A New Way Forward for Remote Vendor Sales Tax Collection

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I. Introduction

Since the U.S. Supreme Court decision in *National Bellas Hess*[1] over 40 years ago, the states have been saddled with significant limitations on their authority to impose sales and use tax collection responsibilities on remote vendors. That decision, which predates the significant doctrinal shift ushered in by *Complete Auto Transit*,[2] still stands as controlling commerce clause doctrine, despite transformations in technology and the marketplace that make it obsolete.

This article takes another look at remote vendor sales tax collection, which is again a subject of heightened interest to the states, the business community, and Congress. Its underlying thesis is straightforward — the constitutional prohibition imposed by *National Bellas Hess* and reaffirmed by *Quill*[3] is, in 2010, a relic of a bygone era. Its demise is long overdue.

> ***Even if federal legislation tied to SSUTA were enacted, it would provide a partial solution at best.***

We also assert that the states cannot count on, and should not wait for, federal legislation superseding *Quill* and tied to the Streamlined Sales and Use Tax Agreement. The path to that federal legislation contains hurdles that may well prove insurmountable. Moreover, for legitimate reasons, approximately half the states imposing a sales tax, including California, Texas, Florida, New York, Illinois, and Pennsylvania, have not chosen to join SSUTA. Thus, even if federal legislation tied to SSUTA were enacted, it would provide a partial solution at best.

Instead, the states should pursue a new, multipronged strategy under which they:

- recognize the enormous impact of new technologies on both the national marketplace and the burden of sales tax compliance for multistate vendors;
- adopt aggressive nexus legislation and undertake aggressive compliance efforts to bring as many remote vendors into the fold as possible without federal legislation;
- propose straightforward federal legislation that addresses only the remote vendor issue and ties a remote vendor's obligation to collect tax to simplification within a state rather than uniformity across states; and
- consider action that would lead to litigation challenging the continuing validity of *Quill*.

II. Where We Are

A. The Constitutional Setting

The focus of this article is on the future, so we will fast-forward through the familiar history of how we got where we are now. In *National Bellas Hess*, the Supreme Court first confronted the issue of a state's constitutional nexus with a typical mail-order vendor. The vendor made arguments rooted in both the commerce clause and the due process clause. The Court began its analysis by noting how "closely related" claims are that "the liabilities imposed" by a state tax statute "violate the Due Process Clause of the Fourteenth Amendment and create an unconstitutional burden upon interstate commerce."[4] The Court proceeded to demonstrate the similarity between the claims by conflating them, combining

[1]*National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).

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

[3]*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[4]386 U.S. 753 at 756.

some principles drawn from commerce clause jurisprudence (such as the eventually discredited notion that there is such a thing as "exclusively interstate" commerce that the states cannot regulate) with others drawn from due process jurisprudence (such as the requirement that a state's "contacts" with a taxpayer be sufficient to answer affirmatively the question "whether that state has given anything for which it can ask return"), all without acknowledging the different constitutional sources of those principles.[5]

The Court ultimately concluded that, despite the presence in Illinois of hundreds of thousands of catalogs and millions of dollars of goods to which the vendor held title before delivery, the state lacked sufficient nexus with the vendor to impose its use tax collection statute. The Court based its decision on what it viewed as the "sharp distinction" between mail-order sellers with retail outlets, solicitors, or property within a state — in other words, with an obvious physical presence in the state outside the stream of "pure" interstate commerce — and those that do no more than communicate with customers in the state by mail or common carrier as part of a "general interstate business."[6]

There matters stood for 25 years, when the Court decided *Quill*, in which it embraced a previously unsuspected distinction, for purposes of determining whether states can tax remote sellers, between due process nexus and commerce clause nexus. Whereas due process does not require that a remote vendor have a physical presence in a state, the commerce clause does. That bright-line physical presence commerce clause test, which the Court traced to *National Bellas Hess*, supposedly has the virtue of providing certainty in the marketplace, even though it might "appear artificial at the edges," in that "whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office."[7]

For the Court, the pain of adopting such an artificial test was eased by the possibility, or even the likelihood, that a congressional fix was in the offing.[8] Seventeen years later, however, the bright-line physical presence test is still good law, the Court has never revisited the subject, and Congress has not acted.[9] Whatever the states have done to expand their nexus reach has been defended as operating within the bounds of the constitutional requirements established by *Quill* and *National Bellas Hess*.

B. The Marketplace

In the mid-1990s, retail e-commerce began to supplant the mail-order industry that was at issue in *National Bellas Hess* and *Quill*. According to the U.S. Census Bureau, national retail e-commerce sales in 2008 totaled about $136 billion, or 3.4 percent of total retail sales.[10] Before the economic downturn, which has slowed the entire retail marketplace, U.S. electronic retail (e-tail) sales typically experienced growth well in excess of 20 percent annually.

The e-tail marketplace originally consisted mostly of "pure play" businesses that sold only through their Web sites. Today, many pure play sellers continue to thrive, but the industry is dominated by "brick and click," that is, multichannel businesses with traditional retail stores and e-tail operations that operate in synergetically. Industry research indicates that about 32 percent of the retail Web sales made by the 500 largest Web sellers are made by pure play businesses, compared with 68 percent by multichannel sellers.[11]

C. Advances in Technology

Improvements in computer technology have greatly facilitated sales tax compliance for remote vendors, dramatically reducing the burden on interstate commerce that drove the Court's decision in *National Bellas Hess*. That progress is the result of both private-sector and state revenue department innovations. Every state now either allows or requires electronic payment of tax. Online registration as a sales tax vendor is likewise commonplace. All but a handful of states either allow or require sales tax returns to be filed electronically. New York's

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[5]*See id.* at 756-758.
[6]*Id.* at 758.
[7]504 U.S. 298 at 315.
[8]The Court stated:

> This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. Indeed, in recent years, Congress has considered legislation that would "overrule" the *National Bellas Hess* rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *National Bellas Hess* that the Due Process Clause prohibits States from imposing such taxes, but today, we have put that problem to rest. Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.

504 U.S. 298, 318 (citations omitted).

[9]For a critical examination of *National Bellas Hess* and *Quill*, see Robert D. Plattner, "*Quill*: Ten Years After," *State Tax Notes*, Sept. 30, 2002, p. 1017, *Doc 2002-22037*, or *2002 STT 189-3*.

[10]*See* http://www.census.gov/retail/ecommerce/historic_releases.html.

[11]*Internet Retailer Top 500 Guide*, 2009 edition, p. 10.

e-file service has an upload feature that transmits data directly from the sales tax vendor's software to the e-file application. Also, several states (including New York) offer free Web services enabling sellers to find the correct state and local sales or use tax rate for any address in the state.[12] In the near future, sellers in New York will be able to incorporate that Web service directly into their existing software applications.

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Remote sellers can also look to sales tax solutions offered by private companies, whose services can be directly integrated into a business's own shopping cart software or e-commerce system. As Reed Hastings, CEO of Netflix, recently told *The New York Times*, "We collect and provide to each of the states the correct sales tax. There are vendors that specialize in this. . . . It's not very hard."[13] Indeed, Amazon .com, which does not collect tax in most states and is not a streamlined sales tax volunteer seller, is reported to operate Target Inc.'s Web site, and, as part of that service, bills and collects sales tax on behalf of Target in all the states in which Target has a physical presence.[14]

Nor is it only large retailers that have access to such services. Some e-commerce providers (including eBay, PayPal, Amazon Services, and others) cater to small and medium-sized e-tail businesses and offer low-cost, integrated shopping cart services that include sales tax calculation.

D. The Streamlined Sales Tax Project

1. Background

Even before *Quill* was decided, bills had been introduced in Congress to give states the authority to require some remote sellers to collect sales and use tax. After *Quill*, other strategies were pursued as well. One effort centered on negotiations with the Direct Marketing Association. Another was led by the National Tax Association (the Communications and Electronic Commerce Project). Yet another was undertaken by the Advisory Commission on Electronic Commerce. None of those efforts was successful.

The rapid expansion of retail e-commerce provided the impetus for organizing the Streamlined Sales Tax Project. In the fourth quarter of 1999 (when the U.S. Department of Commerce began to measure e-commerce), U.S. retail e-commerce was $5 billion. By the fourth quarter of 2000, it had grown by nearly 68 percent.[15] That represented approximately 1 percent of total U.S. retail sales, and the expectation of continued double-digit growth raised significant concerns about state and local sales tax revenue losses. State tax administrators, worried about base erosion and revenue losses and frustrated by earlier failed attempts, looked for a new approach to the nexus problem. The SSTP would provide the vehicle.

The SSTP had two goals. The first was to create a simplified voluntary multistate sales tax collection system. That system would adopt the best practices from among the several states, seek to achieve multistate uniformity when appropriate, and encourage the development of technology models for sales tax collection.[16] The second goal, not formally stated at the outset, was to build support for federal legislation that would allow states that participated in the voluntary system to require out-of-state vendors to collect their sales and use taxes.[17]

The states envisioned the SSTP as an effort by tax administrators to build a model multistate sales tax collection system based on best practices. There was a sense that if they succeeded, both states and vendors would willingly participate. Further, they believed that if they made appropriate sacrifices to

[12]The jurisdiction lookup tool is found on the New York state tax department's Online Tax Center, *available at* http://www.nystax.gov.

[13]Saul Hansell, "Amazon Plays Dumb in the Internet Sales Tax Debate," nytimes.com (Feb. 13, 2008), *available at* http://bits.blogs.nytimes.com/2008/02/13/amazon-plays-dumb-in-internet-sales-tax-debate/.

[14]*See id.*

[15]U.S. Census Bureau, Quarterly Retail E-Commerce Sales, Feb. 20, 2002, *available at* http://www2.census.gov/retail/releases/historical/ecomm/01Q4.html.

[16]*See* Diane L. Hardt, Douglas L. Lindholm, and Joseph R. Crosby, "A Lawmaker's Guide to the Streamlined Sales Tax Project," Deloitte & Touche Center for Multistate Taxation, 2002, at 4 (hereinafter "A Lawmaker's Guide").

[17]Although the federal legislative objective was not initially stated as one of the project's objectives, it was clearly in the mind of commentators and project organizers. A publication coauthored by one of the SSTP cochairs said: "Perhaps the most significant aspect of the [*Quill*] decision . . . is the fact that the Court noted the underlying issue, collection of use taxes on remote sales, is not only one that Congress has the power to resolve, but is an issue that Congress may be better qualified to resolve." "A Lawmaker's Guide," *supra* note 16, at 33. Federal legislation is now acknowledged as an indispensable component of the streamlined plan. *See* "White Paper on Streamlining State Sales Taxes," at 2, *available at* http://www.streamlinedsalestax.org/DOCUMENTS/White%20papers/SST%20white%20paper.pdf ("Why must there be a federal solution?").

ease the sales tax compliance burden on remote vendors, Congress would give them the collection authority they wanted.

An early version of a model agreement was developed by the National Conference of State Legislatures in 2001. That draft, 18 pages long, addressed the fundamental tax administration burdens faced by remote sellers. It required uniformity in the sales tax bases of a state and its local jurisdictions, state administration, vendor compensation, and uniform sourcing rules.[18]

By 2002, however, the SSTP had begun to chart a different course. The business community — more precisely that part of it consisting of large national retailers — had taken on a much more prominent role. Business participants formed an organized group and gained influence with SSTP leaders. They met in closed sessions and functioned independently of the SSTP, but participated freely in, and sometimes dominated, SSTP meetings, all of which were open.

The initial version of SSUTA was adopted in November 2002. Like the 2001 NCSL version, it required state administration of local sales and use taxes and a single state and local base, established uniform sourcing rules,[19] and contemplated vendor compensation. It went far beyond the scope of the 2001 draft, however, by adopting uniform product definitions, prohibiting caps and thresholds, and establishing additional administrative requirements, including notice of tax rate changes, tax rate databases, rules for tax rounding, direct pay permits, and bad debt recovery.

Forty-one states would eventually become "implementing states" by enacting enabling legislation or otherwise formalizing their participation in the SSTP through legislative resolution or executive order.[20] Those implementing states were charged with administering the agreement until it became effective.[21]

By mid-2004 SSTP leaders felt some urgency to finalize the agreement and begin working toward their federal legislative objective. To take effect, however, the agreement required that the combined population of the member states equal at least 20 percent of the population of all states imposing a sales tax.[22] To meet that threshold, the SSTP and business representatives agreed to create a two-tiered state membership. Full members would be states that had "substantially conformed" their sales and use taxes to the agreement's terms. Associate members would be those states that either had not made all the necessary legislative changes or had complying laws that had not yet taken effect. The proposal specified that both full and associate members would be counted for purposes of the population threshold.[23]

The agreement took effect on October 1, 2005. A governing board of 13 member states and 5 associate member states was formed.[24] The agreement would later be amended on 17 separate occasions, and additional amendments are considered every time the governing board meets. Today, SSUTA has 23 member and associate member states, and approximately 1,100 businesses have voluntarily registered

[18]Streamlined Sales and Use Tax Agreement, as amended and adopted by the National Conference of State Legislatures, Jan. 27, 2001 (copy on file with the authors).

[19]The agreement generally applies destination sourcing. Although the sourcing rules were initially uniform, they did not necessarily ensure that the destination jurisdiction would receive the tax. Under SSUTA section 310, in circumstances in which the seller is without sufficient information to apply the general sourcing rules, the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided. The agreement now allows an origin-sourcing option for intrastate sales, if at least five states elect the option, but that five-state threshold has not yet been met. That option was added to accommodate several associate member states — Ohio, Tennessee, Texas, and Utah — for which the change to destination sourcing was a legislative obstacle.

[20]States were not required to make any substantive changes to their sales and use tax laws to the agreement in order to become implementing states. The NCSL developed a model act that a state could enact to become an implementing state. *See* Simplified Sales and Use Tax Administration Act, adopted on January 27, 2001 (copy on file with the authors). The model act generally authorized a state to "participate in multistate discussions . . . to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce." *Id.* New York substantially adopted the model act and became an implementing state in May 2003, with the enactment of Tax Law Art. 28-B (Chapter 62 of the Laws of 2003).

[21]SSUTA section 703.

[22]SSUTA section 701.

[23]*See* SSUTA section 705; Emily Dagostino, "Implementing States Approve Partial Streamlining Membership," *State Tax Notes*, Apr. 25, 2005, p. 237, *Doc 2005-8083*, or *2005 STT 74-2*.

[24]Emily Dagostino, "Streamlining System in Place With Inception of Governing Board," *State Tax Notes*, Oct. 10, 2005, p. 165, *Doc 2005-20143*, or *2005 STT 191-1*.

as streamlined sales tax sellers through the agreement's central registration system.[25]

2. Challenges

Now almost a decade old, the SSTP has confronted and overcome numerous obstacles in pursuing its ambitious goal. Nonetheless, two significant challenges stand in the way of true success.

a. Many States Haven't Joined SSUTA

Many states have shown little or no interest in joining SSUTA. As noted previously, only about half the states imposing a sales tax, and none of the most populous ones, have joined SSUTA. For those states, federal legislation tied to SSUTA is at best neutral, and could prove adverse to their interests.

A major problem with the streamlined approach is that it offers a "one size fits all" solution to states whose circumstances widely differ. New York, for example, has over 19 million people, and more than its share of the very wealthy, who generate significant personal income tax revenue. Its tax department has over 5,000 employees and generates over half a billion dollars in sales and use tax audit revenue annually. Sales tax, although an important revenue source, accounts for less than 20 percent of state tax receipts.

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Other states may be more heavily dependent on sales tax revenue, feel the revenue losses from e-commerce more keenly, and lack the resources to mount extensive audit programs. The trade-offs involved in joining SSUTA may lead those states to favor membership, but they do not tempt New York and many similarly situated states.

The recent study by Profs. Bruce, Fox, and Luna of the University of Tennessee illustrates that point.[26] The study, which estimates state revenue losses from e-commerce, evaluated by state the rate of sales and use tax compliance by large retail e-commerce vendors. New York's compliance rate was the highest, at nearly 90 percent.[27] Compliance rates in other states varied, with the median of all states just above 65 percent. A few other states — Kansas, Kentucky, and Wyoming — had rates of 80 percent or better; Vermont (a SSUTA member state) had the lowest rate, of about 46 percent.

Whatever other differences exist, it is clear from those statistics that states are in widely varying positions regarding the rate of sales and use tax losses resulting from the uncollectibility of taxes on e-commerce. States with low compliance rates may be motivated to make some legal and policy concessions to improve sales and use tax collection. Conversely, states that have high compliance rates will likely have little interest in doing so, particularly if required to pay substantial vendor compensation that puts existing revenues at risk. For New York, conformity to SSUTA is a long way to go for the uncollected 10 percent to 15 percent, and the net result could well be a revenue loss.

> ***States that have high compliance rates will likely have little interest in making legal and policy concessions to join SSUTA.***

A second significant drawback of SSUTA involves state sovereignty. By its own terms, SSUTA purports to preserve a member state's taxing authority. Nevertheless, the requirement that member states must use the uniform tax base definitions contained in the agreement makes it nearly impossible to honor that precept. Although it is true that the agreement allows member states to tax or exempt some defined items, the rules also prevent carveouts for subcategories within the defined terms. For example, a streamlined member state is free to tax or exempt "food and food ingredients." But it could not, within the bounds of the agreement, exempt food while imposing tax on sugared cereals, because they are included within the uniform food definition.[28] It

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[25]A white paper recently posted to the governing board's Web site states that 1,156 retailers are voluntarily registered under the streamlined system. The white paper is available at http://www.Streamlinedsalestax.org/DOCUMENTS/White%20papers/SST%white%20paper.pdf.

[26]*See* Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses From E-Commerce," Univ. of Tennessee (Apr. 13, 2009). *See State Tax Notes,* May 18, 2009, p. 537, *Doc 2009-8903,* or *2009 STT 94-1.*

[27]*See id.* at 552, Table 9. Analysis by the New York State Department of Taxation and Finance indicates that the Bruce, Fox, and Luna study significantly overstates the amount of uncollected taxes on e-commerce for New York, resulting from its assumptions regarding business-to-business transactions. However, the study's estimate of a nearly 90 percent compliance rate by large sellers for New York confirms a similar analysis of the retail Web industry recently conducted by the department. This research, based on the *Internet Retailer Top 500 Guide,* examined each of the 250 largest retail Web sellers to determine which of those sellers are registered as New York sales tax vendors. The study found that approximately 85 percent of the total sales by the largest 250 retail Web sites are made by sellers that collect New York sales tax.

[28]*See* SSUTA section 327.C.

should be within the prerogatives of a state legislature, as informed by the voters, to determine whether that legislation is wise. But a SSUTA member has surrendered its ability to consider those policy options, even when the product, sugared cereal in this instance, is rarely purchased from remote vendors.

Requiring uniform tax definitions across states strikes at the very heart of principles of federalism.

An issue closely related to sovereignty is the delegation of the power to tax. Here, too, SSUTA is problematic. New York's constitution, like that of most states, vests almost all taxing power in its State Legislature, and the Legislature is constitutionally prohibited from surrendering, suspending, or contracting away this power.[29] Moreover, the Legislature cannot delegate the taxing power to those who are not accountable to the electorate.[30] It is difficult to reconcile that prohibition with SSUTA, which vests in its governing board — a body that is not accountable to the citizens of any state — the nearly unreviewable discretion to interpret the words that establish a state's sales tax base and the procedures that govern sales tax administration.

That loss of state sovereignty is magnified by the fact that the SSUTA provisions go far beyond what is necessary to address the narrow issue of the collection burdens on remote multistate sales tax vendors. Sales tax simplification for multistate vendors is a worthy goal. But simplification does not necessarily require uniformity among the states, and longstanding principles of federalism favor states' rights over the modest benefits to interstate commerce of uniform state tax laws. The agreement, as negotiated, unnecessarily intrudes on states' rights. Requiring a member state to impose a uniform sales tax base of its own choosing statewide is one thing. It asks only that a state exercise control over its local governments, creatures of the state. Requiring uniform tax definitions across states is quite another. It strikes at the very heart of principles of federalism.

The current SSUTA, over 100 pages in length, plus an additional 120 pages of rules, bylaws, and interpretations, requires uniformity even in matters wholly unrelated to remote commerce. For example, the agreement devotes over 10 pages to telecommunications definitions, sourcing provisions, and rules.[31] The federal bill implementing streamlining will likely go even further than the agreement in that regard, requiring a state to apply the agreement's telecommunications provisions to any tax, not just sales tax, that it imposes on telecommunications to obtain authority to require non-nexus sellers to collect its sales and use taxes.[32] Those provisions are essentially irrelevant to addressing the remote vendor issue, and their presence in SSUTA and the federal legislation serves to discourage membership in the agreement.

b. Federal Legislation Remains Elusive

As this article goes to print, streamlined legislation has yet to be introduced in the current congressional session. Several important issues regarding its provisions remain unsettled, including vendor compensation, a de minimis threshold, and the application of the federal law and SSUTA to taxes beyond sales and use taxes. Vendor compensation will likely prove the most difficult of those to resolve.

While the terms of vendor compensation remain unresolved, it appears that those negotiating on behalf of the states have agreed that the federal legislation should embody the following principles:

- all sellers (not just remote sellers) should receive reimbursement for the costs they reasonably incur in collecting and remitting sales tax; and
- all sellers should receive reimbursement for the credit and debit card fees they pay to unrelated entities regarding sales tax.

Twelve of the streamlined states provide no vendor compensation, and the attraction of streamlining may wane for some of the streamlined states once the terms of vendor compensation are established. The costs of vendor compensation will be real, and substantial, while the rewards of remote

[29]N.Y. Const. Art. XVI, section 1 ("The power of taxation shall never be surrendered, suspended or contracted away . . . Any laws which delegate the taxing power shall specify the types of taxes which may be imposed thereunder and provide for their review.").

[30]*See Greater Poughkeepsie Library Dist. v. Town of Poughkeepsie,* 81 NY2d 574 (1993). The power to tax is "inherent in our form of government and justified by legislative accountability to the electorate. *Id.* at 579. It is that accountability that provides "security against erroneous and oppressive taxation." *McCulloch v Maryland,* 4 Wheat [17 U.S.] 316, 428 (1819).

[31]SSUTA section 314, 315; Appendix C, Part II; Streamlined Sales Tax Governing Board Inc., Rules and Procedures, Rule 314.

[32]*See, e.g.*, H.R. 3396/S.34, 110th Cong., 1st Sess. (2007).

vendor collection are, to a degree, speculative.[33] Will states conclude the juice is worth the squeeze when they confront state legislation conforming to the vendor compensation terms dictated by the federal legislation? It is certainly possible that the answer to that question for some SSUTA states will be no.

The introduction of federal legislation supported by a large majority of streamlined states and the business community would represent a significant step forward. Nonetheless, formidable obstacles would remain. First, in the give-and-take of the legislative process, a proposed bill would almost certainly undergo changes. The most likely scenario is that various business interests that had not been part of the earlier negotiations would seek to add provisions limiting states' taxing powers regarding their particular industry, and that some would succeed. In turn, nonstreamlined states, which would see no benefit from the legislation, might find it necessary to actively oppose legislation that diminished their taxing powers. The same might be true for some SSUTA members as well, if the bill, as revised, resulted in costs that outweighed the new revenues they would likely collect.

> ***The costs of vendor compensation will be real, and substantial, while the rewards of remote vendor collection are, to a degree, speculative.***

The final, and perhaps greatest, obstacle to successful federal legislation is that it may not be able to win the support of a majority of U.S. House and Senate members. Simply put, a vote for the streamlined legislation could easily be portrayed by their opponents in the next election as a vote to impose a new tax on consumers — not a record on which incumbents care to run. That the bill would not in fact impose a new tax, but simply improve enforcement of an existing one, would likely be viewed as largely beside the point. Such subtleties are easily lost in the heat of an election campaign. Should that scenario play out, and this solidly Democratic Congress proves unwilling to support such legislation despite the fiscal woes of the states, the streamlined states must ask themselves whether any Congress ever would.

III. New Strategy for the States

A. Overview

The states' strategy should reflect the facts outlined above. The current constitutional sales tax nexus rules are a relic of the last century. The only argument that remains in their defense is that they represent the status quo. But the marketplace and technology have undergone drastic changes that strengthen the arguments supporting the states and weaken those offered by remote vendors. Those who benefit from the status quo will no doubt fight to maintain it. Ultimately, however, this status quo cannot survive because its underpinnings have crumbled.

B. A Multipronged Approach

The states should pursue a multipronged strategy, asserting their taxing powers through aggressive enforcement of their existing laws, new legislation to extend their reach to the outer limits of current commerce clause nexus jurisprudence, and, if appropriate, a constitutional challenge to *Quill*, for example, based on the sales and use tax statute of a single state that is structured to minimize the administrative burden on remote sellers. That challenge would assert that the constitutional question whether a state's taxing statute burdens interstate commerce should turn on the burden that particular statute creates, not the collective burden imposed by the various statutes in the 50 states. Alternatively, a challenge could come from a streamlined state, asserting that its participation in SSUTA has sufficiently addressed the burden on interstate commerce cited by the Supreme Court in *National Bellas Hess* and *Quill*. Finally, the states should seek federal legislation that narrowly addresses the remote vendor issue without requiring the states to cede their individual taxing powers.

C. State Legislation

1. Overview

Every state imposing a sales tax should, consistent with current Supreme Court doctrine, seek to extend its authority over remote vendors. In particular, states should assert attributional nexus when industry business practices support that claim. The clearest case for pursuing that nexus presents itself when a vendor with retail stores in the state and an affiliated e-tail business with no physical presence in the state market the same products using the same logo and sell these products to customers in the state. The in-state vendor collects tax, while the e-tailer, relying on *Quill*, does not. As discussed

[33]In addition to the obvious uncertainties attached to predictions regarding the marketplace, other questions remain — for example, compliance concerns. Under the SSUTA rules and procedures (section 8063.5), when a seller uses a certified service provider (CSP), the scope of an audit will be limited to an audit of the CSP, and not the seller. That is, states will be unable, for example, to audit a seller to determine if it is underreporting its sales to the CSP, unless the states have probable cause to believe the seller has committed fraud.

below, several states have adopted or proposed legislation asserting nexus over the e-tailer in this situation.

Another fact pattern, addressed by New York in legislation enacted in 2008, involves a remote vendor that uses independent sales representatives in the state. In this modern-day version of *Scripto*,[34] these sales "affiliates" drum up business in the state for the remote vendor through in-state solicitation directed at customers within the state, and receive a commission based on sales to customers they refer via the Internet to the vendor. As described below, New York's "Amazon" law has been challenged as unconstitutional, with the state prevailing in the trial court decision, which is now on appeal.

Also, under some fact patterns, states could appropriately assert nexus over an out-of-state seller based on a combination of the in-state activities of an "independent company" providing services to tangible personal property purchased from the out-of-state seller, and the nature of the relationship between the out-of-state seller and in-state service provider. New Mexico successfully applied this theory in *Dell*,[35] in which the U.S. Supreme Court denied certiorari.

States should assert attributional nexus when industry business practices support that claim.

Finally, states should seek to assert due process nexus when the facts do not support commerce clause nexus. For example, a state could not, under current law, impose sales tax collection duties on a pure e-tailer (with no affiliate program) despite millions of dollars of sales by the e-tailer to in-state customers. The state could, however, successfully assert due process nexus under *Quill*, and on that basis require the e-tailer to submit information returns providing data on sales by the e-tailer delivered to customers in the state.[36] The e-tailer would not be required to make any determination as to the tax status of a transaction or the correct amount of tax. It would not be asked to invoice, collect, or pay over the tax, which was the burden cited in *National Bellas Hess* and *Quill*. Rather, it would simply be required to transmit data from its own records in a form that would allow the state to pursue use tax from its own residents. A state could also assert due process nexus to require e-tailers to disclose to customers making purchases for delivery into the state, at the time of the transaction, some or all of the following information:

- that their purchases, if taxable when purchased at a store in the state, are also taxable when purchased from a remote vendor even when the vendor doesn't collect the tax;
- how to pay the tax directly to the state;
- that the state may require the remote vendor to provide it with transaction information regarding purchases delivered into the state; and
- that taxpayers failing to timely pay the required tax are subject to interest and penalties.

To date, neither New York nor any other state has proposed or adopted any disclosure requirement of this kind.

2. Affiliate Nexus

Several states, including Alabama, Arkansas, Idaho, Indiana, Kansas, Minnesota, New York, and Wisconsin, have enacted legislation that imposes vendor status on remote sellers when a business carries on its retail store operations and its e-tail or catalog sale operations through separate corporate entities and only the retailer has a physical presence in the state. That legislation generally requires that the businesses have common ownership and use a common trademark or logo. Some states, including Alabama, go further, essentially asserting nexus over an e-tailer when an entity with nexus is part of the unitary business carried on by the e-tailer in the state and provides services that inure to the benefit of the e-tailer in establishing or maintaining its market in the state.[37]

The Supreme Court should approve of nexus acquired through an affiliate as described above. As

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[34]*Scripto v. Carson*, 362 U.S. 207 (1960).

[35]*See Dell Catalog Sales, L.P. v. Taxation and Revenue Dep't,* 199 P.3d 863 (N.M. App. 2008). (For the decision, see *Doc 2008-14074* or *2008 STT 124-18*.)

[36]Before *Quill*, when due process nexus and commerce clause nexus were undistinguishable, the states could not successfully assert their authority in this fashion (*see, e.g.*, *L.L. Bean v. Commonwealth of Pennsylvania*, 516 A2d 820 (Pa. Commonw. 1986). The distinction between due process nexus and commerce clause nexus established in *Quill* dictates a result in favor of the states.

[37]The Alabama statute, for example, reads as follows:

An out-of-state vendor has substantial nexus with this State for the collection of both state and local use tax if: (1) the out-of-state vendor and an in-state business maintaining one or more locations within this State are related parties; and (2) the out-of-state vendor and the in-state business use an identical or substantially similar name, trade name, trademark, or goodwill, to develop, promote, or maintain sales, or the in-state business and the out-of-state vendor pay for each other's services in whole or in part contingent upon the volume or value of sales, or the in-state business and the out-of-state vendor share a common business plan or substantially coordinate their business plans, or the in-state business provides services to, or that inure to the benefit of, the out-of-state business related to developing, promoting, or maintaining the in-state market.

a general rule, states have the authority to disregard the self-serving structure of a corporate family and impose their taxes based on the economic substance of the business activities being carried on in the state. The Court would likely have little patience with a large e-tailer that seeks to avoid its vendor collection responsibilities in a state in which a sister corporation operates retail outlets and collects tax. Neither of the arguments that drove the decision in *National Bellas Hess* is persuasive in this context. Since the e-tailer's sister corporation already collects sales tax in the state, the e-tailer would not be able to challenge the tax based on the burden of collection. Likewise, the e-tailer would have difficulty, even under the outdated thinking of *National Bellas Hess*, contending that it receives no meaningful benefits from the state in light of the substantial benefits received by its sister corporation and the symbiotic relationship between the two corporations.

3. New York's Amazon Tax

a) The Statute

In 2008 New York adopted first-of-its-kind sales tax nexus legislation, now widely known as the Amazon law, in reference to Amazon.com, the nation's largest pure e-tailer. Under the new legislation, a remote seller will be presumed to be a vendor required to collect sales tax if:

- the seller enters into an agreement or agreements with a New York state resident or residents[38] under which, for a commission or other consideration, the resident representative directly or indirectly[39] refers potential customers to the seller, whether by link on an Internet Web site or otherwise; and
- the cumulative gross receipts from sales by the seller to customers in New York state as a result of referrals to the seller by all of the seller's resident representatives under this type of contract or agreement total more than $10,000 during the preceding four quarterly sales tax periods.[40]

A seller may rebut the presumption by establishing that the only activity of its in-state representatives in New York on behalf of the seller is placing a link on their Web sites to the seller's Web site. Solicitation activities that would support the presumption would include the distribution of flyers, e-mail blasts, newsletters, and public speaking engagements.[41]

Despite widespread characterizations to the contrary, advertising agreements do not trigger the presumption of vendor status. For example, assume that, as part of its business plan to market its products in New York state, a remote vendor enters into agreements with several local businesses to place advertisements on their Web sites. When clicked, those ads lead the Web site user to the vendor's retail Web site. In exchange for placing its advertisements on those Web sites, the vendor pays the businesses a fee based only on the number of clicks on the link to its Web site, regardless of whether sales are made. Those agreements are for the purchase of advertising and are outside the scope of the statute.

b) Remote Vendor Responses

In response to New York's legislation, more than 30 e-tailers registered as sales tax vendors and began to collect tax. Estimated state and local revenues from the newly registered vendors for fiscal 2009-2010 are approximately $70 million. Amazon is one of those vendors. However, Amazon also filed a suit challenging the constitutionality of the new provision. Overstock.com not only sued the state but also ended its affiliate programs in New York. According to one source, approximately 60 sellers have ended their New York affiliate programs.[42] Another vendor, Newegg.com, initially registered but, as it stated on its Web site, later amended its agreements with its New York sales affiliates, and, on the basis of those new agreements, stopped collecting tax on behalf of the state. Newegg presumably believes that its amended agreements and the conduct of its affiliates in New York enable it to rebut the statutory presumption and avoid registering or collecting tax as a vendor.

c) The Litigation

In January 2009 a New York supreme court (that is, trial court) judge rejected the constitutional

[38]A seller is also considered to have met the condition of having an agreement with a New York state resident when the seller enters into an agreement with a third party (known in the industry as aggregators or networks) under which the third party, in turn, enters into an agreement with the New York resident to act as the seller's representative.

[39]A resident representative would be indirectly referring potential customers to the seller when, for example, the resident representative refers potential customers to its own Web site or another party's Web site, which then directs the potential customer to the seller's Web site.

[40]*See* TSB-M-08(3)S, "New Presumption Applicable to Definition of Sales Tax Vendor."

[41]*See* 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."

[42]*See* http://forum.abestweb.com/showthread.php?t=105869.

claims raised by Amazon and Overstock in their suits for declaratory relief.[43] The decision supporting that ruling stands (for now) as a striking judicial endorsement of the constitutionality of the state statute.

The decision concluded that Amazon was not even entitled to have its summary judgment motion addressed, for its complaint was subject to dismissal on its face for failure to state a cause of action. As the court said, "even accepting all the facts alleged to be true, there is no basis on which Amazon can prevail."[44] After a review of relevant commerce clause doctrine, including *Quill* and *Scripto*, the court found that Amazon's contention that New York's statute is invalid because "it imposes tax collection obligations based on activities that are insufficient to create a substantial nexus under the dormant Commerce Clause" was simply "wrong."[45]

Thus, to the court, the statute was exactly what it was meant to be: something "carefully crafted to ensure that there is a sufficient basis for requiring collection of New York taxes and, if such a basis does not exist, it gives the seller an out."[46] The court recited the many requirements the statute imposes before the state can impose a tax collection obligation on a remote seller: the seller's contracts with New York residents; the residents' referral of potential customers to the seller; the payment of commissions or other consideration to the residents for the referrals; the minimum revenue of $10,000 traceable to New York referrals; and the opportunity for sellers to prove, despite the satisfaction of all of the foregoing requirements, that the New York residents with whom it contracts did not engage in any solicitation that would satisfy the constitutional nexus requirement. Nor, as Amazon contended, does the statute bring within its ambit "simple advertising." Rather, it "imposes a tax-collection obligation on sellers who contractually agree to compensate New York residents for business that they generate and not simply for publicity."[47]

Both Amazon and Overstock have appealed.

[43]*See Amazon.com, LLC v. New York State Dep't of Taxation and Finance*, 23 Misc.3d 418 (Sup.Ct. NY Co. Jan. 12, 2009). (For the decision, see *Doc 2009-641* or *2009 STT 8-16*.)

[44]*Id.* at 423.

[45]*Id.* at 425.

[46]*Id.*

[47]*Id.* at 426.

d) Other States' Responses

Rhode Island and North Carolina have adopted legislation similar to New York's.[48] Amazon.com has ended its affiliate program in both states. In California and Hawaii, New York-type statutes have been vetoed by the governor. In several other states, including Connecticut, Illinois, Minnesota, Maryland, and Tennessee, legislation has been proposed but not adopted.[49]

4) Test Case Statute and Litigation

Another course of action available is test case litigation. For example, one state could enact a simplified sales and use tax statute, including remote vendor collection rules, that directly confronts *Quill* and sets the stage for a constitutional challenge to *Quill*. That statute might include a single statewide sales and use tax base, local tax rates (if any) that could be determined by the ZIP code of the customer or software provided free of charge by the state, and an exemption for remote vendors with sales under a threshold amount.

The state would argue that the constitutionality of its statute should not be based on the cumulative burden imposed by the thousands of sales tax jurisdictions nationwide, but on the burden its sales and use tax imposes on remote vendors making sales within its borders. Applying that test, the court could find the simplified statute constitutional. Other states seeking to extend their reach over remote vendors could then do so by conforming their laws to the test case statute. Presumably, the result

[48]*See* Rhode Island Gen. Laws section 44-18-15 and General Statutes of North Carolina section 105-164.8.

[49]One might anticipate that "Main Street" retailers would actively support legislation along the lines of New York's Amazon law in their states, because it would help remove the competitive advantage enjoyed by some "pure e-tailers" that do not collect tax in their states. However, with the exception of the independent book stores, they have not. In fact, the National Retail Federation, the industry's lobbying arm, has vigorously opposed those proposals. One explanation for that behavior is that the large retailers, which have stores in many states, including many of the streamlined states, would much prefer federal legislation tied to the SSUTA. That legislation would not only level the playing field, but would also require the SSUTA states to pay them millions of dollars in vendor compensation. Amazon-type laws are seen as a threat to streamlining, because they represent a shortcut for the states; that is, some of the remote vendors would be required to collect tax, resulting in significant new revenue for the states, while the states would not be obligated to pay vendor compensation or conform to the rules of the SSUTA.

would be widespread simplification of state sales tax schemes coupled with collection by most remote vendors.[50]

Some members of the current Supreme Court hold a narrow or even dim view of the dormant commerce clause, so there may be some interest in overturning* Quill *on ideological grounds.

The Supreme Court very consciously shifted the burden of resolving the remote vendor collection issue to Congress in 1992, presumably anticipating that Congress would indeed address the issue. That has not happened, and the Court may now, 17 years later, be tired of waiting. Also, in the interim, enormous growth in the e-tail industry and remarkable gains in technology favor the state's position rejected by the Court in *Quill*. The Court might well see things differently now. Moreover, some members of the current Court hold a narrow or even dim view of the dormant commerce clause, so there may be some interest in overturning *Quill* on ideological grounds.

[50]A SSUTA member state could bring litigation asserting that states conforming to SSUTA should be able to impose sales tax collection responsibilities on remote vendors because they have taken sufficient steps to alleviate the burden on interstate commerce cited by the Supreme Court in *National Bellas Hess* and *Quill*.

D. Federal Legislation

The states should propose federal legislation that would authorize states whose sales and use tax statutes meet specific requirements to assert nexus over most remote vendors. The minimum requirements for each state might include:

- state administration of local sales taxes;
- a single, uniform state and local sales and use tax base (perhaps with exceptions for some goods or services that generally are not sold remotely);
- a minimum sales threshold designed to relieve truly small vendors from collection responsibilities;
- state provision to vendors of software with the proper combined state and local sales tax rate for all addresses in the state, or, alternatively, a safe harbor for remote vendors that use ZIP codes to determine rates; and
- a prohibition against sales tax holidays.

If enacted, that legislation would provide a strong incentive for states to simplify their sales taxes to meet the requirements of the federal statute.

IV. Conclusion

The states cannot rest all their hopes for remote vendor collection on federal legislation tied to SSUTA. That legislation remains an elusive goal that may prove unattainable, and in any event, represents a solution for only about half the states imposing a sales and use tax. Instead, the states, acting strategically and in concert, should pursue a multipronged strategy that includes state legislative and administrative actions, litigation, and continued attempts at federal legislation both tied to and separate from SSUTA. ✰