts [was] more than sufficient for due process purposes, and that the use tax [was] related to the benefits Quill receive[d] from access to the State”); see also *Red Earth LLC v. United States*, 657 F.3d 138, 144 (2d Cir. 2011).

⁵⁴ See *Quill* 504 U.S. at 314–15 (“Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.”); *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 753, 758 (1967). The most recent Supreme Court reaffirmation of *Quill* came from Justice Ginsburg in her concurring opinion in *Hemi Group, LLC v. City of New York*, 130 S. Ct. 983 (2010) (ruling that New York City could not use RICO to side step its inability to force the company to collect tax for it as enunciated in *Quill*).

necessary in-state activity to establish the *Complete Auto* “substantial nexus” requirement.⁵⁵ In an effort to consolidate Commerce Clause jurisprudence, the Court clarified that *Bellas Hess* stood for the assertion that an out-of-state vendor whose in-state activity was carried on exclusively through a common carrier or the United States mail lacks the “substantial nexus” required by the Commerce Clause under the first part of the *Complete Auto* test.⁵⁶

The *Quill* opinion was unanimous in all parts except that regarding the Commerce Clause.⁵⁷ Even at the time *Quill* was decided, Justice White foresaw the inadequacy of the majority opinion.⁵⁸ In his concurrence, Justice White warned, “reasonable minds surely can, and will, differ over what showing is required to make out a ‘physical presence’ adequate to justify imposing responsibilities for use tax collection.”⁵⁹ Justice White predicted, “the vagaries of ‘physical presence’ will be tested to their fullest in [the] courts.”⁶⁰

B. The Practical Limitations of State Sales Tax Collection in an Unlimited Online World

Since the *Quill* decision, Internet progression and the growing tendency of consumers to purchase items over the Internet

⁵⁵ *Quill*, 504 U.S. at 317 (“To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the rule remains good law.”).

⁵⁶ *Quill*, 504 U.S. at 311. The *Quill* Court noted that “while contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases.” *Id.*

⁵⁷ *Id.* at 320. Regarding the Commerce Clause, the court ruled 5-3-1. *Id.* Justice Scalia, joined by Justice Kennedy and Justice Thomas, agreed with the majority that the Commerce Clause holding of *Bellas Hess* should not be overruled but disagreed with the majority reasoning. *Id.* at 320 (Scalia, J., concurring) (“I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*.”). Justice White dissented regarding the Commerce Clause holding because he believed “the Court should also overrule that part of *Bellas Hess* which justifies its holding under the Commerce Clause.” *Id.* at 321–22 (White, J., dissenting).

⁵⁸ *Id.* at 330–31 (White, J., concurring).

⁵⁹ *Id.*

⁶⁰ *Id.*

produced a new commercial landscape.⁶¹ As a result, the states are scrambling to apply traditional state sales tax laws to a nontraditional setting.⁶²

1. The Evolution of the Internet into an Online Marketplace Transformed the Way We Shop

The use of the Internet has grown at staggering rates since its inception.⁶³ From 2000 until 2010, Internet usage grew by 444.8%.⁶⁴ Since the emergence of the online marketplace, the amount of total retail sales in the United States attributed to e-commerce has rapidly increased.⁶⁵ In 1998, e-commerce accounted for only 0.2% of total retail sales in the United States, representing just over \$5 billion.⁶⁶ Just ten years later, in 2008, e-commerce accounted for 3.6% of total retail sales in the United States, which translates to approximately \$142 billion.⁶⁷

⁶¹ See World Intellectual Property Organization, WIPO Seminar For Asia and the Pacific Region on the Internet and the Protection of Intellectual Property Rights, 28-30 April 1998, IV. The Exercise and Management of IP Rights in Electronic Commerce, WIPO/INT/SIN/98/7, 2 (1998,) (explaining that the Internet began “as an experimental computer network sponsored by the United States military,” was then used for research and education, and in 1998 the Internet was being used primarily for e-mail and was slowly transforming into a “virtual and global market”).

⁶² See *First-Quarter Online Retail Sales Up 12%: comScore*, MARKETWATCH (May 10, 2011, 3:10 PM), <http://www.marketwatch.com/story/first-quarter-online-retail-sales-up-12-comscore-2011-05-10> (“It’s clear that e-commerce has become a mainstay in consumer behavior.”).

⁶³ See TIMOTHY P. TRAINER & VICKI E. ALLUMS, CUSTOMS ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS, § 4:2 (2012) (“Although Internet usage in developed countries such as the United States is peaking, growth is expected to continue in developing countries for another decade.”).

⁶⁴ See *id.* (“As of 2010, ‘1,966,514,816’ people now use the Internet.”). From the summer of 2003 to the year 2010, the number of Internet users worldwide has grown from 580 million to approximately 1.9 billion. *Id.*

⁶⁵ See U.S. CENSUS BUREAU, 1998 ANNUAL RETAIL TRADE SURVEY 4 (1999), available at <http://www.census.gov/econ/estats/1998/1998tables.pdf>; U.S. CENSUS BUREAU, E-STATS 1 (2010), available at <http://www.census.gov/econ/estats/2008/2008reportfinal.pdf>.

⁶⁶ See *id.* at 4. States generally tax retail sales, which are business-to-consumer sales (B2C), as opposed to manufacturer and merchant wholesaler sales. See Michael J. Payne, *Selling the Main Street Fairness Act: A Viable Solution to the Internet Sales Tax Problem*, 44 ARIZ. ST. L.J. 927, 934–35 (2012).

⁶⁷ See U.S. CENSUS BUREAU, E-STATS, *supra* note 65, at 1.

The evolution of the Internet has had far-reaching consequences, including the complete transformation of the publishing and music industries.⁶⁸ This transformation is illustrated by the disappearance of major retailers like Borders and Tower Records.⁶⁹ In January of 2011, the Borders bookstore chain had 642 stores.⁷⁰ In July of 2011, Borders announced going-out-of-business sales for its remaining 399 retail stores after it failed to find a buyer for its struggling company and went into bankruptcy.⁷¹ Similarly, the once popular Tower Records music store chain sought bankruptcy and closed its stores in 2006.⁷² Meanwhile, Apple's iTunes is booming and the market is full of successful tablets, such as Apple's iPad, Google's Nexus and Amazon's Kindle, all used to download and read what was once only available in hard copy form.⁷³

⁶⁸ See Hang Nguyen, *Details on Borders Liquidation Sales*, ORANGE COUNTY REGISTER, <http://www.ocregister.com/articles/borders-309227-square-stores.html> (last updated Aug. 21, 2013) (explaining that the Borders book store chain was forced to close its doors); Alison Fensterstock, *The End of an Era*, GAMBIT WEEKLY (Nov. 21, 2006), <http://www.bestofneworleans.com/gambit/the-end-of-an-era/Content?oid=1246759> ("The closing of Tower Records marks the end of the downtown media outlet and the old way of collecting music.").

⁶⁹ See *id.*

⁷⁰ See *id.*

⁷¹ See *id.* ("Borders, which currently employs about 10,700 employees, filed for Chapter 11 Feb. 16."); see also Press Release, Att'y Gen. George Jepsen, Consumer Advisory: Borders Group to Close Remaining Stores (July 20, 2011), available at http://www.ct.gov/ag/lib/ag/press_releases/2011/7-20-11borders.pdf.

⁷² See Fensterstock, *supra* note 68 ("The closing of Tower Records marks the end of the downtown media outlet and the old way of collecting music."); Paul Swan, *Tower Records Stores to Close*, THE ADVOCATE, Oct. 7, 2006 ("Tower Records, the 46-year-old music retailer that sought bankruptcy protection in August, was sold to a group led by liquidator Great American Corp. for \$134.3 million . . . Tower's 89 stores in 20 states . . . will probably close by the end of the year . . .").

⁷³ See Michael Amicone, *Apple Took Big Bite Out of the Market*, BILLBOARD, Apr. 17, 2004, at 44, 48 (observing just one year after iTune's release that "[o]ne thing is certain: The success of iTunes has confirmed that the future of digital music distribution is now"); Dan Graziano, *Maps and Passbook Estimated to Help Apple Increase App Store Revenue by 70% in 2012*, BOY GENIUS REPORT (Sept. 21, 2012, 7:15 PM), <http://bgr.com/2012/09/21/app-store-revenue-2012-ios-6-apple> ("Apple now has more than 435 million iTunes accounts with credit cards attached, dramatically up from 225 million in June 2011."); see also Dan Ritter, *The New Kindle Fire Could Be Really Cool*, WALL ST. CHEAT SHEET (Sept. 24, 2012), <http://wallstcheatsheet.com/stocks/the-new-kindle-fire-could-be-really-cool.html> (comparing the Kindle Fire to the Apple iPad and

These industries are not alone; many brick-and-mortar stores are losing business to online sellers.⁷⁴ People no longer rely on their local stores to provide them with the goods they seek.⁷⁵ The evolution of the Internet into a thriving online marketplace has resulted in a new commercial landscape where brick-and-mortar stores are struggling and online companies are thriving.⁷⁶

2. The States Look to Sales Tax Expansion to Solve a Bad Economic Situation

While e-commerce is steadily growing, the financial condition of state governments is increasingly less stable.⁷⁷ The 2008 nationwide economic downturn left states facing major fiscal challenges.⁷⁸ Those challenges continue, as thirty-one states have

the Google Nexus tablets); Kevin Smith, *Apple's Huge iTunes Revamp Is Rumored To Be Released Tomorrow*, BUS. INSIDER, (Oct. 22, 2012, 11:49 AM), <http://www.businessinsider.com/itunes-11-launch-2012-10> (describing Apple's continuing popularity and success in providing product updates and new products).

⁷⁴ See Press Release, Rep. Steve Womack, Rep. Steve Womack on Marketplace Equity Act of 2011 (July 27, 2012), available at <http://womack.house.gov/news/documentsingle.aspx?DocumentID=304943> (arguing that the lack of use tax reporting in Internet transactions is devastating to "traditional retailers" and "critical local services" due to "the exponential growth of internet").

⁷⁵ See Barbara Friedberg, *Trend Watch: Traditional Retail is Dying*, BENZINGA (Apr. 20, 2012, 2:03 PM), <http://www.benzinga.com/personal-finance/financial-advisors/12/04/2516027/trend-watch-traditional-retail-is-dying> (observing that "[a]s our comfort with the internet grows, along with both parents working outside the home, the convenience of shopping on line is gaining ground . . . so much ground that it is squeezing out traditional retail" to the extent that if you "[w]alk the streets of any metropolitan downtown [] you can't help but notice the increasing vacancies").

⁷⁶ See *id.*

⁷⁷ See F. LAWRENCE STREET, LAW OF THE INTERNET, § 9.02 (Matthew Bender) (2011) (updated by Roger A. Nichols, M.A., J.D.) ("Since 2008 and for the foreseeable future, governmental units in the U.S. have been facing a financial crisis."). The states are struggling even as they receive subsidies from the federal government. See Darien Shanske, *How Less Can be More: Using the Federal Income Tax to Stabilize State and Local Finance*, 31 VA. TAX REV. 413, 469 (2012) ("A longstanding common, and reasonable, assumption has been that if the federal government saves money through cutting its subsidies to the states, this will heighten the crisis in the states.")

⁷⁸ See Phil Oliff et al., *States Continue To Feel Recession's Impact*, CTR. ON BUDGET & POL'Y PRIORITIES 2 (June 27, 2012), <http://www.cbpp.org/cms/index.cfm?fa=view&id=711> ("States continue to face a major fiscal challenge."); CAL. STATE COMM'N ON THE 21ST CENTURY ECON., REPORT OF THE COMMISSION ON THE 21ST CENTURY ECONOMY 3, 9 (2009), available at <http://www.cotce.ca.gov/documents/reports/documents/Commission>

projected budget gaps for the fiscal year 2013.⁷⁹ Although state finances are slowly recovering, commentators predict that the “sluggish economic growth” will likely increase budget shortfalls for the foreseeable future.⁸⁰

Some states argue that the increasing popularity of e-commerce adds to their fiscal crisis by reducing the amount of sales tax revenue collected.⁸¹ This is because online sellers do not need to collect and remit sales taxes to states with which they do not have nexus.⁸² If a consumer is looking to purchase an item online, he or she is likely to purchase the item from a store that lacks “substantial nexus” with the state in which the consumer resides.⁸³ In that situation, the consumer will not be charged sales tax by the out-of-state seller.⁸⁴ However, if that same consumer purchases that same item online from a store that has “substantial nexus”

_on_the_21st_Century_Economy-Final_Report.pdf (explaining that “[a] nationwide economic downturn hit the state hard” and that “[o]ne result was that Californians, already struggling with the effects of the national economic recession that hit the state hard, saw their taxes increase.”).

⁷⁹ See Oliff, *supra* note 78 (“Thirty-one states projected . . . budget gaps totaling \$55 billion for fiscal year 2013.”).

⁸⁰ *Id.* (noting that “[s]tate finances are recovering, but slowly” and “that even if economic improvement accelerates, state fiscal recovery tends to lag recovery in the broader economy”). Although “[t]he shortfall totals for fiscal year 2013 are smaller than the totals from the last few years” those shortfalls are “large by historical standards.” *Id.* In addition, unemployment will likely “depress[] state revenue collections, . . . [and] increase[] demand for Medicaid and other essential services that states provide.” *Id.*

⁸¹ See, e.g., CAL. STATE COMM’N ON THE 21ST CENTURY ECON., *supra* note 78, at 9, 20 (arguing that because “[s]ellers outside of the state with no physical presence in California are not required to pay the [Sales and Use Tax] when taking orders from California residents” out-of-state retailers have an advantage and it “results in a substantial revenue loss to [the State of] California”).

⁸² See *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–12 (1992).

⁸³ See *id.* (reaffirming that sellers must have “substantial nexus” with a state before that state can impose state sales tax obligations on the seller); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274, 279 (1977) (limiting a state’s ability to tax out-of-state sellers to sellers who established “substantial nexus” with the state); see also Womack, *supra* note 74 (arguing that the lack of use tax reporting in Internet transactions is devastating to “traditional retailers”).

⁸⁴ See *Quill*, 504 U.S. at 311–12 (requiring that sellers have “substantial nexus” with a state before a state can impose state sales tax obligations on the seller).

within the consumer's home state, the consumer will be charged sales taxes on the transaction.⁸⁵

States rely on sales taxes for substantial portions of their revenues, some even for more than 50% of state revenues.⁸⁶ The decline in state sales tax collections results in over twenty billion dollars of lost revenue for state and local governments.⁸⁷ The situation is exaggerated in states that do not impose an income tax and thus rely even more heavily on sales and use taxes for revenue.⁸⁸ In 2012, the projected total revenue loss due to uncollected sales taxes for state and local governments is \$23.3 billion, including \$11.4 billion from remote e-commerce.⁸⁹

Due to these revenue losses, states are applying their state sales tax collection laws to out-of-state vendors more aggressively.⁹⁰ In-

⁸⁵ See *id.*

⁸⁶ See Susan Pace Hamill, *The Vast Injustice Perpetuated by State and Local Tax Policy*, 37 HOFSTRA L. REV. 117, 131 (2008). In 2007, the following states relied on sales taxes for the following percentages: Washington (61.24%); Nevada (58.86%); Tennessee (58.55%); South Dakota (54.27%); Arkansas (53.07%); Florida (48.49%); Alabama (48.01%); Arizona (46.88%); Texas (45.03%); Oklahoma (37.59%); and Colorado (36.09%); Minnesota (33.08%); Rhode Island (30.03%); Ohio (30.01%); Wisconsin (28.17%); Virginia (26.92%); Maryland (24.13%); and New Hampshire (15.67%). *Id.*

⁸⁷ See *Streamlined Sales Tax Master Presentation*, *supra* note 11, at 6 ("By 2012 the projected loss for state and local governments is \$23.3 billion").

⁸⁸ See Michael Mazerov, *Making the "Internet Tax Freedom Act" Permanent Could Lead to a Substantial Revenue Loss for States and Localities*, CTR. ON BUDGET & POL'Y PRIORITIES (Aug. 30, 2007), <http://www.cbpp.org/cms/?fa=view&id=80> (stating that sales taxes are a vital source of state revenue and are especially important in Florida, Nevada, South Dakota, Washington, and Wyoming, which have no state income taxes, and New Hampshire and Tennessee, which have only limited income taxes). The only states without a general retail sales tax are Alaska, Delaware, Montana, New Hampshire, and Oregon. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* 66 (3d. ed. 2012).

⁸⁹ See *Streamlined Sales Tax Master Presentation*, *supra* note 11, at 6 ("By 2012 the projected loss for state and local governments is \$23.3 billion, including \$11.4 billion from remote electronic commerce, \$6.8 billion from business-to-consumer catalog sales, and \$5 billion from business-to-business catalog sales.").

⁹⁰ See Oliff, *supra* note 78, at 3 ("[State] revenues probably won't come close to what states need to restore the programs that they cut during the recession unless states raise taxes, at least temporarily, or receive additional federal aid while the economy slowly recovers."); see also Joel Mathis & Ben Boychuk, Op-Ed., *Red/Blue America Columnists Ponder, Should States Tax Internet Sales?*, L.A. DAILY NEWS, July 13, 2012, 5:27 PM, http://www.dailynews.com/opinions/ci_21071441/red-blue-america-columnists-ponder-

state sales tax collection is simple because businesses collect and remit sales taxes directly to the states.⁹¹ However, out-of-state sellers who lack “substantial nexus” with a state need not collect and remit that state’s sales taxes.⁹² States traditionally employ use taxes to make up for the missing revenue from these uncollected sales taxes.⁹³ Use taxes legally obligate consumers to self-report out-of-state purchases and pay a tax on those purchases directly to the revenue department of their home state.⁹⁴ However, use taxes are not as reliable as sales taxes as a revenue source.⁹⁵ Because many purchasers are unaware of the use tax requirement or choose to ignore it, there is a clear gap between the amount spent and the amount reported.⁹⁶ To battle this discrepancy, some states require their residents to report their out-of-state purchases directly on

should-states-tax (“The National Conference of State Legislatures say such taxes could raise as much as \$23 billion a year.”).

⁹¹ See *Minnesota v. Ristine*, 36 F. Supp. 3, 5 (D. Minn. 1940) (explaining that sales taxes are “imposed upon property at the time of a sale thereof”).

⁹² See *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–12 (1992); see also *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274, 279 (1977).

⁹³ See HELLERSTEIN & HELLERSTEIN, *supra* note 88, at 32 (“States imposing sales taxes have adopted use taxes, both to safeguard their revenues and to protect local merchants against the diversion of purchases by local residents or businesses to non-sales tax jurisdictions . . . or to jurisdictions with lower sales tax rates.”).

⁹⁴ See Mazerov, *supra* note 88, at 2; see also HELLERSTEIN & HELLERSTEIN, *supra* note 88, at 32 (“States imposing sales taxes have adopted use taxes, both to safeguard their revenues and to protect local merchants against the diversion of purchases by local residents or businesses to non-sales tax jurisdictions . . . or to jurisdictions with lower sales tax rates.”).

⁹⁵ See Charles E. McLure, Jr., *Sales and Use Taxes on Electronic Commerce: Legal, Economic, Administrative, and Political Issues*, 34 URB. LAW. 487, 489 (2002) (arguing that “[use] tax is likely to be paid only if vendors collect it” except for purchases of “products that must be registered to be used in the state and for purchases by business that can be audited”); John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. CAL. L. REV. 419, 428 (2002) (“As a practical matter, it is virtually impossible for a state to collect a use tax from each individual consumer who makes a purchase from an out-of-state vendor.”); see also *The Amazon War: More Complicated than the Boston Tea Party, but Potentially as Colorful*, ECONOMIST, July 23, 2011, available at <http://www.economist.com/node/18988624> (“[I]n theory, consumers are supposed to keep receipts and pay so-called ‘use taxes’, but few people have ever heard of them.”).

⁹⁶ See Swain, *supra* note 95, at 474 n.53 (“Most consumers . . . do not self-assess use tax on mail-order or Internet purchases.”); see also Mazerov, *supra* note 88.

state income tax returns and to pay the use tax therein.⁹⁷ Still, this consumer-reporting requirement is not very effective because states are unable to audit the reported amount without a seller obligation to report consumer activity to the state.⁹⁸ Some states attempt to impose such a reporting requirement on out-of-state vendors, causing constitutional issues.⁹⁹ Other states impose aggressive nexus statutes to make up for the decline in collected sales taxes; these statutes also produce constitutional issues.¹⁰⁰

a) E-Commerce Poses Additional Obstacles to the Imposition of Sales Tax Obligations on Out-of-State Sellers

A state that imposes sales tax obligations on out-of-state sellers engaged in e-commerce places a heavy burden on those sellers.¹⁰¹ To comply, a seller must determine within which states it has nexus,¹⁰² whether the items sold are taxable in the consumer's state,¹⁰³ and whether a customer is exempt from the tax.¹⁰⁴ In addition to these steps, a seller in compliance must maintain adequate books and records, the standards for which vary from state to state.¹⁰⁵ E-commerce also provides for unique sourcing

⁹⁷ See, e.g., *Form IT-201: Resident Income Tax Return*, N.Y. STATE DEP'T OF TAXATION & FIN. 3 (2012); *Instructions for Form IT-201*, N.Y. STATE DEP'T OF TAXATION & FIN. 29 (2012), available at http://www.tax.ny.gov/pdf/current_forms/it/it201i.pdf ("You owe sales or compensating use tax [to New York State] if you: purchased an item or service subject to tax that is delivered to you in New York State without payment of New York State and local tax to the seller."); see also Swain, *supra* note 95, at 428 n.53.

⁹⁸ See Swain, *supra* note 95, at 474 n.53 (explaining that it is administratively unfeasible to audit the consumer-reported amounts without a reporting obligation on the out-of-state seller).

⁹⁹ See *infra* Parts II.A.3, II.B.3.

¹⁰⁰ See *infra* Parts II.A.1–2, II.B.1–2.

¹⁰¹ 43 RESEARCH INST. OF AM., *supra* note 28, § 4.01 (explaining that sellers must figure out how to collect sales tax and often do not know where they have the required nexus or whether a good or service is taxable in the first place.)

¹⁰² See *id.*

¹⁰³ See *id.*

¹⁰⁴ See *id.*

¹⁰⁵ See Barry Leibowicz, *Maintaining Adequate Books and Records for Sales and Use Tax in the Electronic Age*, J. OF MULTISTATE TAXATION & INCENTIVES, Oct. 2011, at 1, 2, available at <http://www.leibowiczlaw.com/Articles/multistate%20journal%20article%>

problems.¹⁰⁶ These unique sourcing problems arise during online purchases of digital products where no delivery address is given and where anonymous digital cash transactions are executed.¹⁰⁷ Further, name and credit card information may not provide an adequate basis for sourcing an online transaction.¹⁰⁸

In addition to the practical burdens imposed on sellers, states must also consider federal legislation implicating state nexus statutes as applied to e-commerce.¹⁰⁹ In 1998, Congress enacted the Internet Tax Freedom Act (“ITFA”),¹¹⁰ most recently amended in 2007 and set to expire in 2014.¹¹¹ The ITFA prohibits states and localities from imposing any “discriminatory taxes on electronic commerce.”¹¹² Significantly, the ITFA ensures that state and local governments may only impose a sales tax on tangible goods ordered over the Internet if that tax would apply to that item if purchased in a local store.¹¹³ However, even if a tax is applied

20oct%202011.pdf. For example, in 2011, the New York State Department of Taxation and Finance issued new guidance as to the standards for adequate books and records that led one commentator to argue that the standards “seem to exceed past legislative or judicial requirements and may in fact be impossible to satisfy.” *Id.* at 16.

¹⁰⁶ See DAVID E. HARDESTY, ELECTRONIC COMMERCE: TAXATION AND PLANNING ¶ 19.02(2)(e) (2012) (arguing that although “[s]ourcing has always been an extremely difficult problem for interstate sellers,” online transactions provide even more issues). For example, a customer need only provide a delivery point for tangible goods purchased through mail order catalogs. *Id.* In that case, the vendor has no way of knowing the place where the property is destined to be used by the purchaser. *Id.*

¹⁰⁷ *See id.*

¹⁰⁸ *See id.*

¹⁰⁹ See generally Internet Tax Freedom Act of 1998, Pub. L. No. 105-277, §§ 1100–09, 112 Stat. 2681 (1998).

¹¹⁰ *Id.*

¹¹¹ Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, §§ 2–6, 121 Stat. 1024 (2007).

¹¹² Internet Tax Freedom Act § 1101 (“No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending November 1, 2014: (1) Taxes on Internet access[, and] (2) Multiple or discriminatory taxes on electronic commerce.”); see also Mazerov, *supra* note 88.

¹¹³ Internet Tax Freedom Act § 1101; see also Mazerov, *supra* note 88. For example, a book purchased from an online vendor may be taxed as long as a similar purchase from a brick-and-mortar store would be taxed in the same manner. *Id.* However, to preserve the State and local taxing authority, Congress enacted the moratorium with exception for “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 [that were] in effect” as of October

equally to goods sold in retail stores and goods sold online, and accordingly passes ITFA scrutiny, state and local sales taxes are often not charged on goods purchased online.¹¹⁴ This is because *Complete Auto* and *Quill* require that a seller has a “substantial nexus” with a state to be subject to that state’s tax.¹¹⁵

*C. Legal Interpretations and Complications—The State Courts
Attempt to Interpret Quill and Apply its Mail Order
Transaction Holding to Modern Internet Sales*

States should be mindful of both the practical limitations of collecting sales taxes from out-of-state sellers who conduct business online and of the limits on state power to regulate interstate commerce provided by the dormant Commerce Clause.¹¹⁶ Since 1992, state courts have struggled to decipher the *Quill* ruling, along with its quasi-physical presence requirement and its “substantial nexus” reaffirmation.¹¹⁷ While some courts have interpreted *Quill* as a reaffirmation of the physical presence

21, 1998. Internet Tax Freedom Act § 1101(b) (“[N]othing 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.”).

¹¹⁴ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–12 (1992); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (holding that under the Commerce Clause it is unconstitutional for an out-of-state vendor to be forced to collect sales tax without the required nexus).

¹¹⁵ *Quill*, 504 U.S. at 311–12; *Complete Auto*, 430 U.S. at 279.

¹¹⁶ See U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States . . .”); Internet Tax Freedom Act § 1101 (“No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending November 1, 2014: (1) Taxes on Internet access[, and] (2) Multiple or discriminatory taxes on electronic commerce.”).

¹¹⁷ See *Quill*, 504 U.S. at 299, 311–12 (reaffirming the *Bellas Hess* presence requirement); *Geoffrey, Inc. v. S.C. Tax Comm’n*, 313 S.C. 15, 23 n.4 (S.C. 1993) (“The U.S. Supreme Court [in *Quill*] recently revisited the physical presence requirement of *Bellas Hess* and, while reaffirming its vitality as to *sales and use taxes*, noted that the physical presence requirement had not been extended to other types of taxes.”); *AccuZIP, Inc. v. Dir., Div. of Taxation*, 25 N.J. Tax 158, 169 (N.J. Tax Ct. 2009) (“The Court reaffirmed [the *Bellas Hess*] bright-line physical presence standard for sales and use tax twenty-five years later in *Quill* . . .”).

requirement for imposing sales tax obligations on out-of-state sellers, other courts have interpreted the standard more loosely.¹¹⁸

In their attempt to clarify what in-state activities are required to establish nexus, state courts have developed some additional standards. These efforts produced a confused legal landscape including a “more than the slightest presence” standard, a possible *Quill* physical presence requirement, a declaration that isolated and sporadic activity is insufficient, and a focus on the *Scripto* and *Tyler Pipe* market maintenance theory.¹¹⁹

1. The “More Than the Slightest Presence” Standard Emerges

Just three years after *Quill*, in *Orvis Co., Inc. v. Tax Appeals Tribunal of New York*,¹²⁰ the New York Court of Appeals held an out-of-state seller’s visits to in-state customers “to resolve the more intractable problems involving its computer hardware and software” sufficient to impose an obligation on the seller to collect sales taxes.¹²¹ The *Orvis* court determined that the visits made to in-state customers enhanced sales and significantly contributed to the vendor’s ability to establish a market for its products.¹²² The *Orvis* court did “not read *Quill* . . . to make a substantial physical presence of an out-of-State vendor in New York a prerequisite to imposing the duty upon the vendor to collect the use tax from its

¹¹⁸ Compare *Geoffrey*, 313 S.C. at 23 n.4 (“The U.S. Supreme Court [in *Quill*] recently revisited the physical presence requirement of *Bellas Hess* and, while reaffirming its vitality as to *sales and use taxes*, noted that the physical presence requirement had not been extended to other types of taxes.”), with *Orvis Co., Inc. v. Tax Appeals Tribunal of New York*, 654 N.E.2d 954, 955–56, 960 (N.Y. 1995) (“[T]he Supreme Court never intended to elevate the nexus requirement to a substantial physical presence of the vendor.”).

¹¹⁹ See *Quill*, 504 U.S. at 314; *Tyler Pipe Indus., Inc. v. Wash. State Dept. of Revenue*, 483 U.S. 232, 250 (1987); *Scripto Inc. v. Carson*, 362 U.S. 207, 209 (1960); *In re Appeal of Intercard, Inc.*, 270 Kan. 346, 364 (Kan. 2000); *Koch Fuels, Inc. v. Clark*, 676 A.2d 330, 334 (R.I. 1996); *Orvis*, 654 N.E.2d at 960–61.

¹²⁰ 654 N.E.2d 954.

¹²¹ *Id.* at 962.

¹²² *Id.* (“There was ample support in the record for the State Tax Appeals Tribunal’s finding that VIP’s trouble-shooting visits to New York vendees and its assurances to prospective customers that it would make such visits enhanced sales and significantly contributed to VIP’s ability to establish and maintain a market for the computer hardware and software it sold in New York.”).

New York clientele.”¹²³ Instead, the *Orvis* court supported a “more than the slightest presence” requirement to satisfy the “substantial nexus” prong of the *Complete Auto* test.¹²⁴ The *Orvis* court relied on a 1995 Supreme Court case, *Oklahoma Tax Commission v. Jefferson Lines*,¹²⁵ that focused on the seller’s in-state activity involved in the taxed transaction.¹²⁶

Eight years later, in 2003, the New York Court of Appeals reaffirmed its holding in *Orvis*, ruling once again that the “more than the slightest presence” standard satisfies the “substantial nexus” prong of the *Complete Auto* test.¹²⁷

2. Is There a Physical Presence Requirement in Substantial Nexus?

Soon after the New York *Orvis* decision, the Supreme Court of Rhode Island determined in *Koch Fuels, Inc. v. Clark* that *Quill* did in fact require “a physical presence in the taxing state” before that state can constitutionally impose a sales tax burden upon a seller.¹²⁸ Nonetheless, the Rhode Island court concluded that sufficient physical presence existed where an out-of-state vendor had complete control over its shipments, an exclusive contract with a common carrier, and consummated sales upon delivery in the

¹²³ *Id.* at 955–56, 960 (“[T]he Supreme Court never intended to elevate the nexus requirement to a substantial physical presence of the vendor.”). Meanwhile, the Kansas Supreme Court commented, “The *Orvis* court ignores the *Quill* holding that sufficient physical presence is a necessary element of the nexus required for a state to impose a use tax collection duty.” *In re Appeal of InterCard*, 270 Kan. at 359.

¹²⁴ *Orvis*, 654 N.E.2d at 960–61.

¹²⁵ *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995).

¹²⁶ *Orvis*, 654 N.E.2d at 960–61 (noting that *Jefferson Lines* focused on in-state activity, “such as the site of the origination or consummation of the transaction”); *Jefferson Lines*, 514 U.S. at 184.

¹²⁷ *Moran Towing Corp. v. Urbach*, 99 N.Y.2d. 443, 449–50 (N.Y. 2003); *accord Orvis*, 654 N.E.2d at 960–61.

¹²⁸ *Koch Fuels, Inc. v. Clark*, 676 A.2d 330, 333 (R.I. 1996). The Rhode Island court found the out-of-state vendor’s activities fell outside the *Bellas Hess* “safe harbor” of mere “communication with its customers in the State by mail or common carrier.” *Id.* at 334.

state.¹²⁹ The court held that these activities established a physical presence in the state and therefore satisfied the “substantial nexus” requirement of *Complete Auto*.¹³⁰

3. The “Isolated, Sporadic, and Insufficient” Standard

In 2000, the Kansas Supreme Court considered “whether [a vendor’s] installation activities in the state of Kansas constitute a physical presence sufficient to establish a substantial nexus with the state.”¹³¹ The Kansas court held that the company activity, consisting of eleven visits to Kansas to install card readers, was “isolated, sporadic, and insufficient to establish a substantial nexus to Kansas.”¹³²

4. The *Scripto* and *Tyler Pipe* Market Maintenance Factor Meets the *Orvis* Standard

In 2000, the Arizona Court of Appeals relied on the Supreme Court’s ruling in *Tyler Pipe*¹³³ in holding that a vendor’s in-state activities established a sufficient nexus with the state.¹³⁴ The Arizona court focused on whether the activities were “significantly associated with the taxpayer’s ability to establish and maintain a market” for the business’s sales in Arizona.¹³⁵

¹²⁹ *Id.* at 334 (finding nexus due to the out-of-state vendor’s “complete control over the oil shipments, the exclusive nature of the common carrier’s contract, the unique nature of the cargo, and the fact that the sales were consummated upon delivery in Rhode Island”).

¹³⁰ *Id.*

¹³¹ *In re Appeal of InterCard, Inc.*, 270 Kan. 346, 364 (Kan. 2000).

¹³² *Id.*

¹³³ *Tyler Pipe Indus. v. Dep’t of Revenue*, 483 U.S. 232, 250 (1987) (holding the crucial determination in Commerce Clause nexus requirements to be whether in-state business activities were significantly associated with establishing and maintaining a market for the business’ sales).

¹³⁴ *Ariz. Dep’t of Revenue v. Care Computer Sys., Inc.*, 197 Ariz. 414, 421 (Ariz. Ct. App. 2000) (“In *Complete Auto* [] the Court made ‘substantial nexus’ the touchstone of taxation of interstate transactions. And in *Tyler Pipe*, the Court defined ‘sufficient nexus’ to include those activities ‘significantly associated with the taxpayer’s ability to establish and maintain a market in [the taxing] state for the sales.’”).

¹³⁵ *Id.* at 416 (involving an out-of-state taxpayer who sold and licensed computer hardware and software to nursing homes, conducted most transactions by mail, had one salesperson assigned to Arizona who took business trips to Arizona, and conducted training sessions to customers in Arizona, which were held in Arizona approximately 21 days per year).

Similarly, the Appellate Court of Illinois, informed by its own supreme court's past decision in *Brown's Furniture, Inc. v. Wagner*,¹³⁶ rejected a "substantial" physical presence standard and instead followed the *Orvis* "more than the slightest presence" standard.¹³⁷ The court reasoned that the seller "enhanced its ability to establish and maintain a market for its furniture sales" by making in-state deliveries in its own vehicles and therefore established "more than the slightest presence" in the state, satisfying the "substantial nexus" requirement of the *Complete Auto* test.¹³⁸

5. The Remaining Grey Areas—Slightest Presence? Substantial Nexus?

In 1996, the Supreme Court of Florida held that an out-of-state seller that primarily sells its products through direct mail solicitation, has no offices or employees in Florida, and only visits Florida for a maximum of three days each year, lacks substantial nexus with the state.¹³⁹ The Florida court noted that the grey area between the insufficient "slightest presence" of *National Geographic*¹⁴⁰ and the sufficient "substantial nexus," of *Quill*,¹⁴¹ "may require courts to fill in the gaps and give meaning to the terms 'slightest presence' and 'substantial nexus.'"¹⁴²

In the end, the state courts added to the nexus confusion by introducing the following concepts—the insufficiency of isolated

¹³⁶ *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 423–24 (Ill. 1996) ("Left unclear after *Quill*, however, is the extent of physical presence in a state needed to establish more than a 'slight' physical presence.").

¹³⁷ *Town Crier, Inc. v. Ill. Dep't of Revenue*, 315 Ill. App. 3d 286, 293 (Ill. App. Ct. 2000). The Illinois court noted that *Quill* did not explain "the extent of a retailer's physical presence within a taxing state necessary to establish more than a 'slight' physical presence, [and meet] the substantial nexus requirement." *Id.* at 292–93.

¹³⁸ *Id.* at 294. The court also noted that the vendor could have taken advantage of certain "safe harbors" and "avoided use tax collection responsibilities in Illinois by merely restricting its deliveries in this state to common carriers or by refusing to deliver goods and supply services in Illinois." *Id.*

¹³⁹ *Fla. Dep't of Revenue v. Share Int'l*, 676 So. 2d 1362, 1362–63 (Fla. 1996).

¹⁴⁰ *Share Int'l*, 676 So. 2d at 1363 (citing *Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977)).

¹⁴¹ *Id.*

¹⁴² *Share Int'l*, 676 So. 2d at 1363.

and sporadic in-state activity, the importance of the *Scripto* and *Tyler Pipe* market maintenance factor, a questionable requirement of in-state physical presence, and the emergence of the new “more than the slightest presence” standard.¹⁴³

D. Recent Attempts by the States and Congress to Solve the Nexus Problem

Both the states and Congress have made efforts to solve the ongoing sales tax problem.¹⁴⁴ Many states joined an agreement to simplify their sales tax laws to lessen the burden on interstate commerce.¹⁴⁵ Meanwhile Congress, which can impose tax burdens on interstate commerce, has attempted to enact federal legislation to help the states increase collection.¹⁴⁶

1. Forty-Four States Join Together to Simultaneously Simplify and Expand Sales Tax Collection Through the Streamlined Sales and Use Taxation Agreement

The Streamlined Sales and Use Taxation Agreement (“SSUTA”) effort began in 2000 and the Agreement took effect on October 1, 2005.¹⁴⁷ As of 2012, forty-four states plus the District of Columbia are members of the SSUTA.¹⁴⁸ Of those states, twenty-four have passed the required legislation to conform to

¹⁴³ *In re Appeal of InterCard, Inc.*, 270 Kan. 346, 364 (2000); *Koch Fuels, Inc. v. Clark*, 676 A.2d 330, 333 (R.I. 1996); *Orvis Co., Inc. v. Tax Appeals Tribunal of New York*, 654 N.E.2d 954, 960–61 (1995); *Quill Corp. v. North Dakota*, 504 U.S. 298, 314 (1992); *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987); *Scripto Inc. v. Carson*, 362 U.S. 27, 209 (1960).

¹⁴⁴ See Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); S. 1452, 112th Cong. (2011); Marketplace Fairness Act S. 1832, 112th Cong. (2011); Marketplace Equity Act, H.R. 3179, 112th Cong. (2011); *Streamlined Sales and Use Tax Agreement*, *supra* note 12.

¹⁴⁵ See generally *Streamlined Sales and Use Tax Agreement*, *supra* note 12.

¹⁴⁶ See, e.g., H.R. 2701; S. 1452; S. 1832; H.R. 3179.

¹⁴⁷ GEORGE B. DELTA & JEFFREY H. MATSUURA, *LAW OF THE INTERNET* § 15.06 (2012); Stephen P. Kranz, Lisbeth A. Freeman & Mark W. Yopp, *Is Quill Dead? At Least One State Has Written the Obituary*, 2010 ST. TAX NOTES 310, 311, available at <http://www.sutherland.com/NewsCommentary/Articles/75891/A-Pinch-of-SALT-Is-Quill-Dead-At-Least-One-State-Has-Written-the-Obituary>.

¹⁴⁸ See *Frequently Asked Questions*, *supra* note 12.

SSUTA and nine have introduced conforming legislation in their legislatures.¹⁴⁹

The overarching goal of the SSUTA is to simplify and modernize the sales and use tax administration to reduce the burden of tax compliance.¹⁵⁰ To this end the SSUTA provides for the following: state level administration of local sales and use taxes,¹⁵¹ rate simplification,¹⁵² no caps and thresholds,¹⁵³ common state and local tax bases within a state,¹⁵⁴ a uniform sourcing rule for goods and services,¹⁵⁵ uniform definitions of types of goods and services and other useful terms,¹⁵⁶ a statewide database of local jurisdiction tax rates,¹⁵⁷ a statewide database of local

¹⁴⁹ See *id.* The website lists the following states as having passed conforming legislation: 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. *Id.* “Those states have a total population of 92,781,860 representing 33% of the country’s population.” *Id.* “Recently, conforming legislation was introduced in Texas, Massachusetts, Florida, Illinois, Virginia, Missouri, Maine, California, and Hawaii.” *Id.*

¹⁵⁰ See Kranz, Freeman & Yopp, *supra* note 147, at 311; see also DELTA & MATSUURA, *supra* note 147, at § 15.06.

¹⁵¹ *Streamlined Sales and Use Tax Agreement*, *supra* note 12, at § 102.

¹⁵² *Id.* at § 102. The SSUTA requires one general state rate per state, with a second rate (which could be zero) on food and drugs and one single local rate per jurisdiction. *Id.*

¹⁵³ *Id.* at § 323 (“No member state may have caps or thresholds on the application of state sales or use tax rates or exemptions that are based on the value of the transaction or item or have caps that are based on the application of the rates unless the member state assumes the administrative responsibility in a manner that places no additional burden on the retailer.”).

¹⁵⁴ *Id.* at § 310.1.

¹⁵⁵ *Id.* The SSUTA also includes a uniform sourcing rule for telecommunications, lease or rental of property, and direct mail. *Id.*

¹⁵⁶ *Id.* at § 104. The Agreement includes uniform definitions of the following terms: Food and food ingredients, prepared food, candy, soft drinks, dietary supplement, clothing, lease or rental, tangible personal property, bundled transaction, drugs, durable medical equipment, computer software, prewritten computer software, delivered electronically, load and leave, sales price, and specified digital products. *Id.* at § 147. The SSUTA also provides for uniform treatment of bank holidays, uniform rules for sales tax holidays, a uniform drop shipment rule, a uniform rule for bad debt credits, a uniform rounding rule, and a uniform exemption certificate and simplified exemption processing. *Id.*

¹⁵⁷ *Id.* at § 305.

jurisdiction boundary information,¹⁵⁸ and a taxability matrix that identifies whether defined products are exempt or taxable under the state's laws.¹⁵⁹ The SSUTA provides that sellers who follow the taxability matrix are not liable for errors.¹⁶⁰

One goal of the SSUTA is “Technology Implementation.”¹⁶¹ To achieve this goal the SSUTA certifies certain sales tax administration software, includes a simplified electronic tax return for sellers, and maintains an online Central Registration System.¹⁶² Sellers must register under this system for all full member states and have the option to register for associate member states.¹⁶³ When a new state becomes a full member, sellers are automatically registered to collect taxes in that state.¹⁶⁴ The SSUTA certifies the following three sales tax administration software technology models to assist compliance—Model 1 Sellers use services of a Certified Service Provider, Model 2 Sellers use a Certified Automated System, and Model 3 sellers have an in-house (Proprietary) System.¹⁶⁵ If a seller uses Model One, a Certified Service Provider,¹⁶⁶ or Model Two, a Certified Automated System,¹⁶⁷ the seller may be reimbursed by all member and associate member states in which the seller is a “volunteer seller.”¹⁶⁸ A “volunteer seller” is a seller who does not have

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at § 328 (the taxability matrix includes a list of uniformly defined products and services.)

¹⁶⁰ *Id.* at § 306.

¹⁶¹ *Id.* at § 102.

¹⁶² *Id.* at § 303; *see also Welcome to the Streamlined Sales Tax Registration System*, STREAMLINED SALES TAX PROJECT, <http://www.sstregister.org/sellers> (last visited Nov. 20, 2013) (explaining that sellers must register on Central Registration System to be eligible for amnesty) [hereinafter *Welcome to the Streamlined Sales Tax Registration System*].

¹⁶³ *See Welcome to the Streamlined Sales Tax Registration System*, *supra* note 162.

¹⁶⁴ *See id.* The Governing Board notifies sellers when a new member state joins. *Id.*

¹⁶⁵ *Streamlined Sales and Use Tax Agreement*, *supra* note 12, at §§ 205–07.

¹⁶⁶ *Id.* at § 203 (defining a CSP as “[a]n agent certified under the Agreement to perform all the seller’s sales and use tax functions, other than the seller’s obligation to remit tax on its own purchases”).

¹⁶⁷ *Id.* at § 202.

¹⁶⁸ *Id.* at §§ 601–02; *see also Frequently Asked Questions*, STREAMLINED SALES TAX PROJECT, <https://www.sstregister.org/sellers/SellerFAQs.aspx#faq9> (last visited Jan. 1, 2013) (“[T]he[] services will be paid for by the member and associate member states, at

sufficient nexus within a state under that state's laws and is therefore not legally required to register in or collect sales tax for that state.¹⁶⁹ In that way the SSUTA distinguishes based on nexus.

Additionally, one goal of the SSUTA is to work with Congress on federal legislation.¹⁷⁰

2. Congress Attempts to Solve State Sales Tax Collection Woes Through Federal Legislation

All three opinions in *Quill* indicate that Congress can and should act on this Commerce Clause issue, clearing the way for federal legislation.¹⁷¹ States support federal legislation that would allow them to impose sales tax obligations on remote sellers.¹⁷² Fearing backlash from unpopular tax increases, state legislators would rather Congress pass legislation to raise revenue for state governments facing budget shortfalls.¹⁷³ Those in favor of federal legislation argue that it does not create new taxes but rather makes

no cost to [the seller], in states that [the seller] meet[s] the definition of a volunteer seller.”).

¹⁶⁹ *Id.* at § 303(C) (disallowing member states to charge a registration fee to a seller with no legal requirement to register).

¹⁷⁰ See *Welcome to the Streamlined Sales Tax Registration System*, *supra* note 162.

¹⁷¹ See *Quill*, 504 U.S. 298, 318 (1992) (“The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve.”); *id.* at 333 (“Congress can and should address itself to this area of law”) (White, J., dissenting); *id.* at 320 (“Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so.”) (Scalia, J., concurring). The *Quill* Court’s distinction of the nexus requirements for the Due Process Clause and the Commerce Clause clears the way for congressional action regarding sales and use tax collection for out-of-state vendors participating in e-commerce. See Plattner, *supra* note 18, at 1017.

¹⁷² See Shanske, *supra* note 77, at 469 (“The[] overlapping—and seemingly perennial—crises have spurred many calls for reform, including of the tax systems at both the federal and state levels.”) (citations omitted); see, e.g., CAL. STATE COMM’N ON THE 21ST CENT. ECON., *supra* note 78, at 3, 19 (“In this context, legislative leaders and the Governor formed the Commission on the 21st Century Economy to recommend reforms of the state’s tax system.”).

¹⁷³ See Sen. Jim DeMint, Op-Ed., *No Internet Taxation Without Representation*, WALL ST. J. (July 31, 2012), <http://online.wsj.com/article/SB10000872396390444226904577559414267708728.html> (“[L]egislators in state capitals don’t want to make the hard decisions to cut spending or raise taxes on their constituents—they fear the voter backlash.”).

the collection of existing sales taxes easier.¹⁷⁴ Recently, the states gained an unlikely partner in Amazon.¹⁷⁵ Amazon, the online marketplace giant, has had its share of lawsuits over aggressive state sales and use tax laws on out-of-state vendors conducting business online but has apparently given up the fight.¹⁷⁶ Still, other online sellers argue that federal legislation is not appropriate.¹⁷⁷ Currently, Congress is considering three bills affecting e-commerce taxation: (1) the Main Street Fairness Act,¹⁷⁸ (2) the Marketplace Fairness Act,¹⁷⁹ and (3) the Marketplace Equity Act.¹⁸⁰

a) The Main Street Fairness Act

The Main Street Fairness Act (“MSFA”) was introduced in the Senate and the House of Representatives on July 29, 2011 and was referred to the Senate Finance and the House Judiciary committees, respectively.¹⁸¹ Democrats in both the House and the Senate support the MSFA.¹⁸² The MSFA grants congressional approval to

¹⁷⁴ See Sten Wilson, *Why I Support the Marketplace Fairness Act: It Will Help Millions of Small Businesses Like Mine*, FORBES (Aug. 27, 2012), <http://www.forbes.com/sites/kellyphillipsrb/2012/08/27/guest-post-why-i-support-the-marketplace-fairness-act>.

¹⁷⁵ See Marc Lifsher, *Free Ride is Over—Amazon.com Collecting California Sales Tax*, L.A. TIMES (Sept. 15, 2012), <http://articles.latimes.com/2012/sep/15/business/la-fi-mo-amazon-collecting-ca-sales-tax-20120915> (discussing Amazon’s agreement to collect sales taxes in California).

¹⁷⁶ See, e.g., *Amazon.com, LLC v. N.Y. State Dep’t of Taxation & Fin.*, 913 N.Y.S.2d 129 (N.Y. App. Div. 2010); see also Lifsher, *supra* note 175 (discussing Amazon’s agreement to collect sales taxes in California).

¹⁷⁷ See Bob Johnson Jr., *Federal Nexus Bills: One Focus, Multiple Approaches*, BKD LLP (Dec. 2012), <http://www.bkd.com/articles/2012/federal-nexus-bills-one-focus-multiple-approaches.htm> (“In opposition, remote sellers . . . [point to] Quill . . . which holds that they have no use tax collection obligations for sales made to customers in states in which they lack a “physical presence” nexus . . . [and further argue] that imposition of a use tax collection obligation creates a disproportionate administrative burden . . .”).

¹⁷⁸ Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); S. 1452, 112th Cong. (2011).

¹⁷⁹ Marketplace Fairness Act, S. 1832, 112th Cong. (2011).

¹⁸⁰ Marketplace Equity Act, H.R. 3179, 112th Cong. (2011).

¹⁸¹ H.R. 2701; S. 1452.

¹⁸² See GOVTRACK.US, <http://www.govtrack.us> (search for “Main Street Fairness Act” with either “2701” or “1452”) (last visited Nov. 20, 2013).

the SSUTA.¹⁸³ The MSFA authorizes SSUTA member states to require out-of-state sellers to collect and remit sales taxes sourced to that member state if the seller does not qualify for an unspecified small seller exception.¹⁸⁴ The MSFA provides minimum simplification requirements for the administration of multistate sales taxation and provides for minimum compensation “for expenses incurred by a seller directly in administering, collecting, and remitting sales and use taxes to that Member State.”¹⁸⁵

The MSFA also expresses the intent of Congress that the member states should work with each other to prevent double taxation where a digital good or service is subject to a foreign transaction tax.¹⁸⁶

b) The Marketplace Fairness Act

The Marketplace Fairness Act (“MFA”) was introduced to the Senate on November 9, 2011 and was referred to the Senate Finance committee.¹⁸⁷ The MFA is sponsored by Republican Senator Michael Enzi (WY) and is cosponsored by seventeen Democrats and four Republicans.¹⁸⁸ Similar to the MSFA, the MFA grants congressional approval to the SSUTA.¹⁸⁹ The MFA authorizes a state to require an out-of-state seller to collect sales tax if the seller “has gross annual receipts in total remote sales in the United States in the preceding calendar year exceeding

¹⁸³ H.R. 2701 § 2; S. 1452 § 2.

¹⁸⁴ H.R. 2701 § 4; S. 1452 § 4. The MSFA authorizes the SSUTA once ten states that comprise at least 20% of the total population of all states imposing a sales tax have become member states. *Id.* The MSFA states that those affected by the SSUTA can go before the Governing Board established by the SSUTA for a determination of their SSUTA issue and provides for judicial review of Governing Board determinations by the United States Court of Federal Claims. *Id.*

¹⁸⁵ H.R. 2701 § 6; S. 1452 § 6.

¹⁸⁶ H.R. 2701 § 11; S. 1452 § 11.

¹⁸⁷ Marketplace Fairness Act, S. 1832, 112th Cong. § 3 (2011).

¹⁸⁸ See GOVTRACK.US, <http://www.govtrack.us> (search for “Marketplace Fairness Act,” S. 1832) (last visited Nov. 20, 2013).

¹⁸⁹ S. 1832 § 3.

\$500,000.”¹⁹⁰ Unlike the MSFA, which requires some “uniform rule,” the MFA provides a detailed small business exception.¹⁹¹ Under the MFA, states that are not SSUTA members may require remote sellers to collect and remit sales taxes sourced to that state if certain requirements are met including: (1) providing a uniform, state-level agency to administer all sales and use tax laws, (2) providing a uniform state and local sales and use tax base, (3) relieving remote sellers from liability for any incorrect amounts collected due to reliance on information provided by the state, and (4) providing remote sellers with thirty days notice of any rate change in the state.¹⁹²

The MFA expresses the view of Congress that states should be able to collect sales taxes under their existing sales and use tax laws.¹⁹³

c) The Marketplace Equity Act

The Marketplace Equity Act of 2011 (“MEA”) was introduced to the House of Representatives on October 13, 2011 and was referred to the House Judiciary committee.¹⁹⁴ Republican Representative Steve Womack (AR) is the MEA’s sponsor and it is cosponsored by twenty-nine Democrats and twenty-seven Republicans.¹⁹⁵ Unlike the MSFA and the MFA, the MEA does not grant approval to the SSUTA.¹⁹⁶ Rather, the MEA provides that states may require all remote sellers not qualifying for the small seller exception to collect and remit sales taxes from remote sales¹⁹⁷ into the state if the state provides: (1) an exception for

¹⁹⁰ *Id.* The MFA defines “remote sale as a sale of goods or services attributed to a State with respect to which a seller does not have adequate physical presence to establish nexus under *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).” *Id.* at § 6.

¹⁹¹ *Id.* at § 3.

¹⁹² *Id.*

¹⁹³ *Id.* at § 2.

¹⁹⁴ Marketplace Equity Act, H.R. 3179, 112th Cong. § 2 (2011).

¹⁹⁵ See GOVTRACK.US, <http://www.govtrack.us> (search for “Marketplace Equity Act”, H.R. 3179) (last visited Nov. 20, 2013).

¹⁹⁶ See H.R. 3179 § 2.

¹⁹⁷ *Id.* “The term ‘remote sale’ means a sale of goods or services attributed to a State with respect to which a seller does not have adequate physical presence to establish nexus under the law existing on the day before the date of the enactment of this Act so as to

sellers with gross annual receipts in the preceding calendar year from remote sales in the United States equal to or less than \$1,000,000 or equal or less than \$100,000 in the state,¹⁹⁸ (2) “a single revenue authority within the State with which remote sellers are required to file the return,”¹⁹⁹ and (3) a single identical state-wide tax base.²⁰⁰

Whether or not these bills are passed, the bills are indicative of the status of sales and use taxes today and what may come in the future.²⁰¹

II. IN AN EFFORT TO IMPROVE SALES AND USE TAX COLLECTION, THE STATES ENACT LEGISLATION THAT VIOLATES THE CONSTITUTION

State legislators have used four main strategies to solve their nexus problems.²⁰² Some states attempt to use a combination of these strategies.²⁰³ Nevertheless, these state strategies to collect

allow such State to require, without regard to the authority granted by this Act, the seller to collect and remit taxes covered by this Act with respect to such sale.” *Id.* § 5.

¹⁹⁸ *Id.* § 2(b)(1). While the exception must at least cover those who are within the specified limits, a state is permitted to increase those limits. *Id.* The MEA allows states to determine a greater amount for the small seller exception as well. *Id.*

¹⁹⁹ *Id.* § 2(b)(2).

²⁰⁰ *Id.* § 2(b)(3).

²⁰¹ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992) (confirming that Congress has the “ultimate power” to legislate in the area of interstate sales tax law).

²⁰² See David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 518–19 (2012) (listing referrer nexus, related-entity nexus, and information reporting requirements as state nexus statute strategies); Kranz, Freeman & Yopp, *supra* note 147, at 307 (listing reporting and notice requirements, affiliate nexus statutes, click-through nexus statutes, and “state simplification and later declaration by the state that the physical presence nexus standard no longer applies because of lowered burdens on interstate commerce” as state nexus strategies); Robert Plattner, Daniel Smirlock & Mary Ellen Ladouceur, *A New Way Forward for Remote Vendor Sales Tax Collection*, 55 ST. TAX NOTES 187, 187 (2010) (detailing state nexus legislation).

²⁰³ See *e.g.*, N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2013) (using the Click-Through Nexus approach); N.Y. TAX LAW § 1101(b)(8)(i)(I) (McKinney 2013) (using the Affiliate Nexus approach).

Internet sales taxes are unconstitutional both individually and collectively.²⁰⁴

A. *The States Enact Nexus Laws Using Four Main Approaches*

The first aggressive state attempt to tax out-of-state sellers was New York's "Amazon law" in 2008.²⁰⁵ Since then, at least twelve states have adopted nexus legislation of their own.²⁰⁶ There are generally four approaches to state taxation of out-of-state sellers: (1) click-through nexus statutes, (2) affiliate nexus statutes, (3) notice and information reporting requirements, and (4) arguing *Quill* is not applicable to its statute.²⁰⁷

1. New York and Other States Argue They Can Assert Nexus Under the Click-Through Nexus Approach

The Click-Through Nexus approach²⁰⁸ creates a presumption of nexus over an out-of-state vendor where the vendor makes sales and marketing arrangements with in-state residents.²⁰⁹ States that

²⁰⁴ See *infra* Part II.B–C.

²⁰⁵ N.Y. TAX LAW § 1101(b)(8).

²⁰⁶ See Harley Duncan & Sarah McGahan, *An Overview of Recent Sales and Use Tax Legislation*, 61 ST. TAX NOTES 483, 488 (2011) (listing Arkansas, California, Colorado, Connecticut, Illinois, New York, North Carolina, Oklahoma, Rhode Island, South Dakota, Texas, and Vermont as states that have passed nexus laws).

²⁰⁷ See Gamage & Heckman, *supra* note 202, at 518–19 (listing referrer nexus, related-entity nexus and information reporting requirements as state nexus statute strategies); Kranz, Freeman & Yopp, *supra* note 147, at 307 (listing reporting and notice requirements, affiliate nexus statutes, click-through nexus statutes, and "state simplification and later declaration by the state that the physical presence nexus standard no longer applies because of lowered burdens on interstate commerce" as state nexus strategies); Plattner, Smirlock & Ladouceur, *supra* note 202, at 187 (detailing state nexus legislation).

²⁰⁸ The Click-Through Nexus approach is sometimes referred to as the "Referrer-Nexus Approach" or the "Affiliate Tax Approach." See Gamage & Heckman, *supra* note 202, at 518–19.

²⁰⁹ See Gamage & Heckman, *supra* note 202, at 518–19; Kranz, Freeman & Yopp, *supra* note 147, at 307 (explaining that under click through nexus, the presumption of nexus arises if "the out-of-state Internet retailer has an agreement with an in-state resident who is paid a commission for advertising and referring customers to the out-of-state retailer, provided that the referrals generate sufficient sales"); see, e.g., ARK. CODE ANN. § 26-52-117(d) (West 2013) (presuming nexus "if the [out-of-state] seller enters into an agreement with one (1) or more residents of the state under which the residents, for a

use this method include Arkansas, Connecticut, New York, North Carolina and Rhode Island.²¹⁰ Many online sellers use affiliate programs, also known as associate programs, to increase their exposure.²¹¹ Affiliate programs share revenue with owners of websites that send them business.²¹² The states that enact click-through nexus statutes argue mere participation in an affiliate program is evidence of an out-of-state vendor's nexus with a state.²¹³

New York passed the first aggressive nexus statute in 2008 using this "Click-Through Nexus" approach.²¹⁴ The New York statute provides for sales tax liability for a remote vendor where two conditions are satisfied: (1) "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," and (2) "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 . . . [exceed] ten thousand dollars during the preceding four quarterly periods"²¹⁵ Either condition creates a rebuttable presumption

commission or other consideration, directly or indirectly refer potential purchasers, whether by a link on an Internet website or otherwise, to the seller").

²¹⁰ CONN. GEN. STAT. § 12-407(a)(12) (2013); ARK. CODE ANN. § 26-52-117(d) (West 2013); N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2013); N.C. GEN. STAT. ANN. § 105-164.8(3) (West 2012); R.I. GEN. LAWS ANN. § 44-18-15(a) (West 2012).

²¹¹ See HARDESTY, *supra* note 106, at ¶ 14.03[5][b].

²¹² See *id.*

²¹³ See *id.*

²¹⁴ N.Y. TAX LAW § 1101(b)(8) (McKinney 2013).

²¹⁵ *Id.* § 1101(b)(8)(vi). The Connecticut click-through nexus statute presumes nexus over "every person making sales of tangible personal property or services through an agreement with another person located in this state under which such person located in this state, for a commission or other consideration that is based upon the sale of tangible personal property or services by the retailer, directly or indirectly refers potential customers, whether by a link on an Internet web site or otherwise, to the retailer, provided the cumulative gross receipts from sales by the retailer to customers in the state who are referred to the retailer by all such persons with this type of an agreement with the retailer, is in excess of two thousand dollars during the preceding four quarterly periods" CONN. GEN. STAT. § 12-407(a)(12)(L) (2013). Arkansas law contains a similar click-through nexus provision that applies when sales exceed \$10,000 annually. See ARK. CODE ANN. § 26-52-117(d) (West 2013).

of nexus and shifts the burden onto the seller to prove that the in-state resident “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”²¹⁶

In 2008, Amazon challenged the New York Click-Through Nexus statute.²¹⁷ The New York Court of Appeals relied on its previous decision in *Orvis* and reaffirmed the “more than the slightest presence” nexus standard.²¹⁸ The court explained that such standard could be established by physical presence of property in the state or “the conduct of economic activities in the taxing State performed by the vendor’s personnel or on its behalf.”²¹⁹ The New York court determined that the statute met the “more than the slightest presence” nexus standard because the statute only imposed a duty on out-of-state vendors that enter into a business-referral agreement providing for commission on in-state sales.²²⁰ The court noted that the state has a legitimate basis to conclude in-state representatives will engage in direct solicitation in addition to advertising in light of statements made by Amazon to in-state residents encouraging them to join its referral program, stating: “Our compensation philosophy is simple: reward Associates for their contributions to our business in unit volume and growth.”²²¹ Further, an Amazon document to New York residents stated, “*The higher your referrals, the greater your earnings will be.*”²²² The court upheld the law because it provided a safe harbor to remote sellers that attain annual certification from

²¹⁶ N.Y. TAX LAW § 1101(b)(8)(vi).

²¹⁷ See *Amazon.com, LLC v. N.Y. State Dep’t of Taxation and Fin.*, 913 N.Y.S.2d 129, 132 (N.Y. App. Div. 2010).

²¹⁸ *Amazon.com, LLC*, 913 N.Y.S.2d at 137 (citing *In re Orvis Co., Inc. v. Tax Appeals Tribunal of New York*, 654 N.E.2d 954, 960–61 (1995).)

²¹⁹ *Amazon.com, LLC*, 913 N.Y.S.2d at 137. The New York Court of Appeals affirmed the lower court’s determination of facial constitutionality but ordered that the lower court reconsider the as applied challenge after the parties conduct further discovery. *Id.* at 137–39, 146.

²²⁰ *Id.* at 137–39.

²²¹ *Id.* at 139.

²²² *Id.* at 139. The document also stated, “[t]he Performance structure allows you to earn higher fees when you generate a sufficient volume of referrals that result in sales at Amazon.com during a month.” *Id.*

in-state representatives that they have not engaged in solicitation activities.²²³

One practical downside to the Click-Through Nexus approach is that sellers can easily avoid nexus with a state by suspending its relationships with in-state marketing associates just as Overstock.com has already done in New York.²²⁴

2. Many States Argue They Can Enact Affiliate Nexus Statutes Under the Unitary Business Theory

States that follow the Affiliate Nexus approach create statutory nexus presumptions.²²⁵ States that use the Affiliate Nexus approach include Alabama, Arkansas, California, Idaho, Kansas, New York, Ohio, Oklahoma, Texas, and Wisconsin.²²⁶ This approach establishes nexus within a state under two circumstances: (1) if the out-of-state seller substantially owns, is substantially owned by or is under common control with an in-state business

²²³ *Id.* (noting the prohibition of “the in-state representative from engaging in any solicitation activities in New York State that refer potential customers to the seller” and the significance of the requirement “that there must be solicitation, not passive advertising”) (internal quotation marks omitted).

²²⁴ See Jason Kincaid, *NY’s “Amazon Tax” Takes First Casualty: Overstock Affiliates*, TECH CRUNCH (May 14, 2008), <http://techcrunch.com/2008/05/14/nys-amazon-tax-takes-first-casualty-overstock-affiliates/>; see also Gamage & Heckman, *supra* note 202, at 520 (“The referrer nexus approach ultimately fails as a way forward for the states to tax e-commerce for the simple reason that e-commerce vendors can easily end all referral relationships with in-state residents.”).

²²⁵ See Kranz, Freeman & Yopp, *supra* note 147, at 307–09.

²²⁶ ALA. CODE § 40-23-190 (2013); ARK. CODE ANN. § 26-53-124(a)(3) (2013); IDAHO CODE ANN. § 63-3611 (West 2013); KAN. STAT. ANN. § 79-3702 (2013); MINN. STAT. ANN. § 297A.66 (West 2013); N.Y. TAX LAW § 1101(b)(8)(i)(I) (McKinney 2013); OHIO REV. CODE ANN. § 5741.01(I) (West 2013); OKLA. STAT. tit. 68, § 1401(9)(b) (2013); TEX. TAX CODE ANN. § 151.107(a); WIS. STAT. ANN. § 77.51(13g) (West 2013); CAL. SALES TAX COUNSEL RUL. 220.0002 (June 22, 1999). For example, the Ohio Affiliate Nexus statute provides:

‘Substantial nexus with this state’ exists when the seller . . . (1) Maintains a place of business within this state, whether operated by employees or agents of the seller, by a member of an affiliated group . . . of which the seller is a member, or by a franchisee using a trade name of the seller; . . . [or] (5) Has membership in an affiliated group, . . . at least one other member of which has substantial nexus with this state

OHIO REV. CODE ANN. § 5741.01 (West 2013).

(that is, they are subsidiaries of the same parent company),²²⁷ or (2) if the out-of-state seller and the in-state business use an identical or substantially similar name, trade name, trademark, or goodwill to maintain sales, or if “the in-state business provides services to . . . the out-of-state business related to developing, promoting, or maintaining the in-state market.”²²⁸ This approach, also known as the unitary business theory, fundamentally treats separate businesses as one unified business.²²⁹

State tax authorities use the Affiliate Nexus approach even though it has been unsuccessful in the California and Ohio state courts.²³⁰ In *SFA Folio v. Tracy*, the State of Ohio argued that Saks-Ohio’s nexus should be attributed to SFA Folio because the two were essentially one business.²³¹ The Ohio court explained that although the unitary business theory may be successful

²²⁷ See, e.g., ALA. CODE § 40-23-190 (2013); OKLA. STAT. tit. 68, § 1401(9)(b) (2013).

²²⁸ ALA. CODE § 40-23-190 (2013). For another example, Oklahoma statutes asserts nexus over a retailer if it “holds a substantial ownership interest in, or is owned in whole or in substantial part by, a retailer maintaining a place of business within [Oklahoma],” and if:

[T]he retailer sells the same or a substantially similar line of products as the related Oklahoma retailer and does so under the same or a substantially similar business name, or the Oklahoma facilities or Oklahoma employees of the related Oklahoma retailer are used to advertise, promote or facilitate sales by the retailer to consumers

OKLA. STAT. tit. 68, § 1401(9)(b) (2013).

The statute also asserts nexus over a “retailer [that] holds a substantial ownership interest in, or is owned in whole or in substantial part by, a business that maintains a distribution house, sales house, warehouse or similar place of business in Oklahoma that delivers property sold by the retailer to consumers.” *Id.* In addition, the statute asserts that “[a]ny retailer that is part of a controlled group of corporations, . . . [which] has a component member that is a retailer engaged in business in this state . . . shall be presumed to be a retailer engaged in business in this state.” *Id.*

²²⁹ See *Gamage & Heckman*, *supra* note 202, at 521 (arguing that the Affiliate Nexus approach “disregard[s] corporate structure and treat[s] related business entities as though they were a single unitary business”). This approach “purports to attribute nexus based on connections between two corporations, including common ownership, common management, integration or combination of certain business activities, and shared trademarks and trade names.” HARDESTY, *supra* note 106, at ¶ 14.03[6][h].

²³⁰ See *Current, Inc. v. State Bd. of Equalization*, 29 Cal. Rptr. 2d 407, 408, 412 (Cal. Ct. App. 1994); *SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693, 696–97 (Ohio 1995); see, e.g., ARK. CODE ANN. § 26-53-124(3) (2013) (Arkansas statute based on unitary nexus).

²³¹ *SFA Folio Collections*, 652 N.E.2d at 696–97.

regarding income taxes, it was not valid in the realm of sales taxes and could not be applied to Folio because it did not have the in-state physical presence required by *Quill*.²³² The court concluded that “to impute nexus to Folio because a sister corporation has a physical presence in Ohio runs counter to federal constitutional law and Ohio corporation law.”²³³

Similarly, the California court held that the physical in-state nexus of one company was insufficient to justify the imposition of tax on a separate company because the two companies “did not have integrated operations or management, were organized and operated as separate and distinct corporate entities, and, neither . . . was the alter ego or agent of the other for any purpose.”²³⁴ Citing *Quill* the California court explained that the law burdened interstate commerce, disregarded the substantial nexus requirement, and violated the Commerce Clause.²³⁵

3. Colorado and Oklahoma Argue They Can Impose Notice and Information Reporting Requirements on Out-of-State Sellers

Focusing on the deficiency of traditional use taxes, Colorado and Oklahoma attempt to enforce notice and information reporting requirements to improve use tax collection.²³⁶ This method imposes a duty on out-of-state sellers to provide the state with a list of sales made to in-state residents and to inform in-state customers

²³² *Id.* The unitary concept is more useful regarding income tax under the theory “that the net income of a single corporation may not be representative of the profits earned by a company in a state when that corporation is a member of a unitary group . . . [and] that the net profit earned by the unitary group as a whole is more reflective of the level of profits earned by any member of the group.” HARDESTY, *supra* note 106, at ¶ 14.03[6][h].

²³³ *SFA Folio Collections*, 652 N.E.2d at 697 (the court explained that under Ohio state law, the two businesses are separate and distinct legal entities.)

²³⁴ *Current, Inc.*, 29 Cal. Rptr. 2d at 412 (internal quotations marks omitted).

²³⁵ *Id.* at 411–12 (reasoning that substantial nexus is a requirement to limit state burdens on interstate commerce and therefore the statute was unconstitutional in violation of the Commerce Clause).

²³⁶ See Kranz, Freeman & Yopp, *supra* note 147, at 307; see, e.g., COLO. REV. STAT. § 39-21-112(3.5) (2010); OKLA. STAT. tit. 68 §§ 1352(1), 1354.1 (2013).

of their use tax obligation to their home states.²³⁷ States considering imposing these requirements on remote sellers should consider the lack of enforcement available under this method because the Colorado court determined the reporting requirements to be unconstitutional and thus businesses have reason to disregard the likely unenforceable statutes.²³⁸

In 2011, the Colorado District Court ordered a preliminarily injunction to enjoin the enforcement of Colorado state's information-reporting requirements.²³⁹ The court held, "the burdens imposed by the [statute] . . . are inextricably related in kind and purpose to the burdens condemned in *Quill*."²⁴⁰ The Colorado statute required out-of-state retailers who sell products to Colorado residents to (1) notify in-state customers that the purchaser is obligated to self-report and pay use taxes, (2) inform

²³⁷ COLO. REV. STAT. § 39-21-112(3.5) (2010); OKLA. STAT. tit. 68 §§ 1352(1), 1354.1 (2013). Colorado requires an out-of-state seller to report information necessary for the state to effectively collect use taxes from in-state residents. *See* COLO. REV. STAT. § 39-21-112(3.5) (2010).

²³⁸ *See* COLO. REV. STAT. § 39-21-112(3.5) (2010); *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS, 2012 WL 1079175, at *7 (D. Colo. Mar. 30, 2012). The Colorado legislature threatens, "Failure to provide the notice required . . . shall subject the retailer to a penalty of five dollars for each such failure, unless the retailer shows reasonable cause for such failure Failure to send the notification required . . . shall subject the retailer to a penalty of ten dollars for each such failure, unless the retailer shows reasonable cause for such failure. [] Failure to file the annual statement required . . . shall subject the retailer to a penalty of ten dollars for each purchaser that should have been included in such annual statement, unless the retailer shows reasonable cause for such failure." *Id.*

²³⁹ *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS, 2011 WL 250556 (D. Colo. Jan. 26, 2011). The Colorado statute states as follows: "Each retailer that does not collect Colorado sales tax shall notify Colorado purchasers that sales or use tax is due . . . and that the state of Colorado requires the purchaser to file a sales or use tax return." COLO. REV. STAT. § 39-21-112(3.5) (2010). Further, the Colorado statute requires retailers that do not collect Colorado sales taxes to notify all Colorado customers annually of the total amount paid by that purchaser that year, the dates of purchases, the amounts of each purchase, and the category of the purchase, including whether the purchase is exempt from taxation. *Id.* In addition, the statute requires each retailer that does not collect Colorado sales tax but makes more than one hundred thousand dollars that year from Colorado customers to file statements for each purchaser annually showing the amount paid. *Id.*

²⁴⁰ *Direct Mktg. Ass'n*, 2011 WL 250556, at *5 ("I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in *Quill*.").

each in-state customer who spends more than five-hundred dollars in the calendar year that the retailer is required to report the customer's name and total amount of purchases to the Department of Revenue, and (3) provide the Department of Revenue with an annual report stating the name, billing address, shipping addresses, and total amount of purchases by each in-state customer if the retailer has one-hundred-thousand dollars in-state annual sales.²⁴¹

In 2012, the Colorado District Court issued its final ruling.²⁴² The court ruled the statute unconstitutional for two reasons.²⁴³ First, because the statute “directly regulate[s] and discriminate[s] against out-of-state retailers and, therefore, interstate commerce.”²⁴⁴ The court explained, “*Quill* creates the in-state versus out-of-state distinction, and the dormant Commerce Clause prohibits differential treatment based on that distinction.”²⁴⁵ Second, the court ruled the Colorado statutes unconstitutional under the dormant Commerce Clause because they imposed an undue burden on interstate commerce.²⁴⁶ The court explained, “under the standard established in *Quill*, a state law that imposes a use tax collection burden on a retailer with no physical presence in the state causes an undue burden on interstate commerce.”²⁴⁷

4. Oklahoma Argues *Quill* is No Longer Relevant to its Statute

In a bold move, Oklahoma enacted legislation indicating that its tax system is simplified and does not overly burden interstate commerce and therefore can force out-of-state sellers to collect and remit state sales taxes to the state.²⁴⁸ The Oklahoma statute states:

The Oklahoma Legislature finds that the sales and use tax system established under Oklahoma law does not pose an undue burden on out-of-state

²⁴¹ *Direct Mktg. Ass'n*, 2012 WL 1079175, at *2.

²⁴² *Id.* at *7.

²⁴³ *Id.* (granting summary judgment to the plaintiff on two counts).

²⁴⁴ *Id.* (“That discrimination triggers the virtually per se rule of facial invalidity.”).

²⁴⁵ *Id.*

²⁴⁶ *Id.*

²⁴⁷ *Id.* at *9.

²⁴⁸ OKLA. STAT. tit. 68, § 1407.5(C) (2013).

retailers and provides sufficient simplification to warrant the collection and remittance of use taxes by out-of-state retailers that are due and owing to the State of Oklahoma and its local jurisdictions.²⁴⁹

B. Each Approach to State Nexus Legislation Individually Conflicts with the Constitution

Each approach to state nexus legislation is unconstitutional on its own in light of Supreme Court precedent.²⁵⁰ In *Quill*, the Supreme Court reaffirmed *Bellas Hess* by requiring a minimum level of physical presence in the state to meet the *Complete Auto* “substantial nexus” requirement.²⁵¹ The Click-Through Nexus approach, the Affiliate Nexus approach, the notice and information reporting requirements approach, and the approach where a state self-declares that *Quill* is no longer relevant to its statute, each individually violates Supreme Court Commerce Clause precedent.²⁵²

1. The Click-Through Nexus Approach Disregards Supreme Court Precedent

Although the *Amazon* case indicated one court’s approval of the Click-Through method as long as it denies nexus where there is no solicitation whatsoever, this method poses two significant constitutional problems.²⁵³ First, the Click-Through method violates Supreme Court limitations on state power to regulate and

²⁴⁹ *Id.* The statute declares “the intent of the Oklahoma Legislature to [] include within the use tax . . . all storage, use or other consumption of tangible personal property purchased or brought into this state through the continuous, regular or systematic solicitation in the Oklahoma consumer market by out-of-state retailers through the Internet, mail order and catalog publications.” *Id.* § 1407.5(A).

²⁵⁰ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 317 (1992).

²⁵¹ See *id.* (noting that even though “cases subsequent to *Bellas Hess* and concerning other types of taxes have not adopted a bright-line, physical presence requirement similar to that in *Bellas Hess*, . . . their reasoning does not compel rejection of the *Bellas Hess* rule regarding sales and use taxes”); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

²⁵² See *Quill*, 504 U.S. at 317; *Complete Auto*, 430 U.S. at 274, 279 (1977).

²⁵³ *Amazon.com, LLC v. N.Y. State Dep’t of Taxation & Fin.*, 913 N.Y.S.2d 129, 138–39 (N.Y. App. Div. 2010).

burden interstate commerce.²⁵⁴ The *Quill* Court reaffirmed the *Complete Auto* “substantial nexus” requirement and required a minimum presence in the state before a seller can be obligated to collect that state’s sales tax.²⁵⁵ The Click-Through nexus approach does not incorporate this requirement of presence and instead looks only to its solicitation activity through an in-state affiliate.²⁵⁶ Second, critics argue this method asserts nexus over a seller “based solely on an independent third party’s Web site advertisement link to the Internet retailer, regardless of whether the activity (that is, the Internet link) targets the [in-state] market.”²⁵⁷ It is often the case that the solicitation activities occur without regard to any geographical market and consequently lack the “substantial nexus,” in violation of *Quill* and *Complete Auto*.²⁵⁸ The Click-Through nexus statutes are unconstitutional because they are contrary to the *Scripto* and *Tyler Pipe* market maintenance theory by not considering whether the in-state affiliate’s referral activities are associated with the in-state market.²⁵⁹

²⁵⁴ See *Quill*, 504 U.S. at 299, 312; *Complete Auto*, 430 U.S. at 274, 279 (1977).

²⁵⁵ *Quill*, at 504 U.S. at 299, 311–12.

²⁵⁶ See Gamage & Heckman, *supra* note 202, at 518 (“The ‘referrer-nexus’ approach presumes that a vendor has a physical presence within a state whenever the vendor makes sales and marketing arrangements with in-state residents.”).

²⁵⁷ Michele Borens & Mark Yopp, *Overextending Attributional Nexus: States’ Latest Attempts To Tax Internet Sales*, 51 ST. TAX NOTES 697, 698 (Mar. 2 2009), available at <http://www.sutherland.com/NewsCommentary/Articles/75876/A-Pinch-of-SALT-Overextending-Attributional-Nexus-States-Latest-Attempts-To-Tax-Internet-Sales> (“That approach is fundamentally flawed because it is premised on the residence, and not the market making activities, of the in-state third party.”).

²⁵⁸ See Kranz, Freeman & Yopp, *supra* note 147, at 309 (“That disassociation between the solicitation activities and the taxing state creates too tenuous a connection to establish a presumption of nexus.”); see also *Quill*, 504 U.S. at 311–12; *Complete Auto*, 430 U.S. at 274, 279.

²⁵⁹ See *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 483 U.S. 232, 250 (1987); *Scripto Inc. v. Carson*, 362 U.S. 207, 212–13 (1960); Kranz, Freeman & Yopp, *supra* note 147, at 309.

2. The Affiliate Nexus Approach is Unconstitutional Because it Misapplies the Unitary Nexus Theory and Imputes Nexus on the Wrong Business

The Affiliate Nexus approach violates *Quill* because it imputes nexus on a business with insufficient contacts with the state.²⁶⁰ While some states continue to embrace the unitary business theory and enact affiliate nexus statutes, both the Ohio and California courts ruled this theory inapplicable to sales taxes.²⁶¹ The Ohio court stated, “to impute nexus to [an out-of-state seller] because a sister corporation has a physical presence in Ohio runs counter to federal constitutional law and Ohio corporation law.”²⁶² While those in favor of this method argue that *Scripto* and *Tyler Pipe* support their argument that affiliates are agents of the seller or that they enable a seller to maintain a market within a state,²⁶³ critics of this strategy insist, “[n]owhere does the Constitution, or the cases applying it, give support to the idea that two retailers that are simply members of the same controlled group of corporations create nexus for each other.”²⁶⁴ This approach violates *Quill* because it imputes nexus on a seller that lacks sufficient presence in the state.²⁶⁵

²⁶⁰ See Kranz, Freeman & Yopp, *supra* note 147, at 308–09.

²⁶¹ See *SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693, 696–97 (Ohio 1995); *Current, Inc. v. State Bd. of Equalization*, 29 Cal. Rptr. 2d 407, 412 (Cal. Ct. App. 1994).

²⁶² *SFA Folio Collections*, 652 N.E.2d at 697.

²⁶³ See HARDESTY, *supra* note 106, at ¶ 14.03[5][b][i]. In fact, one commentator argues, “states should feel unconstrained in enforcing sales tax collection obligations against companies currently attempting to avoid taxation through entity isolation techniques.” Swain, *supra* note 95, at 424.

²⁶⁴ Kranz, Freeman & Yopp, *supra* note 147, at 309.

²⁶⁵ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 299, 311–12 (1992) (requiring a seller to have presence within a state and substantial nexus within a state before it can be taxed); *SFA Folio Collections*, 652 N.E.2d at 696–97 (explaining that the state cannot impose nexus on the remote seller under the unitary business theory because it is not valid in the realm of sales taxes and the seller therefore did not have the in-state physical presence required by *Quill*).

3. Notice and Information Reporting Requirements are Unconstitutional Because They Disregard Supreme Court Precedent and are Discriminatory and Unduly Burdensome

The Notice and Information Reporting method violates the Commerce Clause on two grounds. First, this method unfairly discriminates against interstate commerce, which specifically violates the *Complete Auto* test.²⁶⁶ This discrimination also violates the ITFA's prohibition against discriminatory taxes on e-commerce.²⁶⁷ Second, this method imposes undue burdens on interstate commerce and violates the Commerce Clause by ignoring *Quill*'s presence requirement for imposing obligations on an out-of-state vendor.²⁶⁸ Not only is it burdensome to comply with these reporting requirements, the burden is potentially multiplied by fifty states plus the District of Columbia who could all enact varying reporting requirements.²⁶⁹

²⁶⁶ See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (requiring that a tax “does not discriminate against interstate commerce” to be constitutional); Kranz, Freeman & Yopp, *supra* note 147, at 309. Additionally, critics argue that this method promotes economic protectionism for in-state sellers and is thus discriminatory and unconstitutional. *Id.* at 308.

²⁶⁷ See Internet Tax Freedom Act of 1998, Pub. L. No. 105-277, § 1101(a), 112 Stat. 2681 (1998) (“No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending November 1, 2014: (1) Taxes on Internet access[, and] (2) Multiple or discriminatory taxes on electronic commerce.”); *Direct Mktg. Ass’n v. Huber*, No. 10-CV-01546-REB-CBS, 2012 WL 1079175, at *7 (D. Colo. Mar. 30, 2012) (“*Quill* creates the in-state versus out-of-state distinction, and the dormant Commerce Clause prohibits differential treatment based on that distinction.”); see also Mazerov, *supra* note 88.

²⁶⁸ See *Direct Mktg. Ass’n*, 2012 WL 1079175, at *7; *Quill Corp. v. North Dakota*, 504 U.S. 298, 299, 311–12 (1992); see also Kranz, Freeman & Yopp, *supra* note 147, at 307. But see Andrew Haile, *Defending Colorado’s Use Tax Reporting Requirement*, 57 ST. TAX NOTES 761, 764 (2010) (arguing that information-reporting requirements are “significantly less onerous than the burden of actually collecting use taxes”).

²⁶⁹ See Gamage & Heckman, *supra* note 202, at 524 (“If we take the *Quill* decision seriously that the purpose of the physical presence requirement is to prevent the excess burden on remote vendors that might result from numerous taxing jurisdictions imposing tax compliance obligations, then the physical presence rule should also apply to information-reporting requirements.”).

4. State Declaration that *Quill* is No Longer Relevant to its Statute Violates *Quill* and its Protection of the Commerce Clause

Under the dormant Commerce Clause, the courts determine the extent that the states may regulate interstate commerce.²⁷⁰ There is no indication that the courts allow a state to self-declare that changed circumstances allow it to go against the reigning Supreme Court precedent.²⁷¹ The “substantial nexus” requirement is set in place to monitor the overall effect of state regulation on interstate commerce.²⁷² If one state sufficiently simplifies its tax system, the Commerce Clause requirement of “substantial nexus” is not thrown aside.²⁷³ A state’s burdensome tax system may be one factor of the burden on interstate commerce, but the *Quill* ruling discussed a more general burden informing the nexus requirement.²⁷⁴ One commentator argues, “[t]he Oklahoma rules appear to go beyond the guidelines of *Quill* . . . and it is doubtful that an out-of-state vendor, with no physical presence in Oklahoma, could be compelled to collect sales and use tax.”²⁷⁵ Moreover, this method disregards the practical burdens imposed on interstate commerce as a result of varying legislation, even if those varying sales tax systems are in fact simplified.²⁷⁶

In addition, when a state attempts to force out-of-state vendors to collect and remit sales tax under the theory that the state system is sufficiently simplified, such behavior disregards the *Quill*

²⁷⁰ See U.S. CONST. art. I, § 8, cl. 3; Plattner, *supra* note 18, at 1017–18.

²⁷¹ See *Quill*, 504 U.S. at 318 (“The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve.”). In fact, the Court explained that it is Congress, not the states that has the power to regulate commerce. *Id.*

²⁷² See *id.* at 312 (“[T]he Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy.”).

²⁷³ See *id.*

²⁷⁴ See *id.* (discussing the Court’s “structural concerns about the effects of state regulation on the national economy”).

²⁷⁵ HARDESTY, *supra* note 106, at ¶ 17.39.

²⁷⁶ See Gamage & Heckman, *supra* note 202, at 524 (arguing a similar line of reasoning regarding varying information and reporting requirements).

Court's message that Congress is best suited to deal with this question.²⁷⁷

C. The Varying State Nexus Statutes Collectively Violate the Commerce Clause

Each state has its own “nexus” definition and sales tax collection requirements.²⁷⁸ These variations violate the commerce clause because they impose practical burdens on complying businesses engaged in interstate commerce.²⁷⁹

The extent of these burdens is illustrated by New York's nexus statute and rules of compliance.²⁸⁰ Under New York law, a seller has nexus with New York State and is subject to collecting state sales taxes if the seller:

(1) Maintains a physical presence within the state through employees, agents or a place of business in the state,²⁸¹

²⁷⁷ See *Quill*, 504 U.S. at 318 (“The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve.”); *Id.* at 333 (“Congress can and should address itself to this area of law . . .”) (White, J., dissenting); *Id.* at 320 (“Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so.”) (Scalia, J., concurring); see also Kranz, Freeman & Yopp, *supra* note 147, at 307 (“Th[is] tactic ignores Supreme Court precedent and usurps the authority reserved for Congress under the commerce clause of the U.S. Constitution to regulate commerce . . .”). Commentators note that the constitutionality of this aggressive law will likely be challenged in court, which one commentator poses was the intention of the legislature. See Plattner, Smirlock & Ladouceur, *supra* note 202, at 196 (describing this type of statute as a “test case statute . . . that directly confronts *Quill* and sets the stage for a constitutional challenge to *Quill*”).

²⁷⁸ See, e.g., ALA. CODE § 40-23-190 (2013); IDAHO CODE ANN. § 63-3611 (West 2013); KAN. STAT. ANN. § 79-3702. (2013); N.C. GEN. STAT. § 105-164.8(3) (2013); R.I. GEN. LAWS ANN. § 44-18-15(a) (West 2013); OKLA. STAT. tit. 68, § 1401(9)(b) (2013); WIS. STAT. ANN. § 77.51(13g) (West 2013).

²⁷⁹ See *Quill*, 504 U.S. at 299 (“[T]he continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the rule remains good law.”); *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 759–60 (1967) (explaining that varying state and local sales tax laws “could entangle [the seller]’s interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government”).

²⁸⁰ N.Y. TAX LAW § 1101(8) (McKinney 2013).

²⁸¹ *Id.* § 1101(8)(i)(C)(I).

(2) “regularly or systematically delivers [] property or services in this state by means other than the United States mail or common carrier,”²⁸²

(3) “solicits business” within the state either “by employees, independent contractors, agents or other representatives; or [] by distribution of catalogs or other advertising matter . . . if such person has some additional connection with the state which satisfies the nexus requirement of the United States constitution,”²⁸³

(4) satisfies the affiliate nexus statute where either “one of such persons has an ownership interest of more than five percent . . . or where an ownership interest of more than five percent . . . is held in each of such persons by another person or by a group of other persons which are affiliated persons with respect to each other,”²⁸⁴ or

(5) satisfies the click-thorough nexus statute under which a seller is “presumed to be soliciting business through . . . [a] representative if the seller enters into an agreement with a [New York] resident . . . 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 . . . [unless the seller proves] that the resident . . . [did] not engage in any solicitation in the state on behalf of the seller

²⁸² *Id.* § 1101(8)(i)(D).

²⁸³ *Id.* § 1101(8)(i)(I).

²⁸⁴ *Id.* The following activities will make the seller a “vendor” under this statute; If either “an affiliated person that is a vendor as otherwise defined in this paragraph uses in the state trademarks, service marks, or trade names that are the same as those the seller uses;” or if “an affiliated person engages in activities in the state that inure to the benefit of the seller, in its development or maintenance of a market for its goods or services in the state, to the extent that those activities of the affiliate are sufficient to satisfy the nexus requirement of the United States constitution.” *Id.* However, the statute provides that the following activities of an affiliated person within the state will not result in making the seller a vendor: “providing accounting or legal services or advice to a seller, or in directing the activities of a seller, including, but not limited to, making decisions about (a) strategic planning, (b) marketing, (c) inventory, (d) staffing, (e) distribution, or (f) cash management.” *Id.*

that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question.”²⁸⁵

To comply with applicable sales tax requirements, a business that has nexus with New York must register with the State of New York and collect sales tax for all products listed in the statute.²⁸⁶ A seller whose taxable receipts total less than \$300,000 and greater than \$3,000 for each of the last four quarters must file quarterly returns,²⁸⁷ while those whose taxable receipts total \$300,000 or more for each of the last four quarters must file monthly returns.²⁸⁸ If the seller has no tax to report for a given month or quarter, they must file an online “zero return.”²⁸⁹ In addition, annual information returns may be required,²⁹⁰ vendors are required to keep adequate records,²⁹¹ and late or missing returns may be subject to penalties, plus interest.²⁹²

Businesses engaged in e-commerce must endure the headache of nationwide compliance, requiring thorough analysis of each

²⁸⁵ *Id.* § 1101(8)(vi). A seller qualifies under the click-through statute “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 ending on the last day of February, May, August and November.” *Id.*

²⁸⁶ *See id.* § 1134 (explaining who must register with the State); *id.* § 1105 (listing taxable items).

²⁸⁷ *See id.* § 1136(a)(1).

²⁸⁸ *See id.* § 1136(a)(2).

²⁸⁹ *See Sales Tax Web File*, N.Y. STATE DEP’T OF TAXATION & FIN., <http://www.tax.ny.gov/bus/st/stmp.htm> (last modified Sept. 20, 2013) (“Filing returns for reporting periods when you had no activity (‘zero returns’)”).

²⁹⁰ *See, e.g., Technical Memorandum from the Office of Tax Policy Analysis Taxpayer Guidance Div., New Requirement for the Filing of Information Returns for Franchisors*, N.Y. STATE DEP’T OF TAXATION & FIN. (on file July 7, 2009), available at http://www.tax.ny.gov/pdf/memos/sales/m09_9s.pdf (explaining new requirements for the filing of information returns for franchisors).

²⁹¹ *See* N.Y. TAX LAW § 1135(a)(1) (McKinney 2013) (“Every person required to collect tax shall keep records of every sale . . . [which] shall include a true copy of each sales slip, invoice, receipt, statement or memorandum . . .”).

²⁹² *See id.* § 1145 (describing the penalties and interest due when a seller fails to file a return or pay tax when due).

individual state's sales tax laws.²⁹³ As a result, the current array of state legislation is unduly burdensome and unconstitutional.²⁹⁴

III. IT IS TIME FOR CONGRESS TO ACT TO PERMANENTLY REJECT THE CONCEPT OF NEXUS

Many states are violating the Constitution by disregarding court-imposed limitations on their power to regulate interstate commerce. Although state court interpretations of the Supreme Court's ruling in *Quill* provide for much confusion, it remains good law that a state cannot impose sales and use tax obligations on an out-of-state seller that lacks the necessary nexus with the state.²⁹⁵ In addition, it is clear that *Quill* intended for some presence requirement to remain.²⁹⁶ Nevertheless, current state approaches to dealing with the lack of sales tax collections disregard the Court's nexus and presence requirement and are thus unconstitutional. While the SSUTA effort is a step in the right direction, the agreement falls short of providing a complete solution because it does not include a uniform nexus statute. Similarly, the three bills pending in Congress are inadequate

²⁹³ See Leibowicz, *supra* note 105, at 1 (explaining that the standards for maintaining adequate books and records vary from state to state). Sellers must be aware that state nexus statutes vary from state to state, requiring thorough analysis of each state's nexus statutes. Compare ARK. CODE ANN. § 26-52-117(d) (2013) (using the Click Through Nexus approach), and R.I. GEN. LAWS ANN. § 44-18-15(a) (West 2013) (using the Click Through Nexus approach), with ALA. CODE § 40-23-190 (2012) (using the Affiliate Nexus approach), and WIS. STAT. ANN. § 77.51(13g) (West 2013) (using the Affiliate Nexus approach).

²⁹⁴ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992) (“[T]he Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy.”).

²⁹⁵ See *Quill*, 504 U.S. at 311–12; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

²⁹⁶ *Quill*, 504 U.S. at 317 (“[T]he continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the [*Bellas Hess*] rule remains good law.”); see also *AccuZIP, Inc. v. Dir., Div. of Taxation*, 25 N.J. Tax 158, 169 (N.J. Tax Ct. 2009) (“The Court reaffirmed [the *Bellas Hess*] bright-line physical presence standard for sales and use tax twenty-five years later in *Quill* . . .”).

because they do not address the nexus problem.²⁹⁷ To solve the states' sales tax collection problems while remaining within constitutional bounds, Congress should act to permanently reject the concept of nexus as it applies to sales taxes. Federal legislation should require all out-of-state sellers to collect and remit sales taxes for each state that opts in to the new scheme and should provide an exception for small sellers and a credit for compliance.

A. *Current State Legislative Approaches are Unconstitutional on their Own and Collectively*

Modern nexus statutes are unconstitutional in two ways: (1) each individual statute exceeds constitutional limits imposed by the United States Supreme Court, and (2) the combination of varying nexus statutes unduly burdens businesses engaged in interstate commerce and therefore violates the dormant Commerce Clause.²⁹⁸

Each statute violates the Constitution by overstepping court-imposed limits on state ability to impose sales and use tax obligations on out-of-state sellers. First, the Click-Through Nexus approach disregards the “substantial nexus” requirement of *Complete Auto* and *Quill*,²⁹⁹ and goes against the *Scripto* and *Tyler Pipe* market maintenance theory.³⁰⁰ Second, the Affiliate Nexus Approach violates the *Complete Auto* and *Quill* “substantial nexus” standard by asserting nexus based solely on common ownership with an in-state company.³⁰¹ While the Affiliate Nexus approach does prevent certain intentional tax avoidance techniques, it is over-inclusive because it will likely entrap many legitimately separate and distinct businesses. Third, the Notice and Information

²⁹⁷ See Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); S. 1452, 112th Cong. (2011); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Marketplace Equity Act, H.R. 3179, 112th Cong. (2011).

²⁹⁸ See *Quill*, 504 U.S. at 311–12.

²⁹⁹ See *id.* at 311; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

³⁰⁰ See *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250 (1987); *Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977); *Scripto Inc. v. Carson*, 362 U.S. 207, 209 (1960).

³⁰¹ See *Quill*, 504 U.S. 298, 311–12 (1992) (requiring a seller to have presence within a state and substantial nexus within a state before it can be taxed).

Reporting method violates the Commerce Clause because it discriminates against interstate commerce in violation of *Complete Auto* and the ITFA,³⁰² ignores *Quill*'s "substantial nexus" requirement,³⁰³ and varying state requirements impose the same undue burdens on interstate commerce as varying nexus statutes. Finally, a state's self-declaration that its tax system is sufficiently simplified boldly disregards the *Quill* physical presence "substantial nexus" requirement and the Court's message that Congress is best suited to deal with this question.³⁰⁴

In addition to each individual statute's unconstitutionality, the state laws collectively impose an undue burden on out-of-state vendors engaged in interstate commerce.³⁰⁵ Current nexus legislation is in dire need of an update.

B. The SSUTA is a Step in the Right Direction but Lacks the Necessary Nexus Uniformity

Although the SSUTA is a substantial step in the right direction, it does not provide for a uniform nexus statute and consequently lacks the uniformity required by the constitution. The SSUTA makes no effort to promote nexus uniformity. Instead, the SSUTA adds to the existing nexus issue by treating a "volunteer seller" more favorably than a seller who is legally obligated to collect sales tax in a state.³⁰⁶ This distinction leads to the same old nexus dispute.

³⁰² See Internet Tax Freedom Act of 1998, Pub. L. No. 105-277, § 1101, 112 Stat. 2681 (1998); *Complete Auto*, 430 U.S. at 279.

³⁰³ See *Quill*, 504 U.S. at 311–12.

³⁰⁴ See *id.* at 318 ("[T]he underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve."); *id.* at 333 ("Congress can and should address itself to this area of law . . .") (White, J., dissenting); *id.* at 320 ("Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so.") (Scalia, J., concurring).

³⁰⁵ See *supra* Part II.C.

³⁰⁶ See *Streamlined Sales and Use Tax Agreement*, *supra* note 12, at §§ 601–02; George Isaacson, Tax Counsel, Testimony: A Promise Unfulfilled: How The Streamlined Sales Tax Project Failed To Meet Its Own Goals For Simplification Of State Sales And Use Taxes, Address Before the U.S. Senate Finance Committee Subcommittee on International Trade (July 25, 2006), available at <http://www.the-dma.org/taxation/testimony7-25-06.pdf> ("States will undoubtedly claim that marketers were required to collect the tax anyway, and thus are not entitled to collection cost

While the SSUTA provides for increased uniformity in many aspects of sales taxes, the issues caused by varying nexus legislation must be solved. As Senator Jim DeMint argues, “[i]f states want to raise taxes they have the power to do so—yet only on citizens and businesses within their political jurisdiction.”³⁰⁷ He argues that democracy requires that “[t]he nexus among Americans, their taxes, and their votes must remain as tight as possible.”³⁰⁸

Therefore, the SSUTA should be amended to incorporate one specific nexus statute to be used by all states wishing to impose sales tax obligations on remote sellers.³⁰⁹ If that proves impossible, the SSUTA should provide directions, with as much specificity as possible, regarding which nexus statutes are to be used. In addition, if the effort continues through state action, the states should focus on increasing the number of SSUTA full member states to achieve a further uniform and simplified constitutional nexus scheme.

C. The Best Solution is for Congress to Solve the Nexus Problem, But Not with the Acts Currently Pending in Congress

While the SSUTA can be amended to provide for a more constitutional nexus scheme, the most effective measure to ensure all legislation is within constitutional bounds is congressional action. Given the power to regulate commerce and lacking any concern of burdening commerce, Congress is best situated to provide a nexus solution.³¹⁰ In fact, the Supreme Court advised that Congress is best suited to provide this solution.³¹¹ Although

compensation. Is the Quill nexus standard to be litigated over this continuing qualification controversy?”).

³⁰⁷ DeMint, *supra* note 173.

³⁰⁸ *Id.* (“Today’s origin-based sales tax system, which allows states to tax purchases made at any business within their borders, is fair.”).

³⁰⁹ That is: “To be part of this Agreement, each State must enact the *following* nexus statute:”

³¹⁰ See U.S. CONST. art. I, § 8, cl. 3 (“The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes”).

³¹¹ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992).

there are three bills currently pending in Congress,³¹² all three are inadequate because they lack any mention of the nexus problem or any uniformity effort. Instead of enacting any of these three bills, Congress should enact a law nullifying the antiquated “substantial nexus” standard. The concept “presence” is not what it used to be. Online marketing allows a business in any state to establish “presence” in the mind of consumers all over the nation.

To best solve the ongoing e-commerce nexus problem, Congress should act to permanently reject the entire concept of nexus as it applies to sales taxes. Instead of relying on state nexus laws, Congress should enact a law providing for: (1) a uniform, destination-based sourcing rule for all goods and services, (2) in the form of a tax credit, the MSFA “minimum required compensation” based on “the expenses incurred by sellers in administering, collecting, and remitting sales and use taxes,”³¹³ and (3) the MEA small seller exception providing for “[a]n exception for remote sellers with gross annual receipts in the preceding calendar year from remote sales of items, services, and other products in the United States not exceeding \$1,000,000 . . . or in the State not exceeding \$100,000 (or such greater amount as determined by the State).”³¹⁴ This scheme does not discriminate against interstate commerce, as brick and mortar stores conducting business online would be treated equally. Even though Congress can burden interstate commerce, this scheme does not impose too many practical burdens on interstate commerce because of the small seller exception and the “minimum required compensation” credit. This law should allow for states to opt in to the new scheme, so as not to commandeer the states in violation of the Constitution.³¹⁵ However, as part of its implementation of this

³¹² See Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); S. 1452, 112th Cong. (2011); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Marketplace Equity Act, H.R. 3179, 112th Cong. (2011).

³¹³ H.R. 2701, 112th Cong. § 6; S. 1452, 112th Cong. § 6.

³¹⁴ H.R. 3179, 112th Cong. § 2(b)(1). While the exception must at least cover those who are within the specified limits, a state is permitted to increase those limits. *Id.*

³¹⁵ See U.S. CONST. amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States, respectively, or to the people.”).

new overall scheme, Congress should invalidate the current unconstitutional state nexus laws as they pertain to sales tax collection.³¹⁶

CONCLUSION

The four approaches to state taxation of out-of-state sellers disregard the Supreme Court's "substantial nexus" and presence requirements and are thus unconstitutional. Further, the combination of the varying state nexus statutes result in an undue burden on businesses engaged in interstate commerce; therefore these statutes are unconstitutional. Many states are exceeding constitutional limits because "substantial nexus" is an antiquated standard. In today's world, the idea of "presence" is not what it used to be. Through the use of online marketing and websites, a business that is not "present" in a customer's state may *feel* more "present" to that customer than a business that is a short drive away. Clearly, there is a need for a modern sales tax collection scheme. While the SSUTA attempts to accomplish this feat, the agreement falls short of its goal and sidesteps the very core of the issue—the nexus problem. In the absence of congressional legislation the SSUTA should be amended to include a uniform nexus statute to reduce the burden on interstate commerce. However, the best-case scenario is for Congress to enact a law stating that all out-of-state sellers must collect and remit sales taxes for all states that opt in to this scheme. The bill should include a strong exception for small sellers and a tax credit for costs of compliance without any distinction between "volunteer sellers" and legally obligated sellers. Obviously, any distinction between "volunteer sellers" and legally obligated sellers will continue to provide a basis for nexus litigation. Such a bill would be constitutional because Congress has an enumerated power to

³¹⁶ See U.S. CONST. art. I, § 8, cl. 18 (granting Congress the power "[t]o make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the Government of the United States, or in any department or officer thereof.").

regulate interstate commerce, even if such regulation burdens interstate commerce.

The debate over nexus is no longer relevant. It is time for Congress to acknowledge the opportunity provided by the *Quill* Court and permanently reject the concept of nexus as it applies to sales tax collection obligations.