COMMENTS

A STATE'S WAY OF CIRCUMVENTING THE CONSTITUTION: THE UNCONSTITUTIONAL TAXATION OF OUT-OF-STATE CORPORATIONS THAT DO INSTATE BUSINESS OVER THE INTERNET

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I. INTRODUCTION

Along with new technology, such as the Internet, come complications with the application of the law. A state's ability to impose taxes on a transaction is no exception. Prior to the use of the Internet, when a sale occurred within a state, the sale physically occurred within the state lines; therefore it would be permissible for the State to impose sales and use taxes. However, now that the Internet allows for sales transactions by citizens over the Internet, states see a potential source of untapped revenue. States look to impose a sales tax on out-of-state Internet vendors, who would otherwise be untaxable due to their location outside of the state. The imposition of a sales tax on an out-of-state Internet vendor for sales transactions occurring with citizens of the state is unconstitutional on several levels.

Such a sales tax imposes a taxation without a sufficient nexus with the state, as was deemed required by the Supreme Court of the United States in *Quill Corp. v. North Dakota*.[1] Furthermore, in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*[2] the Supreme Court held that if an out-of-state businesses' only connection is soliciting sales and delivering orders through common carriers in the state, such is an insufficient presence in the state to meet the requirement of nexus.[3] A nexus can typically be established if an out-of-state business has independent contractors in a state, employees in the state, or property in the state.[4]

[1] 504 U.S. 298 (1992).

[2] 386 U.S. 753 (1967), *overruled in part by* Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

[3] *Id.* at 758–60.

[4] *See id.* at 764. For purposes of nexus, "property in a state" ranges from real

Without such a nexus, a state imposing a sales tax on a retailer violates the Commerce Clause.[5] When *Quill* was decided by the Supreme Court, the use of the Internet by a business for the purpose of expanding sales was in its infancy.[6] If a good or product was going to be sold in a state, the sale of such good would ordinarily be solicited by salesmen or women physically going into a state to solicit the sale of a product.[7] In modern business, it is commonplace for individuals to buy products from corporations and businesses online.[8] These Internet transactions can occur between a buyer in a state in which the company has no business ties besides the sole purchase of the buyer.[9] The juxtaposition between a buyer purchasing a product online and the state's ability to tax companies and businesses that have a physical presence in the state, creates a problem with respect to what is considered a "physical presence," which would create a nexus to satisfy the *Quill* standard.[10] Courts have interpreted the term 'physical presence' very differently. The interpretation of 'physical presence' is determinative. Without a definite physical presence in a state, an imposition of a sales tax by the State on an out-of-state vendor is a violation of the Commerce Clause under the United States Constitution.[11]

In order to avoid a debate with respect to whether or not a corporation is subject to sales tax, many online companies, such as Amazon, have set up subsidiary companies in many states which will ship goods to a certain state, but not actually sell them there, in effect avoiding a "physical presence" in that state. This is called "entity isolation."[12] To counteract this practice done

property, such as an office or manufacturing location, to inventory kept in the state. *See id.*; 2 RICHARD D. POMP, STATE & LOCAL TAXATION, at 9-1 to 9-2 (6th ed. 2009).

[5] *Quill*, 504 U.S. at 311–12.

[6] *See* Robert H. Zakon, *Hobbes' Internet Timeline*, ZAKON.ORG, http://www.zakon.org/robert/internet/timeline/#1990s (last updated Dec. 30, 2011) (indicating that it wasn't until 1993 that "[b]usinesses and media begin taking notice of the Internet.").

[7] *See Quill*, 504 U.S. at 306–07.

[8] Sydney Jones & Susannah Fox, *Generations Online in 2009*, PEW RES. CENTER PUBLICATIONS (Jan. 28, 2009), http://pewresearch.org/pubs/1093/generations-online.

[9] *See* discussion *infra* Part V.

[10] *Quill*, 504 U.S. at 311–12.

[11] *Id.* at 311–14.

[12] Michael R. Gordon, *Up the Amazon Without A Paddle: Examining Sales Taxes, Entity Isolation, and the "Affiliate Tax,"* 11 N.C. J.L. & TECH. 299, 306 (2010).

by many companies, especially online retailers, many states created an "affiliate tax," providing that "if a company makes a certain amount of money through an affiliate's presence in the state, it is deemed to have legal physical presence and is required to collect sales taxes."[13]

Imposing a sales tax on out-of-state corporations for transactions over the Internet also puts a burden on interstate commerce by discouraging out-of-state companies from wanting to do business with individuals within a state.[14] This burden also causes such a sales tax to violate the Commerce Clause.[15] Thus, states looking to tap into revenue for Internet transactions with out-of-state vendors by imposing a use tax will find their actions unconstitutional.[16] In order to successfully implement these use taxes the states would need personal information about the purchaser as well as their purchase, but such information is protected as private under the First Amendment.[17] Thus a state's requirement of access to this information would be a violation of the First Amendment. If states are going to try to enact revenue from their citizens' purchases over the Internet from out-of-state vendors, such as Amazon, they are going to be in violation of both the Commerce Clause and the First Amendment.

II. COMMERCE CLAUSE: HISTORY

Originally, the Supreme Court of the United States adopted a broad interpretation of the contours of the Commerce Clause.[18] The original standard being that "no State has the right to lay a tax on interstate commerce in any form."[19] The practical effect of this standard was an absolute bar on a state's ability to impose a sales and use tax on an out-of-state retailer.[20] Eventually, the Supreme Court lowered this standard to allow a state more deference in the imposition of a sales tax on an out-of-state

[13] *Id.* at 299.
[14] *See* discussion *infra* Parts VII, VIII.
[15] *See* discussion *infra* Part VII.
[16] *See* discussion *infra* Part VIII.
[17] *See* discussion *infra* Parts VIII, IX.
[18] Daniel Tyler Cowan, Recent Development, *New York's Unconstitutional Tax on the Internet: Amazon.com v. New York State Department of Taxation & Finance and the Dormant Commerce Clause*, 88 N.C. L. REV. 1423, 1427 (2010).
[19] Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888), *abrogation recognized by* Quill Corp. v. North Dakota, 504 U.S. 298 (1992).
[20] Cowan, *supra* note 18, at 1427.

vendor.[21] In conjunction, the holdings in *Quill* and *National Bellas Hess* created the standard that out-of-state vendors could be "subject to a sales and use tax if they have a substantial nexus with the taxing state [because] 'a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause.'"[22]

III. COMMERCE CLAUSE: CURRENT STANDARD

The current standard under the Commerce Clause, with respect to a state's ability to impose a sales tax on out-of-state venders, was established by the U.S. Supreme Court in the 1992 case *Quill Corp. v. North Dakota.* In *Quill*, North Dakota imposed a sales tax on an out-of-state mail-order retailer.[23] Justice Stevens held, with respect to the Due Process Clause, it was not required that a business have physical presence within the state for it to constitutionally require a business to collect use tax from its in-state customers.[24] He also held that under the Commerce Clause, it is required that such an out-of-state business have a physical presence in a state for a use tax to be effective.[25] Without this "physical presence," there is no "substantial nexus," which is required by the Commerce Clause.[26] Basically "a State cannot require an out-of-state retailer to collect and remit a use tax unless the retailer has a 'substantial nexus' with the taxing state."[27] When the court applied this rule to the facts in the *Quill* case they found that the imposition of a sales tax was invalid and violative of the Commerce Clause under the U.S. Constitution.[28] In coming to this conclusion, the court relied heavily on its decision in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*.[29] In *Quill,* the court held that "a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."[30] This holding, in effect, reaffirmed the requirement that there be some physical presence in a State for

[21] *Quill*, 504 U.S. at 309–11.
[22] Cowan, *supra* note 18, at 1427 (quoting *id.* at 311).
[23] *Quill*, 504 U.S. at 301–02.
[24] *Id.* at 304–07.
[25] *Id.* at 311–15.
[26] *Id.*
[27] Cowan, *supra* note 18, at 1424.
[28] *Id.*
[29] *Quill*, 504 U.S. at 311–15.
[30] *Id.*

an imposition of a sales tax.[31]

IV. COMMERCE CLAUSE: IMPOSITION OF SALES & USE TAX ON OUT-OF-STATE INTERNET VENDORS

The application of the substantial nexus test created in the *Quill* case to sales and purchases over the Internet is troublesome for states.[32] Internet vendors, by means of conducting business over the Internet, have the ability to conduct consumer transactions with individuals of every state.[33] However, these corporate vendors, who do business over the Internet, will only have their headquarters and workforce, that is, a "physical presence," in a few states.[34] Excluding the states in which a business or corporation has some type of domicile or residency, states are unable to establish a physical presence and thus fail to create a "substantial nexus" between the state and the out-of-state vendor.[35]

In an effort to circumvent the bar to taxing sales from out-of-state Internet vendors, states will impose use taxes on their residents.[36] Yet, the imposition of a use tax on a state's residents generally is not an effective remedy, as most citizens do not claim their out-of-state purchases on their tax returns; the effect of this is that the states lose revenue from the Internet purchases of their residents.[37] Some states, in an effort to obtain this lost revenue, try to statutorily bypass the substantial nexus requirement as applied to Internet vendors.[38] New York was one of the first states to do this,[39] the result of which was the case

[31] *Id.*; Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967), *overruled in part by Quill*, 504 U.S. 298; Cowan, *supra* note 18, at 1424.

[32] Cowan, *supra* note 18, at 1428.

[33] *Id.*

[34] *Id.*

[35] *Id.* (citing Wendy Trahan, Note, *The Future of Sales and Use Tax on Electronic Commerce: Promoting Uniformity After Quill*, 21 VA. TAX REV. 101, 107 (2001); Seth Cooper & Jonathan Williams, *An Unconstitutional Interstate Sales Tax,* FORBES (May 14, 2008, 6:00 AM), http://www.forbes.com/2008/05/13/amazonlaw-states-rights-oped-cx_scjw_0514amazonlaw.html).

[36] N.C. GEN. STAT. ANN. §§ 105-164.6(b), -164.16(d) (West 2012).

[37] Cowan, *supra* note 18, at 1428 (citing Megan E. Groves, Note, *Where There's a Will, There's a Way: State Sales and Use Taxation of Electronic Commerce,* 74 IND. L.J. 293, 310 (1998); John C. Blase & John W. Westmoreland, *Quill Has Been Plucked! MTC States Are Slowly Eroding the Substantial Nexus Standard*, 73 N.D. L. REV. 685, 685 (1997)).

[38] Cowan, *supra* note 18, at 1429.

[39] N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012); *id.* A statutory imposition of a sales tax on an out-of-state Internet vendor is commonly referred to as an

Amazon.com LLC v. New York State Department of Taxation & Finance.[40] Furthermore, by 2010 "no fewer than sixteen other states either have considered passing or have passed the so-called Amazon tax."[41] It is debatable whether the standard furthered by the U.S. Supreme Court in the *Quill* case is applicable to sales transactions done over the Internet. The states have used this gray area as a rationale for imposing a sales tax on out-of-state Internet vendors.[42] However, this practice raises constitutional issues with respect to the Commerce Clause and the First Amendment.[43]

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

In an effort to establish the validity of a sales tax on Amazon, New York State claimed that solicitation by in-state "Associates" under Amazon's "Associates Program" created a substantial connection with New York State within the meaning of the standard furthered in *Quill*.[44] When hearing the case, the New York trial court failed to properly apply the *Quill* standard, consequently upholding the tax as valid.[45] But, if the proper

"Amazon Tax." This namesake comes from the original New York case, *Amazon.com LLC v. N. Y. State Department of Taxation & Finance*.

[40] 877 N.Y.S.2d 842 (Sup. Ct., N.Y. County 2009), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dept. 2010).

[41] Cowan, *supra* note 18, at 1429 (citations omitted).

[42] *See e.g.* N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012) (discussing how New York's statutory scheme is geared at several presumptions of contact or nexus within the state, which is making use of a gray area between the Supreme Court's guidance and the wishes of the states to have a fair taxation between in-state vendors and out-of- state commercial entities).

[43] *See* Amazon.com LLC v. Lay, 758 F. Supp. 2d 1154, 1160 (W.D. Wash. 2010) (referring to privacy laws related to certain provisions of the tax code as a constitutional issue and an issue of federal privacy laws); *Amazon.com LLC*, 877 N.Y.S.2d at 844–46.

[44] *Amazon.com LLC*, 877 N.Y.S.2d at 845–46 ([The Amazon] "Associates Program," . . . allows participants ("Associates") to maintain links to Amazon.com on their own websites and compensates them by paying 'a percentage of the proceeds of the sale.' Amazon also offers incentives to Associates that 'directly refer' customers to its Amazon Prime program through website links, paying them a '$12 bounty' for each new enrollee.) (internal citations omitted); Quill Corp. v. North Dakota, 504 U.S. 298, 311–15, 317 (1992).

[45] *Amazon.com LLC*, 877 N.Y.S.2d at 848–49 ("There is nothing infirm about [the New York taxation statue, which] . . . requires 'demonstrably more than a 'slightest presence" and obligates collection of taxes based on economic activities in New York performed by the vendor's personnel or on its behalf.") (citing Matter of Orvis Co. v Tax Appeals Trib. of State of N.Y., 654 N.E.2d 954 (N.Y.

standard was applied, the tax should have been deemed in violation of the Commerce Clause.

In this case, Amazon did not own any property in New York, nor did Amazon have any offices in New York, and Amazon did not have any employees that either worked or resided in New York.[46] However, "[o]n April 23, 2008, Governor Paterson signed into law N.Y. Tax Law §1101(b)(8)(vi)."[47] The statute reads:

> A person making sales of tangible personal property or services taxable under this article ("seller") shall be presumed to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller, if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods . . . . This presumption may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question.[48]

So, the New York Law will apply and create a substantial nexus "to retailers that have affiliates residing in the state, provided that a retailer's cumulative gross receipts from all sales to customers in the state referred by all such affiliates exceed $10,000 for the preceding four quarterly sales-tax reporting periods."[49] Pursuant to this law, New York State imposed a sales tax on Amazon.[50] In reaction, Amazon brought a lawsuit against New York State citing that the New York statute was in violation of both the Due Process Clause and the Commerce Clause of the U.S. Constitution.[51] After this lawsuit was initiated, the New York State Department of Taxation and Finance issued two

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1995)); *infra* Part VI.

[46] *Id.* at 844–45.

[47] *Id.* at 846.

[48] N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012).

[49] Scott M. Susko & Lucia Cucu, *State and Local Government's Turn to Online Business for Tax Revenue in an Attempt to Remedy Budget Shortfalls,* J. MULTISTATE TAX'N & INCENTIVES. Sept. 2009, at 13, 16.

[50] *Amazon.com, LLC*, 877 N.Y.S.2d at 846.

[51] *Id.* at 842.

memoranda.[52] In the first memoranda, the Department of Taxation and Finance furthered "that the statute applied to sellers, including e-commerce retailers, which 'solicit business within the state through employees, independent contractors, agents or other representatives and, by reason thereof, make sales' to New York Residents of taxable property or services."[53] This memorandum also included six examples of the types of transactions that would fall under the statute, and thus be subject to a sales tax.[54] Within the examples given in the first memorandum, "example 4" specifically touched on the issue of consumer transactions done by out-of-state businesses with a resident and their subsequent liability to sales tax, stating:

> [T]he statutory presumption would only be triggered by commission-based referral agreements, as opposed to flat-fee agreements. The memorandum further explained that the presumption that solicitation had occurred could be rebutted if the seller established that 'the only activity' of its in-state representatives consisted of the placement of Internet links connecting their Web sites to the out-of-state seller's Web site, i.e., advertisers only, and that "none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the seller." Thus, more than a mere pass-through 'click' on the Internet was required to impose tax collection responsibilities on the out-of-state sellers. The in-state contractor actually has to engage affirmatively in customer solicitation before the out-of-state vendor becomes subject to the statute.[55]

On June 30, 2008, the New York State Department of Taxation and Finance followed up their first memorandum with a second memorandum, which created a "safe harbor" procedure.[56] Under

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[52] *See* Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129, 133 (App. Div., 1st Dep't 2010) (noting the timing of the issuance of the department's memos).

[53] *Amazon.com, LLC*, 913 N.Y.S.2d at 133 (quoting N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, TSB-M-08(3)S, NEW PRESUMPTION APPLICABLE TO DEFINITION OF SALES TAX VENDOR (2008), *available at* http://www.tax.ny.gov/pdf/memos/sales/m08_3s.pdf).

[54] *Amazon.com, LLC*, 913 N.Y.S.2d at 133; N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, TSB-M-08(3)S, NEW PRESUMPTION APPLICABLE TO DEFINITION OF SALES TAX VENDOR (2008), *available at* http://www.tax.ny.gov/pdf/memos/sales/m08_3s.pdf.

[55] *Amazon.com, LLC*, 913 N.Y.S.2d at 133 (quoting N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, TSB-M-08(3)S, NEW PRESUMPTION APPLICABLE TO DEFINITION OF SALES TAX VENDOR (2008), *available at* http://www.tax.ny.gov/pdf/memos/sales/m08_3s.pdf).

[56] *Amazon.com, LLC*, 913 N.Y.S.2d at 133; N.Y. STATE DEP'T OF TAXATION AND

this "safe harbor" procedure, businesses have the ability to overcome the presumption that they are subject to the tax, by including a provision in any

> business-referral agreement[] . . . prohibiting their in-state representatives from "engaging in any solicitation activities in New York State that refer potential customers to the seller," and requiring each in-state representative to submit a signed certification every year, stating that it has not engaged in any such solicitation during the prior year.[57]

VI. APPLICATION OF THE COMMERCE CLAUSE TO THE DECISION IN *AMAZON.COM LLC V. NEW YORK STATE DEPARTMENT OF TAXATION & FINANCE*: INSUFFICIENT NEXUS

When Amazon brought suit against the New York State Department of Taxation and Finance, the corporation argued that the New York statute violated the Dormant Commerce Clause both on its face and as applied.[58] The New York court held against Amazon and upheld the New York statute.[59] In coming to this holding, the court relied heavily on the 1960 case *Scripto, Inc. v. Carson*[60] and the 1995 New York case *Matter of Orvis Company v. Tax Appeals Tribunal of the State of New York*.[61] The New York court, however, minimized the application and importance of the Supreme Court precedent in the *Quill* case.[62] Yet, the rule in *Quill* is directly applicable to situations involving an out-of-state business selling their product over the Internet to in-state residents.[63]

FIN., OFFICE OF TAX POLICY ANALYSIS, TSB-M-08(3.1)S, ADDITIONAL INFORMATION ON HOW SELLERS MAY REBUT THE NEW PRESUMPTION APPLICABLE TO THE DEFINITION OF SALES TAX VENDOR AS DESCRIBED IN TSB-M-08(3)S (2008), *available at* http://www.tax.ny.gov/pdf/memos/sales/m08_3_1s.pdf.

[57] *Amazon.com, LLC*, 913 N.Y.S.2d at 133 (quoting N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, TSB-M-08(3.1)S, ADDITIONAL INFORMATION ON HOW SELLERS MAY REBUT THE NEW PRESUMPTION APPLICABLE TO THE DEFINITION OF SALES TAX VENDOR AS DESCRIBED IN TSB-M-08(3)S (2008), *available at* http://www.tax.ny.gov/pdf/memos/sales/m08_3_1s.pdf).

[58] Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842, 846, 848 (Sup. Ct., N.Y. County 2009), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010).

[59] *Id.* at 848.

[60] 362 U.S. 207 (1960).

[61] 654 N.E.2d 954 (N.Y. 1995).

[62] *See Amazon.com, LLC*, 877 N.Y.S.2d at 847; Quill Corp. v. North Dakota, 504 U.S. 298, 311–15 (1992).

[63] *Quill*, 504 U.S. at 301–02.

Under the holding in *Quill*, the Supreme Court held that there is no substantial nexus "between a retailer and a state when the retailer's only connection with the state is by mail or common carrier."[64] The *Quill* court further explained that physical presence is required, and such presence must be in the form of a "small sales force, plant, or office."[65] In the *Amazon* case, the New York court chose to not rely on the Supreme Court ruling in *Quill*, but rather focused on *Scripto* and *Orvis*. The two latter cases impose a different, less strict, requirement with respect to establishing a substantial nexus by a physical presence in the state.[66] The standard derived from those cases is that a substantial presence in the state is not necessary to establish nexus, but more is needed than a "slight presence."[67] However, physical presence "can be actual or imputed based on the in-state solicitation of sales by an employee, agent, or independent contractor of the retailer on its behalf."[68] Based on this rationale, the New York court held that Amazon had "independent contractors," thus, a sufficient nexus with New York State.[69]

However, in practice, Amazon's associates acted more as advisors than independent contractors.[70] The associates of Amazon were "independent third parties . . . only in the business of generating their own content and displaying it on their own websites, while also publishing electronic advertisements for Amazon and other Internet retailers."[71] Furthermore, once the buyer clicks on the Amazon link, "the affiliate has no further connection with or knowledge of the communications between the potential customer and Amazon concerning a transaction or its fulfillment. The affiliate also has no ability to insert itself in the sales transaction and influence the customer to make a purchase."[72] The process of how a purchase from Amazon works

64 Cowan, *supra* note 18, at 1436 (citing *Quill Corp*, 504 U.S. at 311).

65 *Id.* (quoting *Quill*, 504 U.S. at 315).

66 *See* Cowan, *supra* note 18, at 1436–37.

67 Matter of Orvis Co. v Tax Appeals Trib. of State of N.Y., 654 N.E.2d 954, 966 (N.Y. 1995).

68 Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842, 846, 848 (Sup. Ct., N.Y. County 2009) (citation omitted), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010); Cowan, *supra* note 18, 1436–37.

69 *Amazon.com, LLC*, 877 N.Y.S.2d at 845, 851.

70 Cowan, *supra* note 18, at 1438.

71 Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants at 16, Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010) (No. 601247/08); *id.*

72 Brief of Amicus Curiae Performance Marketing Alliance in Support of

is as follows: "Amazon and the consumer enter into a transaction; Amazon receives payment from the consumer; Amazon ships the product to the consumer—it is only after the transaction is completed that the associate receives payment for the 'click through.'"[73] Essentially, the actual sale of the product involves Amazon and the buyer, separate and apart from the associate. In light of this disconnect between the associate and Amazon's meaningful role in the actual sale of the good, qualifying such associate as an independent contractor would be misplaced and inappropriate.

If the New York court had acknowledged this fact they would have then relied on the *Quill* decision, instead of primarily deciding the case based on the *Scripto* and *Orvis* decisions, as they did.[74] In relying on the *Quill* decision, along with the information of the nature of Amazon's associate program, the New York court would have been inclined to hold "that a substantial nexus does not exist between Amazon and New York."[75]

VII. NEW YORK STATUTE DISCRIMINATES AGAINST INTERSTATE COMMERCE & EQUATES TO A VIOLATION OF THE DORMANT COMMERCE CLAUSE

Besides the lack of nexus between Amazon and New York State, the New York statute is violative of the Dormant Commerce Clause, because it discriminates against interstate commerce. The basic standard for determining if a state tax law violates the Dormant Commerce Clause is that "[a] tax that by its terms or operation imposes greater burdens on out-of-state goods, activities, or enterprises than on competing in-state goods, activities, or enterprises will be struck down as discriminatory under the Commerce Clause."[76] Commerce Clause jurisprudence is very dense and a law can fail because it is either

Plaintiffs-Appellants at 16 Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010) (No. 601247/08); Cowan, *supra* note 18, at 1438.

[73] Cowan, *supra* note 18, at 1438–39 (citing Brief of Amicus Curiae Performance Marketing Alliance in Support of Plaintiffs-Appellants at 12 Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010) (No. 601247/08).

[74] *See supra* notes 63–69 and accompanying text.

[75] Cowan, *supra* note 18, at 1438 (citing Quill Corp. v. North Dakota, 504 U.S. 298 at 313 & n.6 (1992).

[76] WALTER HELLERSTEIN, STATE TAXATION ¶ 4.14 (3d ed. 2011).

discriminatory on its face or discriminatory in its effect.[77]

In *Amazon*, the corporation argued that the use tax violated the Dormant Commerce Clause both on its face and in its effect when applied.[78] On this ground, the New York court failed to find the tax violative, and again this analysis was flawed.[79] In regard to the first charge of facial invalidity, the New York court's holding that the law may seem appropriate depending on the analysis applied, but if a state statute is found to discriminate on its face, the Supreme Court imposes a "per se rule of invalidity,"[80] and such a statute must be struck down as in violation of the Commerce Clause.[81] The Court has interpreted "facial discrimination" both broadly and narrowly.[82]

If the analysis is looked at narrowly, discrimination is determined by "looking at the terms of the statute and nothing else, including how people are likely to behave or how commerce is likely to be carried on."[83] By just looking at the New York statute, it is not apparent that it favors in-state businesses and corporations over out-of-state corporations.[84] New York State is not imposing a sales tax on out-of-state businesses that resident businesses are not subject to.[85] If construed narrowly, Amazon would not be able to argue that the statute discriminated on its face.

A broader analysis, as was used in the case *South Central Bell Telephone Co. v. Alabama,*[86] would allow for a statute to be held

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[77] *Id.* at ¶ 4.14[1][a], [b].

[78] Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842, 846 (Sup. Ct., N.Y. County 2009) (citation omitted), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010).

[79] *See id.* at 850. Notably, the Appellate Division, on appeal did not find the trial court's reasoning sufficient. 913 N.Y.S.2d 129 at 203 ("Inasmuch as there has been limited, if non-existent, discovery on [the issue of an as-applied violation of the Commerce Clause] we are unable to conclude as a matter of law that plaintiffs' in-state representatives are engaged in sufficiently meaningful activity so as to implicate the State's taxing powers, and thus find that they should be given the opportunity to develop a record which establishes, actually, rather than theoretically, whether their in-state representatives are soliciting business or merely advertising on their behalf.").

[80] Chem. Waste Mgmt., Inc. v. Hunt, 504 U.S. 334, 344 n.6 (1992) (quoting Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)).

[81] HELLERSTEIN, *supra* note 76, at ¶ 4.14[1][a].

[82] *See id.*

[83] *Id.;* Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 575–76 (1997).

[84] *See* N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012).

[85] *Id.*

[86] 526 U.S. 160 (1999).

discriminatory on its face, even when knowledge or assumptions outside the text of the statute itself are needed to determine that the statute is discriminatory.[87] Under such an analysis the New York statute would a burden interstate commerce, thus be invalid. Every state has the ability to impose a sales tax on resident businesses.[88] This is common knowledge among the legislatures who are drafting the tax laws.[89] The implication of New York State taxing Amazon, a Washington based company, is that both New York and Washington are imposing a sales tax on Amazon.[90] Thus, in-state corporations and businesses are only being subjected to one sales tax on their consumer transactions, while out-of-state business or corporations, such as Amazon, are being subjected to double taxation for taking part in the same business transactions. This scenario imposes a greater burden on out-of-state goods and businesses than on those goods sold in-state by in-state businesses and corporations thus is a discriminatory burden under the dormant commerce clause.[91]

Yet, regardless of whether a court chose to interpret the statute's prime facie implication narrowly or broadly, the New York statute would violate the Dormant Commerce Clause by reason of its effect.[92] A State that imposes a tax that discriminates in its "practical effect against interstate commerce are as offensive to the Commerce Clause as are taxes that explicitly discriminate against such commerce."[93] So there is no difference between the constitutional invalidity of a statute that violates the Commerce Clause on its face as opposed one that does so in its practical effect. Furthermore, in the U.S. Supreme Court case, *Best & Co. v. Maxwell*[94] the Court found that "[t]he commerce clause forbids discrimination, whether forthright or ingenious."[95] The *Best* Court then went on to state that "[i]n each case it is our duty to determine whether the statute under attack

[87] HELLERSTEIN, *supra* note 76, at ¶ 4.14[1][a] (citing S. Cent. Bell Tel. Co. v. Alabama, 526 U.S. 160, 169 (1999)).

[88] *See* ADELMAN KATZ & MOND LLP, ANALYSIS: NEXUS AND THE STATES' JURISDICTIONAL RIGHT TO TAX 5, *available at* http://akmcpa.com/Bulletins/AKM%20Nexus%20Report.pdf.

[89] *See id.*

[90] N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012); WASH. REV. CODE ANN. § 82.08.050 (West 2012).

[91] HELLERSTEIN, *supra* note 76, at ¶ 4.14.

[92] *Id.* at ¶ 4.14[1][b].

[93] *Id.*

[94] 311 U.S. 454 (1940).

[95] *Id.* at 455.

. . . will in its practical operation work discrimination against interstate commerce."[96]

With respect to the New York statute, the practical effect it has to impose a double taxation on out-of-state businesses and corporations that in-state corporations and businesses are not subject to for the sale consumer transactions,[97] is in direct violation of the Dormant Commerce Clause.

VIII. FOR A STATE TO PUT A SALES TAX ON AN OUT-OF-STATE RETAILER THAT HAS NO PHYSICAL PRESENCE IN THE STATE IS A BURDEN ON INTERSTATE COMMERCE

Recently, a similar issue came to the attention of the U.S. District Court for the Western District of Washington.[98] In *Amazon.com, LLC v. Lay*,[99] North Carolina wanted to impose a sales tax on Amazon, related to their sales to residents within the state.[100] Amazon, as a corporation, is very protective of the fact that they are solely located in the State of Washington.[101] Amazon is also very stern on the principle that if a corporation or business does not have the required nexus, such business or corporation does not have the responsibility of collecting and paying sales or use tax in a foreign state.[102] The way a use tax works is that rather than placing the tax on the vendor or retailer, a tax is placed on the consumer.[103] The mechanics of a use tax are that a consumer pays the use tax on the day they buy

[96] *Id.* at 455–56.

[97] Washington State will impose a sales tax on Amazon's sales because Amazon is a Washington based company. *See* WASH. REV. CODE ANN. § 82.08.050 (West 2012). New York imposing an additional tax on Amazon's sales would cause for Amazon to be taxed twice on the same sales that when done by an in-state New York business or company would only be taxed once. *See* N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2012).

[98] Amazon.com, LLC v. Lay, 758 F. Supp. 2d 1154 (W.D. Wash. 2010).

[99] 758 F. Supp. 2d 1154 (W.D. Wash. 2010).

[100] *Id.* at 1158.

[101] *See id.* at 1160 (arguing that the Washington State Constitution is protective of the identities of its customers' purchases, and that North Carolina should be required to apply the Washington Constitution).

[102] *See* Amazon.com, LLC v. N.Y. State Dep't of Taxation and Fin., 877 N.Y.S.2d 842, 848–49 (Sup. Ct., N.Y. County 2009) (elaborating on Amazon's argument, as Amazon was not located in New York State and had not established a sufficient nexus within the State, they could not be taxed within New York), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010).

[103] *See* 1 RICHARD D. POMP & OLIVER OLDMAN, STATE & LOCAL TAXATION at 6-33 (5th ed. 2005) ("Use taxes are typically levied upon the use, storage, or consumption of tangible personal property within the state . . . .").

the good or product, or the consumer pays the tax at the end of the year on their personal income tax return.[104] The problem is that consumers do not actually follow this practice, that is, they generally fail to actually claim everything they have bought during the year on their personal income tax return.[105]

However, when the state does their audit, this practice shows to be extremely burdensome. It would be both administratively and financially difficult to hunt down every individual that makes a purchase within the state and then inquire into their purchases over the year, and in this situation, what the consumer bought from Amazon.[106] These administrative and financial difficulties were the foundation of North Carolina's objective to put the tax on Amazon, rather than the consumer.[107] North Carolina bases its ability to tax Amazon on the premise that since Amazon hired someone in North Carolina to help with their website, they had an agent in the state.[108] North Carolina would then presumably argue that New York's interpretation of the *Quill* standard is valid.[109] Pursuant to such interpretation, North Carolina would presumably claim that having an agent in the state would be a sufficient nexus for the State to impose a sales tax on Amazon. Yet, even if a court did accept this argument, that there is sufficient nexus with Amazon for North Carolina to impose a sales tax, such a tax would burden interstate commerce.

When a state collects a tax it does so on the premise that the revenue collected from such tax will be used for the benefit of those being taxed.[110] Due to the fact that Amazon has no actual presence in the state, nor does the corporation use the services provided by the State of North Carolina, Amazon would argue

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[104] *Id.* at 6-33, 6-35.

[105] *See id.* at 6-35.

[106] *Id.* at 6-33 to 6-35.

[107] *See* Amazon.com, LLC v. Lay, 758 F. Supp. 2d 1154, 1158–60 (W.D. Wash. 2010) (noting the materials and information that North Carolina required from Amazon).

[108] N.C. GEN. STAT. ANN § 105-164.8(b)(3) (West 2012); Scott W. Gaylord & Andrew J. Haile, *Constitutional Threats in the E-Commerce Jungle: First Amendment and Dormant Commerce Clause Limits on Amazon Laws and Use Tax Reporting Statutes*, 89 N.C. L. REV. 2011, 2031 (2011).

[109] *See* Amazon.com, LLC v. N.Y. State Dep't of Taxation & Fin., 877 N.Y.S.2d 842 (Sup. Ct., N.Y. County 2009), *aff'd as modified* 913 N.Y.S.2d 129 (App. Div., 1st Dep't 2010).

[110] *See id.* at 848 (explaining that New York's statute makes clear that they are intending to tax companies, such as Amazon, who derive a benefit from their state).

that it is being taxed without receiving any benefit.[111] Yet, the State of North Carolina, would argue that Amazon does receive a benefit from the tax in the form of having an organized society. Moreover, North Carolina would likely make an "economic nexus" argument. When arguing for an economic nexus, North Carolina would contend that Amazon is exploiting the market place in North Carolina from their sales in the state and thus, North Carolina should share in their profits.[112]

However, the *effect* of an imposition of a sales tax on Amazon, without a presence in the state, would make the sales tax a violation of the Commerce Clause.[113] In the case *Fulton Corp. v. Faulkner*,[114] the Supreme Court held that, "[a] regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage . . . corporations from plying their trades in interstate commerce."[115] Here, the effect of a sales tax on Amazon would violate the Commerce Clause because such a tax will discourage other out-of-state businesses from selling products to people or businesses in North Carolina.[116]

North Carolina also gave attention to imposing a use tax on those who purchased goods from Amazon over the Internet.[117] In pursuance of issuing their use tax, North Carolina demanded that Amazon give them their customer list, so that the state was able to make sure they are able to tax all of their residents that purchased goods from Amazon.[118]

Customer lists are very valuable to a business, and Amazon was not willing to hand over their customer lists for business reasons.[119] There are important privacy issues implicated when the North Carolina Department of Revenue requested the

111 *See id.* at 847–48.

112 *See id.* at 846–48.

113 Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 578 (1997).

114 516 U.S. 325 (1996).

115 *Id.* at 333.

116 Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521–22 (1935).

117 *See* Amazon.com LLC v. Lay, 758 F. Supp. 2d 1154, 1158–60 (W.D. Wash. 2010) (explaining how North Carolina sought billing information of North Carolina residents from Amazon).

118 *See id.*

119 *Id.* at 1158–61.

personal information of the consumers of Amazon.[120] However, if Amazon had to give the North Carolina Department of Revenue the names, addresses, and purchases of its consumers, Amazon could also be giving away very private information. For instance, if someone bought something very private from Amazon, such as a pornographic tape, they would get a letter from the North Carolina Department of Revenue listing the product and informing the individual that they were being taxed for the product. Purchasing a pornographic tape is presumably a purchase that the majority of people would like to keep private; the knowledge that this would be public information would discourage a purchaser from buying pornography from Amazon.

North Carolina, realizing the privacy issues implicated by such a taxing system, then instead requested that Amazon give North Carolina a list of every person's purchase.[121] Rather than listing the exact purchase item, the North Carolina Department of Revenue requested that Amazon list a general categorical description such as, clothing, shoes, kitchen, etcetera, and under such description send information of the purchase to the North Carolina Department of Revenue.[122] However, this categorical description system suggested by the North Carolina Department of Revenue would place too much of a burden on Amazon. Amazon would effectively be forced to create a whole new department to determine the characterization of all of the thousands of products it sold online.[123] Furthermore, a whole new system would have to be created to determine how the items would even be characterized.[124] This would be a huge administrative and financial burden on Amazon. Having to create such a system, just in order to sell products to North Carolina consumers, would be a huge disincentive, not only for Amazon to continue business in North Carolina, but also to similarly situated corporations. This discouragement to companies that do not have a presence in North Carolina from selling their products to people in North Carolina creates a massive burden on instate commerce, and in effect violates the

120 *See id.* at 1162.

121 *Id.* at 1159.

122 *Id.*

123 Gaylord & Haile, *supra* note 108, at 2079–83 (addressing the argument that reporting requirements place a burden on interstate commerce).

124 *See id.* at 2090–91 (demonstrating the difficulty posed by categorizing Amazon products).

Commerce Clause.

Therefore, every method suggested by the North Carolina Department of Revenue to acquire the customer lists with the private information of the customers of Amazon is in violation of the Commerce Clause.

IX. THE DEPARTMENT OF REVENUE'S REQUEST FOR ALL INFORMATION RELATED TO AMAZON'S SALES TO NORTH CAROLINA RESIDENT'S VIOLATES THE FIRST AMENDMENT

A buyer has protection under the First Amendment "from having the expressive content [in their] purchases of books, music, and audiovisual materials disclosed to the government," and they are allowed to receive such information anonymously.[125] For example, in *McIntyre v. Ohio Elections Commission*,[126] when discussing handbills, the Supreme Court held that anonymity "exemplifies the purpose behind the Bill of Rights, and of the First Amendment in particular."[127]

Furthermore, allowing the North Carolina Department to obtain the personal information regarding the purchases of its customers would create a chilling effect on the First Amendment.[128] There has always been a "fear of government tracking and censoring one's reading, listening, and viewing choices," and such a measure by the North Carolina Department of Revenue would fall within the contours of this fear.[129] Justice Douglas, in a concurring opinion in *United States v. Rumely*,[130] pronounced that when the government is able to get involved with the reading habits of the citizens, "[s]ome will fear to read what is unpopular what the powers-that-be dislike. When the light of publicity may reach any student, any teacher, inquiry will be discouraged."[131] Although, a limitation on the reading materials of its citizens is not the objective of the North Carolina Department of Revenue, such might be the effect.

In limited situations the government may gain access into the private matters of its citizens, related to their reading, listening,

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125 *Amazon.com*, 758 F. Supp. 2d at 1167.

126 514 U.S. 334 (1995).

127 *Id.* at 357; *see also* Talley v. California, 362 U.S. 60, 64–65 (1960) (protecting anonymity in handing out campaign literature).

128 *Amazon.com*, 758 F. Supp. 2d at 1168.

129 *Id.*

130 345 U.S. 41 (1953).

131 *Id.* at 57 (Douglas, J., concurring).

and viewing habits.[132] As the district court in *Amazon* referenced, the government is able to do so when they demonstrate that their actions were motivated by a compelling governmental interest.[133] In *In re Grand Jury Subpoena to Amazon.com Dated August 7, 2006*,[134] which was a federal tax evasion case, a grand jury issued a subpoena requesting the "identities of a representative sample of . . . buyers."[135] In this case, the court found that the government was not entitled to access the buyers' identification.[136] The court found that the subpoena was problematic because:

> [I]t permits the government to peek into the reading habits of specific individuals without their prior knowledge or permission. True, neither the government nor the grand jury is directly interested in the actual titles or content of the books that people bought, and I have enormous trust in the prosecutors and agents handling this investigation, with whom this court has worked many times before. But it is an unsettling and un-American scenario to envision federal agents nosing through the reading lists of law-abiding citizens while hunting for evidence against somebody else. In this era of public apprehension about the scope of the USAPATRIOT Act, the FBI's (now-retired) "Carnivore" Internet search program, and more recent highly-publicized admissions about political litmus tests at the Department of Justice, rational book buyers would have a non-speculative basis to fear that federal prosecutors and law enforcement agents have a secondary political agenda that could come into play when an opportunity presented itself. Undoubtedly a measurable percentage of people who draw such conclusions would abandon online book purchases in order to avoid the possibility of ending up on some sort of perceived "enemies list."[137]

Here, the governmental interest was related to resolving a federal tax evasion and mail wire fraud, and the court found that this interest was not compelling enough to allow the government to obtain the personal information related to the buyers' identification.[138] Surely, if the government was prohibited from

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[132] *Amazon.com*, 758 F. Supp. 2d at 1168–69.

[133] *Id. See also* McIntyre v. Ohio Elections Comm'n, 514 U.S. 334, 348–350 (1995) (stating that preventing fraudulent or libelous statements is a compelling state interest).

[134] 246 F.R.D. 570 (W.D. Wis. 2007).

[135] *Id.* at 571.

[136] *Id.* at 573.

[137] *Id.* at 571–73.

[138] *Id.* at 571–73.

accessing personal information on First Amendment grounds in the face of tax evasion and fraud, a state government's interest in closing their tax gap would also fail the compelling interest test.[139]

The type of censoring that allowing the North Carolina Department of Revenue to obtain from Amazon would create the exact chilling effect that the First Amendment is aimed to protect. Individuals would feel limited to freely purchase the books, videos, and other materials that they otherwise would purchase. Moreover, if the North Carolina Department of Revenue was able to gain information to impose a use tax on its citizens that buy products from Amazon, there would be nothing stopping the North Carolina Department of Revenue from collecting such information from all online out-of-state vendors. Furthermore, allowing the North Carolina Department of Taxation to gain such information, would encourage other states to enact a similar system to raise their revenue. Coupled together, the result would be a mass chilling effect on our citizen's First Amendment rights to privacy in their reading, listening, and viewing habits.

X. CONCLUSION

The Internet has caused many new challenges in its application to our traditional constitutional law jurisprudence; with the taxation on out-of-state companies or businesses doing business in the state being no exception. However, the enforcement of a sales or use tax on these out-of-state corporations is not a solution, as doing so is a violation of the Commerce Clause and the First Amendment.

139 *Id.*