New York's Amazon Tax Not Out of the Forest Yet: The Battle Over Affiliate Nexus

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"[I]n this world nothing is certain but death and taxes."
Benjamin Franklin[1]

I. INTRODUCTION

We've all done it. After finding an item we want in a store, we think, "I can find it online for less. Plus, I won't have to pay sales tax!" This phenomenon, occurring at an ever-increasing rate, has left many state governments feeling that they are missing out on tax revenue from those online sales.[2] For this reason, it was a virtual certainty that states would attempt to impose state sales tax on sales by internet retailers, or "e-tailers," located out-of-state.

On April 9, 2008, New York attempted to do just that.[3] As part of its budget for the 2008–2009 fiscal year, the state of New York passed § 1101(b)(8)(vi) of the New York Tax Law ("the Statute"), more commonly known as the "Amazon Tax."[4] The Statute seeks to impose a state sales tax collection obligation on out-of-state e-tailers by creating a rebuttable presumption that the vendor has a taxable physical presence in New York.[5] The most controversial feature of the Statute is that an in-

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1. JOHN BARTLETT, FAMILIAR QUOTATIONS (Nathan Haskell Dole ed., 10th ed., Bartleby.com 2000) (quoting Letter from Benjamin Franklin to M. Leroy (1789)), *available at* http://www.bartleby.com/100/245.24.html.

2. *See* Eric A. Ess, Comment, *Internet Taxation Without Physical Representation?: States Seek Solution to Stop E-Commerce Sales Tax Shortfall*, 50 ST. LOUIS U. L.J. 893, 894 (2006).

3. N.Y. TAX LAW § 1101(b)(8)(vi) (2008).

4. Saul Hansell, *Amazon Sues Over State Law on Collection of Sales Tax*, N.Y. TIMES, May 2, 2008, *available at* http://www.nytimes.com/2008/05/02/nyregion/02amazon.html [hereinafter Hansell 1].

5. N.Y. COMP. CODES R. & REGS. tit. 20, § 526.10 (2009). The presumption is that once the vendor has entered into an agreement with a New York resident and that agreement has generated more than $10,000 of New York sales, the vendor is presumed to have solicited sales in the state and the Statute applies to that vendor. *Id.* This obligates the vendor to collect and remit New York sales

ternet retailer's agreements with its affiliate marketers[6] located in New York trigger this rebuttable presumption, creating a taxable "nexus"[7] in New York.[8] Not surprisingly, Amazon.com was unimpressed with the idea of the Amazon Tax and filed suit against New York.[9] The suit challenging the constitutionality of the Statute was filed on April 25, 2008, just two weeks after the measure was adopted.[10] Overstock.com filed a similar suit on May 30, 2008.[11,12]

The plaintiffs, Amazon and Overstock, advanced nearly identical arguments, noting that U.S. Supreme Court precedent erects significant hurdles to imposing state sales tax collection obligations on vendors who do not have a physical presence in the state.[13] The plaintiffs argued that these hurdles should preclude New York's attempt to impose state tax collection obligations on internet vendors.

Unfortunately for the plaintiffs, the New York Supreme Court ("NY Court")[14] did not agree. On January 12, 2009, the court ruled in

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tax on all of its New York sales. *Id.* The presumption of solicitation is rebutted when the vendor positively refutes that its activities in the state constitute solicitation. *Id.*

6. Affiliate marketing involves a merchant developing advertisements, hyperlinks, and e-mail campaigns that the affiliate can post on its website, or send to its customers, to promote the merchant's products. Tom Taulli, *Creating a Virtual Sales Force*, FORBES, Nov. 9, 2005, http://www.forbes.com/business/2005/11/08/marketing-ecommerce-internetcx_tt_1109straightup.html (last visited Mar. 17, 2009). The affiliate is compensated by the merchant every time a customer "clicks through" the advertisement or link on the affiliate's website into the merchant's website and then completes the action agreed upon by the merchant and the affiliate (e.g., purchasing a product, completing a form). *Id.* The relationship between the affiliate and the merchant is governed by an agreement that the affiliate agrees to before it can receive compensation from the vendor. *Id.*

7. A taxable "nexus" is loosely defined as a physical presence in the state that warrants the imposition of a tax collection obligation. *See* Quill Corp v. North Dakota, 504 U.S. 298, 314 (1992); *see also infra* Part V.B.1.

8. Hansell 1, *supra* note 4. The Statute defines physical presence to include an agreement with any website that earns referral fees for sending customers to the online retailer—i.e. affiliate marketers. *See* N.Y. TAX LAW § 1101(b)(8)(vi).

9. Complaint at 1, Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009) (No. 601247/08) [hereinafter Amazon Complaint].

10. *Id.*

11. Complaint at 1, Overstock.com, Inc. v. N.Y. State Dep't of Tax'n & Fin., (N.Y. Sup. Ct. 2009) (No. 107581/08) [hereinafter Overstock Complaint].

12. The *Amazon* and *Overstock* cases have been combined due to the similarity of the arguments they make against the Statute. *See infra* note 134.

13. The largest hurdle is found in *Quill Corp. v. North Dakota*, wherein the U.S. Supreme Court held that if a vendor's only connection with a state is through the U.S. mail or other common carriers, there is not a sufficient nexus for the state to impose sales or use tax collection obligations. 504 U.S. 298 (1992).

14. The New York Supreme Court is the trial court for the state of New York, while the state's highest court is called the New York Court of Appeals. New York State Unified Court System, Civil Court Structure, http://www.courts.state.ny.us/courts/structure.shtml (last visited Sept. 29, 2009).

favor of New York, granting summary judgment for the state.[15] In fact, the court was rather emphatic in its decision, stating that "[the plaintiffs] ha[ve] not come close to refuting the [Statute's] presumed constitutionality . . . ."[16]

This Comment argues that the NY Court's dismissal was only partially correct.[17] The court was correct in noting that applying the Statute to the plaintiffs is consistent with the Due Process Clause under current U.S. Supreme Court precedent because the plaintiffs purposefully directed their activities toward New York.[18] However, the NY Court erred in holding that the Statute meets the dormant Commerce Clause's "substantial nexus" requirement by imputing the affiliates' activities to the plaintiffs. While the activities of an in-state contractor or salesperson are sufficient to create a taxable nexus, traditional advertising is considered insufficient in this regard. Because the affiliates' activities more closely resemble traditional advertising than the activities of an in-state contractor or salesperson, the Statute is in violation of the Commerce Clause.[19] Because of this violation, the Statute is unconstitutional and should be overturned.[20]

To introduce the issues involved, Part II of this Comment describes sales and use taxes, particularly their significance as a state revenue source and problems with collecting them. Additionally, Part II discusses the motivations behind taxing e-commerce. Part III explores applicable case law, including several relevant Supreme Court cases that define the parameters of the plaintiffs' claims and a New York Court of

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15. *Amazon*, 877 N.Y.S.2d at 846–47; *Overstock*, No. 107581/08, slip op. The *Overstock* decision was minimal and referred the reader to the *Amazon* decision. *Overstock*, No. 107581/08, slip op. at 4.

16. *Amazon*, 877 N.Y.S.2d at 848.

17. The evidence used in writing this Comment is found solely in the parties' briefs, the attached exhibits, the NY Court's ruling, and any other publicly available information. At the time this Comment was written, no discovery had been conducted.

18. *See infra* Part V.A.

19. *See infra* Part V.B.

20. While this Comment argues that the court erred in dismissing the plaintiffs' case, it does so based solely on the substantive constitutional arguments on the two issues noted. Amazon also raised a third constitutional issue—an Equal Protection Clause claim—that is beyond the scope of this Comment. In addition, the parties have made procedural arguments that may affect the eventual outcome of the litigation on appeal, but those arguments are also beyond the scope of this Comment. For example, the plaintiffs claim that the Statute is impermissibly vague, the statutory presumption is irrational, and the presumption is "effectively irrebuttable." *See*, *e.g.*, Plaintiff's Memorandum of Law in Support of Cross-Motion for Summary Judgment and in Opposition to the Defendant's Motion to Dismiss, *Amazon*, 877 N.Y.S.2d 842 (No. 601247/08) [hereinafter Amazon Memo]. In response, New York asserts that the plaintiffs' "as-applied" claims are unripe, the plaintiffs cannot make an "impermissibly vague" argument at this time, and the plaintiffs have not exhausted their administrative remedies. Defendant's Memorandum of Law in Support of Motion to Dismiss, *Amazon*, 877 N.Y.S.2d 842 (No. 601247/08) [hereinafter Defendant's Memo].

Appeals case. Part IV introduces the statutory language and describes how the Statute has been interpreted by the agency charged with enforcing it—the New York State Department of Taxation and Finance (DTF). Part V examines the NY Court's *Amazon* and *Overstock* decisions on both the Due Process Clause and the dormant Commerce Clause challenges. Finally, Part VI briefly discusses the Statute's side effects, including a reduction in business for the New York affiliates.

II. OVERVIEW OF SALES AND USE TAXES

The central issue presented in the *Amazon* and *Overstock* cases is the obligation to collect state taxes on sales when most e-tailers are not presently obligated to do so. In order to understand why the collection obligation exists, this Part briefly introduces the sales tax and its companion tax, the use tax. This Part then examines why New York and other states are attempting to impose a sales tax collection obligation on e-tailers.

A. Sales and Use Taxes Defined

Simply put, a sales tax is a tax on the sale of goods and services.[21] While forty-five states and the District of Columbia employ sales taxes,[22] individual counties or cities within these states may also impose their own separate sales taxes.[23] As a result, there are presently at least 7,600 taxing jurisdictions within the U.S.[24] Sales taxes, along with use taxes, are the largest source of revenue for most states—accounting for nearly one third of all state taxes collected in 2008.[25]

The most unique feature of the sales tax is the way it is collected and remitted to the proper governmental authority. Instead of being the consumer's responsibility, as is the case with income and use taxes, sales

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21. BLACK'S LAW DICTIONARY 1579 (9th ed. 2009). The first sales tax was implemented in Mississippi in 1932 as a way to generate revenue during the Great Depression. Ess, *supra* note 2, at 895.

22. Sarah Saidel Barris, Note, *New Jersey's Legislature May Have Trouble Tapping a New Source of Revenue*, 5 PITT. TAX REV. 61, 64 (2007). No sales or use tax is imposed in Alaska, Delaware, Montana, New Hampshire, or Oregon. Ess, *supra* note 2, at 895 n.24.

23. Ess, *supra* note 2, at 895. Each taxing jurisdiction has its own unique tax code and tax rate. Ryan J. Swartz, Note, *The Imposition of Sales and Use Taxes on E-Commerce: A Taxing Dilemma for States and Remote Sellers*, 2 J. HIGH TECH. L. 143, 144 (2003).

24. Swartz, *supra* note 23, at 144.

25. *See* U.S. CENSUS BUREAU, GOVERNMENTS DIVISION, 2008 ANNUAL SURVEY OF STATE GOVERNMENT TAX COLLECTIONS, *available at* http://www.census.gov/govs/statetax/ (click on "Summary Table" hyperlink to download summary spreadsheet). Total general sales and gross receipts taxes collected by all states for 2008 were $240,415,097,000, while the total taxes collected by all states were $781,325,294,000; thus, sales taxes comprised 30.7% of total taxes collected. *Id.*

taxes require the vendor to collect and remit the tax.[26] Given the large number of jurisdictions, this can be an extraordinarily complex task and a substantial burden on the vendors. Thus, the U.S. Supreme Court has held that states can impose a sales tax collection obligation only on vendors that have a substantial nexus with the state.[27] Due to this limitation, states began to utilize the use tax in order to tax sales from out-of-state vendors.[28]

A use tax is a tax on the use of goods that are purchased outside of a taxing authority's jurisdiction.[29] Because the use tax applies only to the use of products within the state that were purchased out of state, and thus not previously subjected to the sales tax, the use tax is complementary to the sales tax.[30] The main difference between the two taxes is the location of the purchaser relative to the vendor; an intrastate transaction triggers a sales tax, while an interstate transaction triggers a use tax.[31]

Use taxes are generally imposed to discourage interstate transactions for the purpose of avoiding sales tax.[32] Thus, the use tax rate is typically identical to the sales tax rate.[33] A use tax credit must be given for sales tax paid in another state so that the same purchase is not taxed twice.[34] The burden of remitting the use tax lies on the purchaser or user of the goods.[35]

B. Why Tax E-Commerce?

Putting the burden of remitting the use tax on the purchaser creates several problems, which result in almost universal noncompliance. First, most consumers do not realize that they need to remit use tax for online or other out-of-state purchases.[36] It is a common misconception that if a vendor does not collect sales tax, there is no tax at all.[37] Second, an almost complete lack of enforcement of the use tax by states aggravates

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26. Barris, *supra* note 22, at 62–63.

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

28. Barris, *supra* note 22, at 63.

29. BLACK'S LAW DICTIONARY 1579 (9th ed. 2009).

30. Ess, *supra* note 2, at 896.

31. *Id.* Thus, while it is commonly stated that states are attempting to get e-tailers to collect sales tax, more accurately, the states want e-tailers to collect use tax.

32. *Id.*

33. Barris, *supra* note 22, at 64.

34. Ess, *supra* note 2, at 896. This also avoids legal challenges to the use tax under the dormant Commerce Clause, which imparts that states may not hinder interstate commerce by means of double taxation. *Id.*

35. *Id.*

36. Christina T. Le, Note, *The Honeymoon's Over: States Crack Down on the Virtual World's Tax-Free Love Affair With E-Commerce*, 7 HOUS. BUS. & TAX L.J. 395, 400 (2007).

37. Swartz, *supra* note 23, at 144.

this misconception.[38] Without an effective system to monitor residents' purchasing behavior, states have difficulties enforcing payment of the use tax.[39] In addition, any attempt to monitor such behavior would create numerous operational and privacy issues.[40] The third and final problem is plain, old disobedience.[41] Even if a consumer is aware of the use tax obligation, knowledge that a violation is unlikely to be punished contributes to non-compliance.[42]

This non-compliance has long troubled states due to the accompanying loss of tax revenue.[43] The erosion of state tax collections[44] has been exacerbated by the growing popularity of internet retail sales[45] and total dollar amount.[46] One study reported that the increase in e-commerce cost states between $15.5 and $16.1 billion in lost tax revenue in 2003 alone.[47] That amount was predicted to increase to between $21.5

38. Ess, *supra* note 2, at 897.

39. *Id.* at 897.

40. *Id.* at 898. Operational issues include the fact that any system used to conduct audits of use tax would not be cost effective due to the high cost of the infrastructure needed (auditors, software, etc.) and the minimal dollar amount of any collections. Swartz, *supra* note 23, at 144. The tracking of consumers' purchases required to make such a system effective would also create invasion-of-privacy concerns. Ess, *supra* note 2, at 898.

41. Ess, *supra* note 2, at 898.

42. This is likely an understatement: the use tax has been referred to as the "most ignored tax on the books." *Id.* at 897 (quoting H.R. REP. NO. 107-240, at 37 (2001)).

43. Ess, *supra* note 2, at 898 (noting that because of the internet, consumers can now avoid the sales tax on almost any item by purchasing from a remote e-tailer who lacks substantial nexus with the taxing state).

44. *Id.*

45. In 2008, e-commerce sales accounted for only 3.35% of total U.S. retail sales. Press Release, U.S. Census Bureau, Quarterly Retail E-Commerce Sales 1st Quarter 2009 (May 15, 2009), *available at* http://www2.census.gov/retail/releases/historical/ecomm/09Q1.html. This percentage breaks down as follows: 1st quarter: $33.543 billion (3.3% of total); 2nd quarter: $33.889 billion (3.3% of total); 3rd quarter: $33.494 billion (3.4% of total); and 4th quarter: $31.482 billion (3.4% of total) (these figures do not include online travel services, financial brokers, and online ticket sales). *Id.* However, prior to the recession that started in 2008, e-commerce sales were growing at four to five times the rate of overall retail sales. *See id.* While total retail sales grew between 2.4% and 4.4% each quarter in 2007 over the same quarter in 2006, corresponding e-commerce sales grew between 17.5% and 20.4%. *Id.*

46. E-commerce sales have been projected to increase to $235.4 billion in 2009 and to further increase each year up to $334.7 billion in 2012, adding approximately $33 billion in sales in each interim year. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2009, at 646 tbl. 1015 (2009), *available at* http://www.census.gov/compendia/statab/2009edition.html. These figures exclude online travel sales. *Id.*

47. DONALD BRUCE & WILLIAM F. FOX, STATE AND LOCAL SALES TAX REVENUE LOSSES FROM E-COMMERCE: ESTIMATES AS OF JULY 2004 4-5 (2004), *available at* http://cber.bus.utk.edu/ecomm/ecom0704.pdf. The estimates were made using a weighted average sales tax rate of 6.5%. *Id.* at 4.

and $33.7 billion in 2008.[48] The states with the largest populations, such as New York, will see the largest losses.[49]

Given the important role that sales taxes play in states' revenue production, states are attempting to fill gaps in the revenue losses resulting from e-commerce. The increasing popularity of internet shopping has begun to erode states' sales tax collections without a corresponding increase in use tax collections because most e-tailers are located out-of-state and therefore are not obligated to collect and remit state use tax. As a result of this erosion, many states are looking for ways to generate additional revenue,[50] including ways to impose tax collection obligations on out-of-state e-tailers. In their search for a solution, states must be aware of certain constitutional issues that may arise.

III. THE EVOLUTION OF SALES AND USE TAX JURISPRUDENCE

Remote retailers typically use two separate constitutional challenges to fight the imposition of a use tax collection obligation on interstate commerce.[51] First, the Due Process Clause, as laid out in the Fifth and Fourteenth Amendments, prevents states from depriving citizens of "life, liberty, or property, without due process of law."[52] The U.S. Supreme Court has interpreted this to mean that taxpayers cannot be unfairly deprived of tax dollars through taxation by jurisdictions with which the seller does not have sufficient minimum contacts.[53] Second, the Commerce Clause gives Congress the right to regulate all interstate commerce,[54] including e-commerce.[55] The Court held that the Com-

48. *Id.*

49. *Id.* at 6.

50. *See, e.g.*, Steve Lawrence, *Schwarzenegger Wants to Tax Golf, Auto Repairs*, VENTURA COUNTY STAR, Jan. 26, 2009, *available at* http://www.venturacountystar.com/news/2009/jan/26/bc-ca—state-budget-service-taxes1208-wants-to/ (describing a potential tax on golf greens fees, auto repair, veterinary services, amusement parks, and appliance and furniture repairs).

51. These challenges have arisen in cases dealing with mail-order catalogs, a predecessor of e-commerce that involves many of the same issues. A mail-order business is similar to e-commerce in that the retailer is located out-of-state and sends the item to the customer through the mail or by common carrier. Ess, *supra* note 2, at 894. Like e-commerce, the physical package is generally the retailer's only connection with the taxing jurisdiction. *See id.*

52. U.S. CONST. amend. V, amend. XIV, § 1.

53. Allied-Signal, Inc. v. Dir. Div. of Tax'n, 504 U.S. 768, 777 (1992) (citing Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)). The jurisdiction must have sufficient minimum contact with the activity, not just the actor, intended to be taxed. *Id.* at 778.

54. *See* U.S. CONST. art. I, § 8.

55. STEVEN MAGUIRE, STATE AND LOCAL SALES AND USE TAXES AND INTERNET COMMERCE, CRS Report for Congress 1 (2005) *available at* http://www.ipmall.info/hosted_resources/crs/RL31252_050128.pdf.

merce Clause requires a retailer to have a substantial nexus with the taxing state before it can be obligated to collect and remit tax.[56]

To understand how these constitutional issues apply to the Statute, this Part examines the case law that has shaped the current sales tax landscape. This Part begins with applicable U.S. Supreme Court precedent, breaking the Court's decisions down into three groups—the first two based on whether the case affects the Due Process Clause or the Commerce Clause analysis and the third consisting of cases that affect attributional nexus. While each of the following cases is discussed in one or more of the groups, a chronology of the cases may be helpful: *Scripto, Inc. v. Carson* (1960), *National Bella Hess v. Department of Revenue of Illinois* (1967), *Complete Auto Transit, Inc. v. Brady* (1977), *National Geographic Society v. California Board of Equalization* (1977), *Tyler Pipe Industries, Inc. v. Washington Department of Revenue* (1987), and ending with the Court's most recent ruling on the subject, *Quill Corp. v. North Dakota* (1992). This Part also examines one relevant New York Court of Appeals ruling that interpreted *Quill—Orvis Company, Inc. v. Tax Appeals Tribunal of the State of New York* (1995).[57]

A. Due Process Clause Cases

With regard to the nexus issue, the U.S. Supreme Court's history with the Due Process Clause is complicated. The Court has steadily lowered the Due Process Clause standard from requiring some minimal physical connection to the taxing jurisdiction to simply requiring that one purposefully direct his or her activities toward the jurisdiction.

One of the first cases addressing the nexus issue was *Scripto, Inc. v. Carson*. In *Scripto*, the Court held that the activities of independent contractors are sufficient to create the necessary "minimum connections" for the state to impose tax under the Due Process Clause.[58] The Court found the fact that Scripto's "salesm[e]n"[59] were independent contractors, as opposed to regular, full-time employees of Scripto, to be without consti-

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56. Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992) (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).

57. 630 N.Y.S.2d 680. The *Orvis* case is important because of the reliance placed on it by New York, in its briefs, and by Justice Bransten in her decision in the Amazon case. *See* Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009).

58. 362 U.S. 207, 211–12 (1960). Scripto was a Georgia corporation that lacked any physical presence in Florida. *Id.* at 208–09.

59. Scripto had hired independent contractors—"wholesalers" or "salesm[e]n"—who were Florida residents with designated territories within Florida, to solicit its sales. *Id.* at 209. The independent contractors were engaged to actively solicit sales and were paid a commission, even on repeat sales. *Id.* Orders were sent to the Atlanta office for approval because the contractors had no authority to collect on sales or incur debts. *Id.*

tutional significance.[60] Consequently, Scripto could be required to collect and remit sales and use taxes to Florida.[61]

Just seven years later, in *National Bella Hess v. Department of Revenue of Illinois*, the Court held that the Due Process Clause did not support a tax collection obligation for a remote seller whose only contact with the state was through the U.S. mail.[62] National Bella Hess's only contact with Illinois was mailing catalogs twice a year.[63] When Illinois attempted to collect tax on Bella Hess's sales in the state, Bella Hess protested, arguing that the Statute was unconstitutional under the Due Process and Commerce Clauses.[64] In order for the taxation to be fair under either clause,[65] the Court held that there must be some definite link or a minimum physical connection between the state and the entity it attempts to tax.[66] The Court acknowledged that it had never found such a link where the vendor's only connection with the state was through the U.S. mail.[67]

The Court clarified the required relationship between the seller's physical connection with the state and the activities giving rise to the use tax collection obligation in *National Geographic Society v. California Board of Equalization*.[68] The Court held that it did not matter whether the activities occurring within the state were connected to the activities giving rise to the use tax collection obligation.[69] As long as there was a

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60. *Id.* at 211–12 (stating that the only non-local part of the transaction was the acceptance of the order and that formally tagging the salesperson as "independent" would not change the "local function of solicitation" or "its effectiveness in securing a substantial flow of goods into Florida"). This statement reflects what is called "attributional nexus," a technique by which a state "attributes" physical presence to an out-of-state retailer in order to subject the remote retailer to taxation. Andrew W. Swain & Nathaniel T. Trelease, *Taxing Time for the Internet?*, 15 BUS. L. TODAY 11, 13, 15 (2005).

61. *Scripto*, 362 U.S. at 211–12.

62. Nat'l Bella Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967).

63. *Id.* at 754. Bella Hess did not own any property in the state and did not send any salespeople into the state. *Id.* With the exception of the catalogs, it also did not do any advertising in the state. *Id.*

64. *Id.* at 755–56. The Illinois statute defined Bella Hess as a "retailer maintaining a place of business in this State" because that term included any retailer "[e]ngaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State." *Id.* at 755 (quoting 35 ILL. COMP. STAT. ANN. 105/2 (1965)). Thus, under the statute, Bella Hess was required to collect and remit use tax to Illinois. 35 ILL. COMP. STAT. ANN. 105/2.

65. The Court noted that the Due Process and Commerce Clause claims were so "closely related" that it considered them together. *Nat'l Bella Hess*, 386 U.S. at 756.

66. *Id.*

67. *Id.* at 757.

68. 430 U.S. 551 (1977). The National Geographic Society had two offices in California that solicited advertising for the magazine. *Id.* at 554 n.2. The offices did not "perform [any] activities related to the Society's operation of a mail-order business." *Id.* at 552.

69. *Id.* at 561.

"definite link, some minimum connection" between the seller and the state, the seller could be obligated to collect use tax.[70] In the Court's view, the Society's two offices in California clearly created this link.[71] The Court also noted that having only the "slightest presence" in a state would not be sufficient to establish nexus.[72]

The Court revisited the *Bella Hess* physical presence standard in *Quill Corp. v. North Dakota*.[73] The case arose from North Dakota's attempt to require Quill Corporation to collect and remit use taxes on its sales in the state, despite Quill's "insignificant or nonexistent" physical presence in the state.[74] While the North Dakota Supreme Court upheld the tax,[75] the U.S. Supreme Court reversed.[76] In its decision, the Court examined the Due Process and Commerce Clause claims separately, contrary to its ruling in *Bella Hess*.[77]

The U.S. Supreme Court moved away from its physical presence requisite under the Due Process Clause, instead deciding that Due Process was more concerned with "fundamental fairness."[78] Examining a line of *in personam* jurisdiction cases, the Court noted that as long as a business's activities are "purposefully directed" toward a state, a lack of physical presence had never been sufficient to defeat jurisdiction in the state.[79] The Court held that the Due Process Clause did not bar enforcement of the state tax obligation against Quill because a business that soli-

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70. *Id.*

71. *Id.*

72. *Id.* at 556.

73. 504 U.S. 298 (1992).

74. The company's only contact with North Dakota was sending catalogs and fulfilled orders into the state by U.S. mail or by common carrier. *Id.* at 302. North Dakota required Quill to collect use taxes under a state law that defined "retailer" to include "every person who engages in regular or systematic solicitation . . . in th[e] state." *Id.* at 302–03. "Regular or systematic" was defined to mean three or more advertisements within a twelve-month period. *Id.* at 303.

75. *Id.* at 303–04. The North Dakota Supreme Court cited changes in the economy and laws as reasons for why following *Bella Hess* was inappropriate, specifically noting that catalog sales had changed from an "inconsequential market niche" to a "goliath" and that computers eased the burden of compliance with multiple taxing jurisdictions. *Id.* at 303. The Court also noted that cases after *Bella Hess* had not required a physical presence under the "minimum contacts" test and said that the relevant inquiry was whether "the state has provided some protection, opportunities, or benefit for which it can expect a return." *Id.* at 304. In the Court's view, the fact that North Dakota had created "an economic climate that foster[ed] demand for" Quill's products was sufficient to generate "a constitutionally sufficient nexus" to justify the tax. *Id.*

76. *Id.* at 319.

77. *Id.* at 305. The Court cited the evolution of its due process jurisprudence since *Bella Hess* and noted that "although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct." *Id.* at 305–07. The Court also noted that "[t]he two standards are animated by different constitutional concerns and policies." *Id.* at 312.

78. *Id.*

79. *Id.* at 307–08 (quoting Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985)).

cits sales in a state through catalogs "clearly has 'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.'"[80] However, the Court had a different take on Quill's obligation under the Commerce Clause.

B. Commerce Clause Cases

The Commerce Clause, unlike the Due Process Clause, is not concerned with fairness, but rather prohibiting discrimination against interstate commerce.[81] To this end, the Court has consistently required at least a minimal physical connection with the jurisdiction before a tax collection obligation could be imposed.

While the Court had previously contemplated the Commerce Clause in *Bella Hess*, it first examined the requirements a tax must meet to survive a Commerce Clause challenge in *Complete Auto Transit, Inc. v. Brady*.[82] Under the new four-part test the Court adopted, a tax is valid when the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state."[83]

In *Quill*, the Court attempted to more clearly define the substantial nexus requirement of *Complete Auto Transit*, but did not specify what level of physical presence would fulfill it.[84] According to the Court, it is possible for a business to have "minimum contacts" with a state sufficient to satisfy the Due Process Clause but still lack a substantial nexus with the state as required by the Commerce Clause.[85] The Court also noted that a "safe harbor" had been created for vendors "whose only connection with customers in the [taxing] State is by common carrier or

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80. *Quill*, 504 U.S. at 308 (quoting Shaffer v. Heitner, 433 U.S. 186, 218 (1977)) (alterations in original).

81. *Quill*, 504 U.S. at 312. More precisely, it is the negative sweep of the dormant Commerce Clause that prevents states from unduly burdening interstate commerce. Ess, *supra* note 2, at 901. The *Bella Hess* bright-line physical presence requirement is a means to "further[] the ends of the dormant Commerce Clause." *Id.* at 314. In footnote six of the *Quill* decision, the Court notes that North Dakota's tax is a good illustration of how a state might unduly burden interstate commerce. *Id.* at 313 n.6.

82. 430 U.S. 274 (1977). Complete Auto Transit was a Michigan corporation that transported cars by motor carrier for General Motors. *Id.* at 276. The state of Mississippi collected taxes based on sales completed when the company delivered cars to dealers located in Mississippi. *Id.* Complete Auto Transit requested a refund, calling the taxes unconstitutional because the "transportation was but one part of an interstate movement." *Id.* at 277.

83. *Id.* at 279. The Court ultimately held for Mississippi, stating that the plaintiff had not claimed that the tax violated any of these four criteria. *Id.* at 287–89.

84. *Quill*, 504 U.S. at 313. The Court stated that the "slightest" physical presence is not sufficient to establish substantial nexus under the Commerce Clause. *Id.* at 315 n.8.

85. *Id.* at 313.

the United States mail."[86] Thus, such vendors are free from any state-imposed obligations to collect sales and use taxes.[87] Because Quill's only connection to North Dakota was by common carrier and U.S. mail, the Court determined that substantial nexus was not satisfied.[88]

The *Quill* decision has created problems for courts throughout the country as they wrestle with what constitutes a substantial nexus.[89] The *Quill* decision regarding catalog sales companies applies to all remote retailers, including e-tailers.[90] Because most e-tailers lack a physical presence in all but a few states, they often fall under the safe harbor created in *Quill* and can therefore avoid the burdens of collecting sales and use taxes.[91] However, not all remote retailers are so lucky.

In *Orvis Company, Inc. v. Tax Appeals Tribunal of the State of New York*, the New York Court of Appeals, the state's highest court, held that the *Quill* substantial nexus standard did not require a substantial physical presence in the state.[92] In refusing to extend the physical presence standard to include the "slightest presence," the *Orvis* court cited *Quill*'s two justifications for keeping the standard.[93] First, the court noted that the physical presence standard furthered the ends of the Commerce Clause by creating a bright-line test that clearly demarcates the vendors who qualify for safe harbor.[94] The creation of a "substantial" physical presence standard would destroy this bright-line rule by requiring a "case-by-case evaluation of the actual burdens imposed."[95] Second, the court noted that the physical presence test has "engendered substantial reliance and has become part of a basic framework of a sizeable industry."[96] Based on these justifications, the court concluded that *Quill* could not

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86. *Id.* at 315 (quoting Nat'l Bella Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967)) (alteration in original).

87. *Id.*

88. *Id.*

89. Le, *supra* note 36, at 405.

90. *Id.* at 407.

91. Ess, *supra* note 2, at 902.

92. 86 N.Y.2d 165, 177–78 (1995). Orvis Company was a Vermont company whose only contact with New York, other than through common carrier, was its salespeople making approximately twelve visits to wholesale customers located in the state during the three-year period in question. *Id.* at 187–88. In deciding that the company had a substantial nexus in the state, the majority noted that this activity accounted for approximately 15% of Orvis' New York sales and that the salespeople traveled "in a loop," which suggested "systematic visitation" to the customers. *Id.* at 179–80. The dissent, however, argued that Supreme Court precedent actually required "continuous" solicitation in the state to meet the substantial nexus standard. *Id.* at 182 (Bellacosa, J., dissenting). Under this standard, the occasional trips by Orvis' salespeople into New York were not sufficient to create substantial nexus. *Id.* at 187.

93. *Id.* at 175–76 (majority opinion).

94. *Id.* at 176.

95. *Id.* at 177 (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 315 (1992)).

96. *Orvis*, 86 N.Y.2d at 176 (quoting *Quill*, 504 U.S. at 315).

have mandated a substantial physical presence standard.[97] Because *Bella Hess*, which the Court relied upon in *Quill*, required only a "definite link or minimum connection," the *Orvis* court reasoned that the presence only needed to be "demonstrably more than a 'slightest presence.'"[98] The court ruled that this standard was met when Orvis's employees made systematic sales calls in the state.[99]

While the standard articulated in *Orvis* begins to answer the question of how much of a physical presence is required for substantial nexus, the physical presence standard is still difficult to apply in any given situation. For example, the standard does not give a definitive answer to the plaintiffs' challenge of the Statute. This is especially true when it is not the activities of employees at issue, but rather the activities of some independent person or entity that must be attributed to the foreign entity.

C. Attributional Nexus Cases

Although never directly addressing attributional nexus, the Court has made several indirect declarations in its rulings on Due Process and Commerce Clause claims. The first declaration appeared in *Scripto*, in which the Court attributed the activities of Scripto's independent contractor salesmen to the company in holding that Scripto had a taxable nexus with Florida.[100]

The Court further clarified the role a company's salespeople can play in fulfilling the substantial nexus requirement of the Commerce Clause in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*.[101] The Court held that whether or not a salesperson was classified as an independent contractor was not determinative for nexus purposes.[102] Instead, the Court found that "the crucial factor governing nexus is whether the activities performed in th[e] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in th[e] state for the sales."[103] In other words, if an independent contractor's activities in the state are significant to the

97. *Id.* at 176.

98. *Id.* at 178.

99. *Id.* at 178–79.

100. *See supra* note 59.

101. 483 U.S. 232 (1987). Tyler Pipe Industries sold pipes in Washington that it manufactured out of state. *Id.* at 249. The company argued that its lone connection with Washington—an independent contractor located in Seattle who acted as the company's in-state salesperson—did not create a sufficient nexus with the state to justify collection of a gross receipts tax on its sales. *Id.* at 249–50.

102. *Id.* at 250.

103. *Id.* The Court held that Tyler Pipe's representative satisfied this standard because the "sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interest . . . ." *Id.* at 251.

foreign seller's ability to sell items in the state, the seller has a taxable nexus in the state.

This is the Court's most current standard for determining whether the activities of an independent entity should be attributed to a foreign e-tailer. However, in a case brought by Amazon and Overstock, the first place to look is at the statutory language and at how the DTF interprets that language.

IV. THE NEW YORK STATUTE AND DTF'S INTERPRETATION

The source of controversy in this case is New York Tax Law § 1101(b)(8)(vi).[104] Even before its enactment on April 23, 2008, the Statute had already engendered significant controversy.[105] To explain why, this Part first introduces the statutory language and examine what makes it controversial. This Part then analyzes both of the technical service bureau memorandums (TSB-M) that the DTF has issued to explain its interpretation of the Statute.[106] The TSB-Ms attempt to head off some of the controversy by explaining how the DTF intends to enforce the Statute.[107]

A. The Statute

What makes the Statute unique and controversial is its novel definition of what constitutes a physical presence in New York.[108] Under the Statute, if any of a merchant's affiliates are located in New York,[109] the merchant is presumed to be soliciting sales in the state and therefore has

104. N.Y. TAX LAW § 1101(b)(8)(vi) (2008).

105. In fact, the Statute was so controversial that the New York Senate seems to have changed its mind on the issue; it voted to repeal the Statute on June 24, 2008. *See* Saul Hansell, *New York Senate Teases Amazon Customers with Sales Tax Repeal*, N.Y. TIMES, July 30, 2008, *available at* http://bits.blogs.nytimes.com/2008/07/30/new-york-senate-teases-amazon-customers-with-sales-tax-repeal-bill/ (last visited October 11, 2009). However, the reversal bill has never made it past the committee in the New York Assembly, and it appears unlikely to do so. *See id.*

106. DTF is the agency charged with enforcing the New York tax laws. N.Y. TAX LAW § 171 (2008). Thus, its interpretation of the statutory language determines the extent to which the Statute will affect remote retailers.

107. *See* N.Y. STATE DEP'T OF TAX'N & FIN., NEW PRESUMPTION APPLICABLE TO DEFINITION OF SALES TAX VENDOR, TSB-M-08(3)S (2008) [hereinafter May TSB-M]; *see also* N.Y. STATE DEP'T OF TAX'N & FIN., 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, TSB-M-08(3.1)S (2008) [hereinafter June TSB-M].

108. Hansell 1, *supra* note 4.

109. For the Statute to apply, the merchant must have signed an agreement with the affiliate(s) located in New York that pays the affiliate(s) "a commission or other consideration" for "directly or indirectly" referring customers to the merchant. N.Y. TAX LAW § 1101(b)(8)(vi). Most affiliate marketing agreements will meet this requirement. *See* Taulli, *supra* note 6.

a substantial nexus with the state.[110] Thus, if just one of a merchant's affiliates is located in New York, the company would theoretically be obligated to collect and remit New York use tax on *all* of its sales in the state, whether or not it was made through the affiliate.[111]

The presumption that the retailer is soliciting sales is triggered only if the applicable criterion is met. However, the presumption can be rebutted. To trigger the presumption, a merchant must have more than $10,000 in total gross receipts for the year ending on the last day of November.[112] These sales must have been to customers located in New York who are referred to the merchant by affiliates who are residents of New York.[113] If the merchant meets these criteria, the presumption that it is soliciting sales in the state can be rebutted by showing proof that its affiliates did not engage in any solicitation that would create a substantial nexus.[114] Unfortunately, the statutory language itself does not elaborate on what sort of proof would suffice to show the absence of solicitation. Thus, DTF provided additional guidance regarding the Statute's application in the form of two TSB-Ms.

B. The Technical Service Bureau Memorandums

The DTF issued two TSB-Ms[115] to provide clarification of the statutory language and to provide information about how it would enforce the Statute.[116] The two TSB-Ms seem to constrict the Statute's scope by adopting a narrower interpretation of the Statute.[117] This is mainly ac-

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110. Hansell 1, *supra* note 4.

111. *Id.*

112. N.Y. TAX LAW § 1101(b)(8)(vi):

> [A] person making sales of tangible personal property . . . shall be presumed to be soliciting business . . . if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods ending on the last day of February, May, August, and November.

113. *Id.*

114. *Id.* ("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.")

115. "A TSB-M is an informational statement of changes to the law, regulations, or Department policies." New York State Department of Taxation and Finance, Memoranda (TSB-Ms), http://www.tax.state.ny.us/pubs_and_bulls/memos/memos_tax_types.htm (last visited Oct. 3, 2009).

116. The DTF issued the first of its two TSB-Ms regarding the Statute on May 8, 2008, just weeks after the Statute was enacted. *See* May TSB-M, *supra* note 107. The second TSB-M was issued on June 30, 2008, and attempted to clarify the first TSB-M and to further clarify the Statute. *See* June TSB-M, *supra* note 107.

117. George S. Isaacson, *Legal Matters: Behind the New York Nexus Saga*, ALL ABOUT ROI, Aug. 1, 2008, http://www.allaboutroimag.com/article/behind-new-york-nexus-saga-114968_1.html (last visited October 11, 2009) (suggesting that this "relatively modest approach to enforcement"

complished by limiting the types of compensation schemes the Statute applies to and by suggesting ways that the statutory presumption can be rebutted.[118]

1. The May TSB-M

The DTF issued the May TSB-M for two main reasons. First, it clarified that the Statute does not apply to mere advertising or pay-per-click compensation schemes.[119] The TSB-M states that "an agreement to place an advertisement [on a website] does not give rise to the presumption" that the remote vendor is soliciting sales, even if the advertisement is stored on a server located in New York.[120] It also states, however, that this is not the case for an advertisement "where the consideration for placing the link on the Web site is based on the volume of completed sales generated by the link."[121] Thus, advertisements compensated on a pay-per-click basis do not bring about the statutory presumption, while any advertisements compensated through performance-based commissions do.[122]

Second, the May TSB-M provides information as to how a remote retailer might rebut the statutory presumption that it is soliciting sales.[123] The presumption can be rebutted as long as the seller can establish that the New York resident affiliate's only activity was the link on the website.[124] Unless the seller can establish that each individual New York affiliate refrained from using "flyers, newsletters, telephone calls, or e-mails," the presumption cannot be rebutted and the seller is obligated to collect and remit the tax.[125]

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may have been part of DTF's attempt to defend the constitutionality of the Statute given the plaintiffs' challenge). The plaintiffs have suggested that the TSB-Ms were issued as part of the State's litigation strategy. *See* Amazon Memo, *supra* note 20, at 8.

118. Isaacson, *supra* note 117.

119. May TSB-M, *supra* note 107, at 1–4.

120. *Id.* at 2.

121. *Id.*

122. Isaacson, *supra* note 117. "Pay-per-click" means that the website will be compensated a set amount every time the link is clicked on, whether or not a sale is made. PCMag.com, Definition of: Pay-Per-Click, http://www.pcmag.com/encyclopedia_term/0,2542,t=pay-per-click&i=48908,00.asp (last visited Oct. 18, 2009). The presumption will apply even if the vendor originally contracted with an out-of-state company, who then made an agreement with a New York resident on behalf of the vendor. May TSB-M, *supra* note 107, at 3–4. This situation is shown in Example Three of the May TSB-M. *Id.*

123. May TSB-M, *supra* note 107, at 4–5.

124. *Id.* at 4.

125. *Id.* at 5.

2. The June TSB-M

The June TSB-M further clarified the showing required to rebut the presumption that the Statute applies. It provides two conditions that, if met, will effectively rebut the presumption.[126] First, contractual language prohibiting the New York affiliate from soliciting sales through techniques including flyers, newsletters, telephone calls, or e-mails should be included in the agreement between the affiliate and the remote retailer.[127] Second, the seller needs to collect a signed certification from each New York-based affiliate annually, stating that the affiliate has not engaged in any prohibited solicitation activities during the year.[128] If the seller does not receive a certification from all of its New York affiliates, the DTF will determine whether the presumption is rebutted by weighing the seller's reliance on the certifications in light of the constitutional nexus standard set forth in *Quill*.[129] If the seller satisfies both conditions, it has fulfilled the safe harbor requirements, and it will not be required to collect or remit sales or use taxes to New York.[130]

While the statutory language and the two TSB-Ms seem to suggest varying conclusions regarding the Statute's reach, the courts will make the ultimate decision regarding its interpretation.[131] The statutory language itself is very broad, encompassing all agreements with New York residents that pay a commission or other consideration for directly or indirectly referring customers to the seller.[132] The TSB-Ms narrow the Statute's scope by exempting advertising and pay-per-click compensation schemes from its reach.[133] However, because Amazon and Overstock have challenged the Statute, the final ruling on its reach, and thus its constitutionality, will come from the courts.

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126. June TSB-M, *supra* note 107, at 1.

127. *Id.*

128. *Id.* at 1–2. This certification can be in paper or electronic form. *Id.* In addition, the certification must include a statement advising the representative that any information sent with the certification could be verified or audited by the DTF. *Id.*

129. *Id.* at 2.

130. *Id.*

131. It is worth noting that in its ruling, the NY Court did not cite to, or even mention, either of the TSB-Ms, despite the reliance the State placed on them in its briefs. *See* Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin., 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009).

132. N.Y. TAX LAW § 1101(b)(8)(vi) (2008).

133. May TSB-M, *supra* note 107, at 1–4. The TSB-Ms do not carry much legal weight and thus, are mainly good for two purposes: (1) to show how the DTF intends to enforce the Statute and (2) to show that the DTF is trying to narrow the Statute's scope in an effort to maintain its constitutionality.

V. ANALYSIS OF THE NEW YORK SUPREME COURT'S RULING

On January 12, 2009, the NY Court issued a ruling on New York's motion to dismiss and the plaintiffs' cross-motion for summary judgment.[134] Surprisingly, the court upheld the constitutionality of the Statute and granted the State's motion for summary judgment (dismissing the plaintiffs' claims).[135] This Part analyzes the NY Court's analysis of each of the plaintiffs' claims, critiques the court's decision, and offers an alternative rationale where appropriate. This Part begins with the Due Process Clause issue and then moves on to the Commerce Clause issue.[136]

A. Due Process Clause Claims

A tax collection obligation imposed on an out-of-state retailer is permissible if it meets the Due Process Clause requirements.[137] The NY Court determined that the Statute met the requirements.[138] This subpart first briefly discusses what rationale the NY Court used in making this determination. It then examines whether Amazon and Overstock even satisfy the minimum contact requirements of the Due Process Clause—an issue the NY Court overlooked.

1. The NY Court's Rationale

The NY Court wasted no time in dismissing the plaintiffs' Due Process Clause claims.[139] The court focused on two parts of the plaintiffs' challenge: the claim that the Statute's rebuttable presumption violated due process, and the claim that the Statute was void because it was

134. *Amazon*, 877 N.Y.S.2d at 846–47. The court considered the plaintiffs' claims collectively, only issuing a brief opinion in the Overstock case that simply referred the reader to the Amazon ruling. Overstock.com, Inc. v. N.Y. State Dep't of Tax'n & Fin., No. 107581/08, slip op. at 4 (N.Y. Sup. Ct. 2009). For this reason, this Comment will also treat Amazon and Overstock as one plaintiff. Any exceptions to this general rule will be noted.

135. *Amazon*, 877 N.Y.S.2d at 846–47. Both plaintiffs have since appealed the NY Court's rulings. Overstock filed its notice of appeal on February 10, 2009. *See* Notice of Appeal, *Overstock*, No. 107581/08. Amazon filed its notice on February 18, 2009. *See* Notice of Appeal, *Amazon*, 877 N.Y.S.2d 842 (No. 601247/08).

136. The plaintiffs have stated very similar cases against the Statute. *Compare* Amazon Complaint, *supra* note 9, *with* Overstock Complaint, *supra* note 11. The two are also very similarly situated in that both have no physical presence in New York—no property, no offices, no employees—and both employ affiliate marketers as part of their marketing strategy. Amazon Complaint, *supra* note 9, at 6–7; Overstock Complaint, *supra* note 11, at 5–6. These factors undoubtedly contributed to the NY Court's decision to treat the two plaintiffs as one in its ruling.

137. St. Tammany Parish Tax Collector v. Barnesandnoble.com, 481 F. Supp. 2d 575, 577 n.1 (E.D. La. 2007).

138. *Amazon*, 877 N.Y.S.2d at 850.

139. *See id.* at 850–51.

unconstitutionally vague.[140] Ultimately, the NY Court rejected both claims.[141] However, the court did not address the larger due process issue of whether the plaintiffs had sufficient minimum contacts with New York to allow the imposition of the Statute's tax collection obligation in the first place.[142]

2. The Bigger Issue

The U.S. Supreme Court has established two related tests for use in examining whether the due process requirements are met.[143] The first test involves a determination of whether the out-of-state retailer had sufficient minimum contacts with the state to justify imposing a tax collection obligation.[144] Alternatively, the second test calls for a determination of whether the retailer's activities met the lower threshold of being "purposefully directed" toward the taxing state.[145] For example, the *Quill* court held that sending catalogs to North Dakota residents to solicit sales satisfied the second test, despite Quill's complete lack of physical presence in the state.[146]

Like Quill, the plaintiffs do not have sufficient minimum contacts with New York to support a tax collection obligation under the Due Process Clause.[147] It is essentially undisputed that the only physical connection the plaintiffs have with New York is that created by their agreements with their affiliate marketers who reside in the state.[148] Assuming that the affiliates' physical presence in New York will not be imputed to the plaintiffs,[149] the plaintiffs would have no physical presence in the state other than by common carrier.[150] Thus, the plaintiffs' minimum contacts with New York would be insufficient to support the imposition of a tax obligation.[151] However, the plaintiffs purposefully directed their

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140. *Id.*

141. *Id.* While the court's reasoning for one or both of these issues may or may not have been sound, both of the issues are procedural and thus beyond the scope of this Comment. *See supra* note 20.

142. *See Amazon*, 877 N.Y.S.2d. 842.

143. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 307–08 (1992).

144. St. Tammany Parish Tax Collector v. Barnesandnoble.com, 481 F. Supp. 2d 575, 577 n.1 (E.D. La. 2007). This is the same test used to determine whether a state has *in personam* jurisdiction over a company. *See Quill*, 504 U.S. at 307.

145. *St. Tammany Parish*, 481 F. Supp. 2d at 577 (quoting *Quill*, 504 U.S. at 305–08).

146. *Quill*, 504 U.S. at 308.

147. *See id.*

148. Amazon Memo, *supra* note 20, at 1.

149. This Comment argues that the affiliates' physical presence and activities should not be imputed to the plaintiffs. *See* discussion *infra* Part V.B.3.

150. Amazon Memo, *supra* note 20, at 1.

151. *See Quill*, 504 U.S. at 307. If the affiliates' presence is imputed to the plaintiffs, they would have sufficient minimum contacts with New York for the imposition of a state tax obligation

activities toward the state. If sending catalogs to North Dakota was sufficient to show that Quill's activities were purposefully directed towards the state, then the plaintiffs signing contracts with their New York affiliates would also be sufficient.[152] Thus, the plaintiffs would have fair warning that they may be subject to a New York tax collection obligation, as required by the Due Process Clause.[153]

Additionally, e-tailers are subject to jurisdiction[154] and thus could be subject to tax collection obligations imposed by any state in which their customers reside. Most courts follow the sliding scale set forth in *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.* for determining whether a state has jurisdiction over an e-tailer.[155] According to the sliding scale, whether jurisdiction can be exercised is "directly proportionate to the nature and quality of commercial activity that an entity conducts over the Internet."[156] Personal jurisdiction is proper "[i]f the [business] enters into contracts with residents of a foreign jurisdiction."[157] Amazon and Overstock—both ranked within the top 30 internet retailers[158]—conduct business and enter into contracts over the internet with New York residents. Thus, the plaintiffs can be subjected to jurisdiction in New York.[159] Because the Due Process Clause analysis generally mirrors jurisdiction analysis,[160] the plaintiffs can also be obligated to collect and remit New York taxes under the Due Process Clause.[161] However, for the imposition of a tax to withstand a constitutional challenge, the more substantial burdens imposed by the Commerce Clause must also be satisfied.

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to be proper under the Due Process Clause. *See id.*; Scripto, Inc. v. Carson, 362 U.S. 207, 211–12 (1960).

152. *See Quill*, 504 U.S. at 308.

153. *See* Burger King Corp. v. Rudzewicz, 471 U.S. 462, 472–73 (1985) (noting that "with respect to interstate contractual obligations, we have emphasized that parties who 'reach out beyond one state and create continuing relationships and obligations with citizens of another state' are subject to regulation and sanctions in the other State for the consequences of their activities").

154. Lakin v. Prudential Sec., Inc., 348 F.3d 704, 710 (8th Cir. 2003).

155. *Id.* (citing Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119, 1124 (W.D. Pa. 1997)).

156. *Lakin*, 348 F.3d at 710 (quoting *Zippo*, 952 F. Supp. at 1124).

157. *Id.*

158. Internetretailer.com, *Overstock Files Legal Challenge to New York's Internet Sales Tax* (June 6, 2008), http://www.internetretailer.com/dailyNews.asp?id=26708. In 2007, Overstock was ranked number thirty while Amazon was far and away number one, nearly tripling the sales of the next closest competitor. *Id.*

159. *See Lakin*, 348 F.3d at 710.

160. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 307 (1992).

161. *See Lakin*, 348 F.3d at 710.

B. Commerce Clause Claims

To be permissible under the Commerce Clause, a state must show that imposing a tax meets all four parts of the test outlined in *Complete Auto Transit*.[162] The first of the four parts—whether a retailer has a substantial nexus with the state—generally allows e-tailers to avoid tax collection obligations.[163] However, the NY Court felt this case was different because the Statute "requires a substantial nexus between an out-of-state seller and New York through a contract to pay commissions for referrals with a New York resident."[164] This subpart first examines the meaning of substantial nexus, looking at the level of physical presence in the state required to satisfy the test. This subpart then considers and critiques the court's ruling on the plaintiffs' Commerce Clause challenges, looking first at the plaintiffs' "facial" challenge of the Statute and then at the "as-applied" challenge.

1. Substantial Nexus

To establish substantial nexus, a "physical presence of the vendor is required."[165] While the *Quill* court set out this standard, it did not elaborate on what level of physical presence would be sufficient to meet it.[166] However, in *Orvis*, the New York Court of Appeals determined that the physical presence required is not a substantial presence, but rather "demonstrably more than a 'slightest presence.'"[167]

The *Orvis* court also adopted the U.S. Supreme Court's determination of what creates the slightest presence.[168] Under this standard, a vendor's physical presence can be actual or imputed through in-state solicitation of sales on the vendor's behalf—by its employee, agent, or independent contractor.[169] Advertising on its own, however, is not sufficient

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162. St. Tammany Parish Tax Collector v. Barnesandnoble.com, 481 F. Supp. 2d 575, 577 (E.D. La. 2007).

163. Le, *supra* note 36, at 407.

164. Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin., 877 N.Y.S.2d 842, 851 (N.Y. Sup. Ct. 2009).

165. Orvis Co., Inc. v. Tax Appeals Tribunal of N.Y., 86 N.Y.2d 165, 178 (1995). Such a presence is required because the *Quill* court preserved the bright-line physical presence standard for substantial nexus found in *Bella Hess*. *Quill*, 504 U.S. at 317–18.

166. Le, *supra* note 36, at 407.

167. *Orvis*, 86 N.Y.2d at 178. The *Orvis* standard is controlling in this case because it was filed in the NY Court.

168. *Id.* at 177–78.

169. Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 249–50 (1987). The question in this case is whether the affiliates' presence can be imputed to the plaintiffs. The NY Court said that it could be, as will be discussed further. *See Amazon*, 877 N.Y.S.2d at 851; *see* discussion *infra* Part V.B.3.

to create a physical presence in the state.[170] A vendor's in-state activities must also be "'significantly associated with the taxpayer's ability to establish and maintain a market in th[e] state for the sales.'"[171]

2. The Facial Challenge

Amazon and Overstock first brought a facial challenge claiming the Statute was unconstitutionally vague.[172,173] The NY Court noted "a party mounting a facial constitutional challenge bears the substantial burden of demonstrating that 'in any degree and in every conceivable application' the law suffers wholesale constitutional impairment."[174] The plaintiffs argued that the Statute "imposes tax collection obligations based on activities that are insufficient to create a substantial nexus under the dormant Commerce Clause."[175] In addition, it was argued that the Statute would apply to "simple advertising by in-state advertisers."[176] The NY Court disagreed with both arguments, stating flatly, "Amazon is wrong."[177]

The NY Court defended its position by noting that the Statute requires that a vendor have connections with New York residents sufficient to create a substantial nexus with the state.[178] To have a substantial nexus, a vendor must have a contract with a New York resident, the resident must refer potential customers to the vendor, the vendor must pay a commission or other consideration, and the arrangement must generate at least $10,000 in New York sales.[179] The court emphasized that the vendor can rebut the statutory presumption by showing that its New York actors did not engage in any solicitation in the state that would create nexus.[180] Finally, the court held that the Statute would not cover mere advertising.[181]

While much of what the NY Court said was correct, its conclusion regarding advertising was not. For instance, the court correctly identified all of the Statute's requirements and recognized that the vendor can rebut

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170. *See Quill*, 504 U.S. at 313 n.6.

171. *Tyler Pipe*, 483 U.S. at 250–51.

172. A "facial" challenge is "a claim that a statute is unconstitutional on its face—that is, that it always operates unconstitutionally." BLACK'S LAW DICTIONARY 261 (9th ed. 2009).

173. Amazon Memo, *supra* note 20, at 15.

174. Amazon.com, LLC v. N.Y. State Dep't of Tax'n & Fin., 877 N.Y.S.2d 842, 847–48 (N.Y. Sup. Ct. 2009) (quoting Matter of Moran Towing Corp. v. Urbach, 99 N.Y.2d 443, 448 (2003)).

175. Amazon Memo, *supra* note 20, at 15.

176. *Id.* at 16.

177. *Amazon*, 877 N.Y.S.2d at 848.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

the presumption.[182] Additionally, it correctly stated that the Statute "*contemplates* a substantial nexus with New York,"[183] considering the Statute is clearly trying to find a way to work around the *Quill* substantial nexus standard.[184] However, the sweeping statutory language that made the NY Court's statements possible ultimately undermines its logic.

The Statute is so broadly worded that it would cover mere advertising. Thus, the NY Court's argument that the Statute did not cover remote retailers that generate only publicity is incorrect.[185] The Statute's requirements—a contract with a New York resident for the direct or indirect referral of potential customers in exchange for a commission or other consideration that results in $10,000 in New York sales—would be met by traditional advertisements such as radio and television.[186] The very purpose of advertising is to attain the referral of potential customers, whether directly or indirectly.[187] Despite this, the NY Court stated that advertising would not fall under the Statute because "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."[188]

When it comes to advertising, however, the distinction between generating business and generating publicity is a distinction without a difference. Advertising is defined as "the action of drawing the public's attention to something to promote its sale,"[189] while publicity can be defined as "paid advertising."[190] Because promoting sales is essentially the same as generating business, advertising is a method of generating business. Further, because advertising is also a part of generating publicity, the NY Court erred in making a principled distinction between the

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182. *Id.* at 846. *See* N.Y. TAX LAW § 1101(b)(8)(vi) (2008).

183. *Amazon*, 877 N.Y.S.2d at 848 (emphasis added).

184. *See* J.P. Finet & Dolores W. Gregory, *New York's Win in 'Amazon.com' Raising Fears of Impact on SSTP Project*, BNA DAILY TAX REP., Jan. 15, 2009.

185. The Statute covers agreements in which a New York resident agrees, "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." N.Y. TAX LAW § 1101(b)(8)(vi) (2008) (emphasis added).

186. *See* Finet, *supra* note 184, at 3 (noting that radio and television advertisements are passive solicitation, which, if on the internet, could trigger the statutory presumption).

187. Entrepreneur.com, Term Definition: Advertising, http://www.entrepreneur.com/encyclopedia/term/82082.html (last visited Mar. 24, 2009).

188. *Amazon*, 877 N.Y.S.2d at 848. Although the NY Court did not mention it, the May TSB-M also stated that mere advertising did not fall under the Statute. May TSB-M, *supra* note 107, at 2; *see also* discussion *supra* Part IV.B.

189. BLACK'S LAW DICTIONARY 63 (9th ed. 2009).

190. Merriam-Webster Online Dictionary: Publicity, http://www.merriam-webster.com/dictionary/publicity (last visited Feb. 16, 2009).

two.[191] The Statute imposes a tax obligation based on mere advertising, which is a direct violation of *Quill*.[192]

Nevertheless, given the extremely high standard of proof required in facial challenges, this error likely did not change the result of the challenge. It is difficult for plaintiffs to satisfy their burden of proving "that no set of circumstances exists under which the [Statute] would be valid."[193] In this case, the Statute would validly apply in many situations (the May TSB-M lists several).[194] As a result, the plaintiffs' facial challenge was doomed before it started. However, the fact that the Statute applies to advertising also impacts the plaintiffs' as-applied Commerce Clause challenge.

3. The As-Applied Challenge

The plaintiffs next brought an as-applied challenge, claiming it was unconstitutional to apply the Statute to the plaintiffs.[195] The plaintiffs had three primary contentions for this challenge.[196] First, the plaintiffs did not have a physical presence in New York because the affiliates' activities were merely advertising, not solicitation.[197] Second, if the affili-

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191. *See* Finet, *supra* note 184, at 3 (noting that affiliate programs are closer to advertising than in-state solicitation of sales). However, the May TSB-M makes clear that DTF believes that mere advertising does not trigger the statutory presumption, and thus, DTF is unlikely to enforce it in that way. May TSB-M, *supra* note 107, at 2; *see also* N.Y. TAX LAW § 12(c)(2) (2008) (stating that a "person" does not become a vendor—someone required to collect and remit tax—"solely by . . . (2) having its advertising disseminated or displayed on the Internet by an individual or entity subject to tax under [certain tax provisions]"). In either case, DTF's interpretation does not matter in a facial challenge, where only the statutory language is examined. *See* Lorillard Tobacco Co. v. Roth, 99 N.Y.2d 316, 322–23 (2003) (quoting N.Y. COMP. CODES R. & REGS. tit. 20, § 2375.6) (noting that TSB-M are merely "advisory in nature" and have no "legal force," but are usually given deference as long as they are not irrational or unreasonable).

192. Quill Corp. v. North Dakota, 504 U.S. 298, 313 n.6 (1992) (stating that basing nexus solely on advertising, mail, and telephone calls would unduly burden interstate commerce).

193. *Amazon*, 877 N.Y.S.2d at 848 (quoting Moran Towing Corp. v. Urbach, 99 N.Y.2d 443, 448 (2003)).

194. May TSB-M, *supra* note 107, at 2–5. For example, the May TSB-M describes a situation in which an Arizona fitness equipment seller has an agreement with several New York health clubs whereby the seller will pay a five percent commission to the clubs for any purchases of equipment by the club's members. *Id.* at 2–3. The statutory presumption would apply here, and as long as the agreement generated over $10,000 in New York sales, the seller would be obligated to collect taxes on its New York sales. *Id.*

195. Amazon Memo, *supra* note 20, at 18. An "as-applied" challenge is "a claim that a statute is unconstitutional on the facts of a particular case or in its application to a particular party." BLACK'S LAW DICTIONARY 261 (9th ed. 2009).

196. *See Amazon*, 877 N.Y.S.2d at 848–49. Each of the plaintiffs' arguments, if accepted, would result in a lack of substantial nexus with New York, and the Statute would be overturned.

197. *Id.* This argument harkens the fact that, under *Quill*, mere advertising does not create substantial nexus. Amazon Memo, *supra* note 20, at 21. Arguing that the affiliates' activities are mere advertising may, at first glance, seem contradictory to the plaintiffs' facial challenge argument that the Statute covers mere advertising. However, because basing a tax collection obligation on

ates were involved in solicitation, it had not been authorized by the plaintiffs and should not have been the basis for substantial nexus.[198] Third, the affiliates' activities were not "significantly associated with [the plaintiffs'] ability to establish and maintain a market for sales in New York."[199] As was the case with the facial challenge, the NY Court did not agree with any of the plaintiffs' claims arising from their as-applied challenge.[200]

The NY Court cited two main reasons for upholding the Statute's constitutionality. First, the NY Court noted that the plaintiffs had contracted with New York residents, which it characterized as the plaintiffs' "incentivized New York sales force."[201] The court reasoned that the plaintiffs benefitted from these contracts by obtaining more than $10,000 in New York sales.[202] "[The plaintiffs] should not be permitted to escape tax collection indirectly . . . when [they] would not be able to achieve tax avoidance directly through use of New York employees engaged in the very same activities."[203] Second, the court determined that it did not matter that the plaintiffs did not ask the affiliates to solicit sales or that the affiliates' operating agreement prohibited them from engaging in certain conduct.[204] It was enough that the New York affiliates could potentially solicit sales in the state and were incentivized to do so (the plaintiffs would pay them commissions, even if unknowingly, for solicited sales).[205] According to the court, the plaintiffs failed to even allege that the affiliates did not solicit sales from New York customers.[206] However, the NY Court's opinion leaves room for disagreement.

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mere advertising would be a violation of *Quill*, the two arguments are not contradictory. *See Quill*, 504 U.S. at 313 n.6.

198. Amazon Memo, *supra* note 20, at 24.

199. *Id.* Amazon states that sales by New York affiliates amounted to less than 1.5% of its total sales in the state. Amazon Memo, *supra* note 20, at 27. Overstock's sales through its New York affiliates were insignificant enough that it decided to cut ties with all 3,400 of them rather than be obligated to collect the tax. Internet Retailer, *New York Judge Dismisses Amazon and Overstock Sales Tax Suits*, Jan. 13, 2009, http://www.internetretailer.com/dailyNews.asp?id=29052 (last visited Mar. 24, 2009).

200. *Amazon*, 877 N.Y.S.2d at 849 ("None of these allegations, however, sufficiently state a claim for violation of the Commerce Clause.").

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.* The court stated the following:

> Amazon chooses to benefit from New York [affiliates] that are free to target New Yorkers and encourage Amazon sales, all while earning money for Amazon in return for which Amazon pays them commissions. Amazon does not discourage its [affiliates] from reaching out to customers or contributors and pressing Amazon sales.

Id.

205. *Id.*

206. *Id.*

The NY Court's first argument—that the plaintiffs should not be able to avoid taxation when having employees engaged in the same activities would trigger an obligation—fails to address two major issues. Characterizing the affiliates as actively soliciting sales too easily dismisses the argument that the affiliates' activities are more akin to traditional advertising than solicitation.[207] In addition, nowhere does the court address the U.S. Supreme Court's requirement, as set forth in *Tyler Pipe*,[208] that the activities be "significantly associated with [the plaintiffs'] ability to establish and maintain a market . . . for the sales" in New York.[209] Each of these omissions deserves greater attention.

The affiliates' activities are more analogous to traditional print, television, or radio advertising than to physical solicitation such as distributing flyers or coupons;[210] the only major difference is the compensation scheme.[211] Like traditional advertising, affiliates passively distribute an advertisement that requires some sort of action by the customer. The affiliates' advertisements are simply disseminated over the internet instead of in print or over the airwaves.[212] Unlike traditional advertising, technology allows the merchant to track whether the affiliates' advertisements are directly contributing to sales and to compensate the affiliate only when it is effectively doing so.[213]

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207. *See* Finet, *supra* note 184, at 3.

208. Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 250 (1987) (quoting Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 105 Wash. 2d 318, 323 (1986)).

209. *See Amazon*, 877 N.Y.S.2d. 842.

210. *See* Finet, *supra* note 184, at 3.

211. *See id.*

212. *See id.*

213. *Id.* (noting that affiliate marketing created a shift from paying for an advertisement and hoping that it works to paying for an advertisement only when it works). In its brief, New York argued that the Statute applies only to "out-of-state sellers who employ a business model that encourages the active solicitation of sales by its representatives located in New York." Defendant's Memo, *supra* note 20, at 25. The NY Court may have adopted this argument without expressly stating it. *See Amazon*, 877 N.Y.S.2d at 849. However, neither the state nor the court elaborated as to why a pay-for-performance compensation scheme meets this criterion while a pay-per-click compensation scheme (or any other similar scheme) does not. Because both schemes require the customer to perform some action before the affiliate is compensated (either a click or a purchase), they seem equally likely to encourage active solicitation. In addition, the plain language of the Statute states that solicitation is presumed when the resident is compensated by "a commission *or other compensation*," which leaves no room for a distinction between commissions and other compensatory schemes. N.Y. TAX LAW § 1101(b)(8)(vi) (2008) (emphasis added). Thus, there is no compelling reason for holding that compensating affiliates through a pay-for-performance compensation scheme should result in a finding of substantial nexus when compensating through a pay-per-click scheme does not. Even if the merchant is allowed to rebut the presumption of substantial nexus, no such obligation should be placed on the merchant in the first place. Doing so contravenes the *Quill* court's reason for keeping the bright-line physical presence standard—namely, to "encourage[] settled expectations and, in doing so, foster[] investment by businesses and individuals." Quill Corp v. North Dakota, 504 U.S. 298, 316 (1992).

While it may seem that compensating only effective advertisers would create an incentive for the affiliates to physically solicit sales, this is not the case due to the nature of internet marketing. Unlike traditional advertising, affiliates and other internet advertisers try to increase traffic to their own website, rather than direct traffic straight to the website of the company running the affiliate program.[214] In fact, most affiliates engage in affiliate marketing for many different companies and, thus, have no incentive to solicit sales for any one company.[215] Because the internet allows the affiliates to reach a broader market, it is easier for them to use online sources to increase traffic to their website than to physically solicit sales in the geographic area where they reside. Furthermore, unlike traditional advertising, which is specific to a particular geographic region, internet marketing can be done from any location without consumers ever knowing where the advertiser is located.[216] For these reasons, there is little incentive for an affiliate to solicit sales locally.

The U.S. Supreme Court has stated that other, similar types of passive advertising activity do not create substantial nexus.[217] In *Quill*, the Court stated that creating a tax obligation based on activities such as advertising, mail, and telephone calls would unduly burden interstate commerce.[218] Because of the similarities noted between these activities and the affiliates' activities, it was inappropriate for the NY Court to base a finding of substantial nexus on the affiliates' activities.

The affiliates' activities are not "significantly associated with the taxpayer's ability to establish and maintain a market in th[e] state for the sales"[219] because the affiliates are not locally based and provide no information about the local market.[220] While it is not explicitly stated anywhere in the decision, it appears that the NY Court attempted to equate the activities of the plaintiffs' affiliates to those of the independent contractors that created a taxable nexus in *Scripto* and *Tyler Pipe*.[221] However, both of those cases can be readily distinguished from the case at hand.

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214. Joshua K. Lawrence & Timothy P. Noonan, *Merchants and Affiliates Struggle to Navigate New York's 'Amazon Law,'* 52 State Tax Notes 73, 73–74 (Apr. 6, 2009).

215. *See id.*

216. Michele Borens & Mark Yopp, *Overextending Attributional Nexus: States' Latest Attempts to Tax Internet Sales*, 51 State Tax Notes 697, 698 (Mar. 2, 2009).

217. *See Quill*, 504 U.S. at 313 n.6.

218. *See id.*

219. Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 250 (1987) (quoting Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 105 Wash. 2d 318, 323 (1986)).

220. Amazon Memo, *supra* note 20, at 27.

221. This argument could have been gleaned from New York's memo, which attempted to do the same thing. *See* Defendant's Memo, *supra* note 20, at 25.

In *Scripto* and *Tyler Pipe*, the in-state independent contractors were the merchants' primary means for obtaining sales and creating lasting relationships with customers in the area.[222] In contrast, the affiliates' activities are not locally based, provide no information about the local market, and do not build relationships with local customers.[223] Moreover, the affiliates play no role in the sale, whereas the contractors in *Scripto* and *Tyler Pipe* collected the sale information and forwarded it to the out-of-state retailer.[224] The geographically untethered nature of the internet indicates that the in-state affiliates' activities are not significantly associated with the plaintiffs' ability to establish or maintain a market for sales in that particular state.

Additional evidence of the insignificance of the affiliates' activities to the plaintiffs' ability to maintain a market in New York is readily available. For example, Amazon had New York sales before it started its affiliate marketing program.[225] Furthermore, sales to New York customers originating from New York-based affiliates comprise less than 1.5% of Amazon's sales in the state.[226]

Instead of worrying about compliance with the Statute, Overstock decided to cut ties with all of its approximately 3,400 New York affiliates on May 15, 2008, guaranteeing that it would not trigger the statutory presumption of solicitation.[227] Because the affiliates' activities are akin to traditional advertising and do not significantly contribute to the plaintiffs' ability to establish or maintain a market for sales in New York, they should not be a basis for a finding of substantial nexus.

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222. Scripto, Inc. v. Carson, 362 U.S. 207, 209–10 (1960); *Tyler Pipe*, 483 U.S. at 249–50.

223. Customers who click on an advertisement on an affiliates' website generally do not know where the affiliate is physically located. The customer using the affiliate's website is just as likely to be from New Delhi as New York; the very nature of the internet makes it equally easy for a person from either place to access the website. Thus, unlike an in-state salesperson that must actually be in-state to be effective, an affiliate could generate the same amount of sales no matter where it is physically located.

224. Amazon Operating Agreement §§ 3, 7, July 23, 2009, https://affiliate-program.amazon.com/ (Follow "Operating Agreement" hyperlink on the right side of the page) (last visited Oct. 6, 2009) [hereinafter Amazon Agreement]; *see Scripto*, 362 U.S. at 209–10; *see also Tyler Pipe*, 483 U.S. at 249–50. The plaintiffs both handle all aspects of the sale on their own; the affiliates' only involvement is redirecting the customer from their website to the plaintiffs' website. *See, e.g.*, Amazon Memo, *supra* note 20, at 27.

225. Amazon Memo, *supra* note 20, at 27.

226. *Id.*

227. Overstock stated that its reason for doing so was that "New York's new tax law required us to choose between New York customers and New York ad businesses. In the end, we chose our customers." Press Release, Overstock.com, Inc., Overstock.com Says 'Yes' to New York Consumers, 'No' to New York's New Internet Sales Tax (May 15, 2008) (*available at* http://investors.overstock.com/phoenix.zhtml?c=131091&p=irol-ewsArticle&ID=1146398&highlight=). Presumably, Overstock would have been unable to cut these ties if the New York affiliates were "significantly associated" with Overstock's ability to maintain a market for sales in New York.

The NY Court's second major argument—that it did not matter that the affiliates were soliciting sales without the plaintiffs' consent—also falls short. The unauthorized activities of independent contractors are an insufficient basis for a finding of substantial nexus because any affiliate that engaged in solicitation activities in New York would be in violation of its agreement with Amazon or Overstock.[228] Also, principals are generally not liable for the acts of independent contractors because they do not control the method the contractor uses to perform its work.[229] Consequently, the affiliates' activities should not be imputed to the plaintiffs to support the creation of tax collection obligations and potential tax liability.[230] This is especially true when the affiliates' actions are unauthorized and in violation of their agreement with the plaintiffs.[231] Neither the State nor the NY Court produced any precedent for holding the merchant liable for the unauthorized acts of independent contractors. Until such precedent is available, the affiliates' unauthorized actions should not create substantial nexus for the plaintiffs.

In the end, the NY Court was correct in holding that the Statute does not violate the Due Process Clause, but it should have found the Statute's application to Amazon and Overstock an unconstitutional extension of current Commerce Clause doctrine. Because the plaintiffs purposefully directed their activities toward New York by contracting with affiliates located in the state, the Statute is consistent with the Due Process Clause. This, however, is not the case with the dormant Commerce Clause. The U.S. Supreme Court has stated that mere advertising does not create substantial nexus and DTF has agreed in its interpretations of the Statute. The NY Court fails in its attempt to equate the activities of the plaintiffs' affiliates with those of the independent salespersons that created a substantial nexus in *Scripto* and *Tyler Pipe*. Affiliates, by agreement, do nothing more than post a passive advertisement

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228. Both plaintiffs' agreements with their affiliates limit the activities that affiliates may engage in on behalf of the particular plaintiff. The Amazon Operating Agreement prohibits affiliates from "tak[ing] any action that could reasonably cause any customer confusion as to our relationship with you, or as to the site on which any functions or transactions . . . are occurring," and

> other than providing Special Links on your site in accordance with this Agreement, [you will not] post or serve any advertisements or promotional content promoting the Amazon Site or otherwise around or in conjunction with the display of the Amazon Site . . . or assist, authorize, or encourage any third party to take any such action.

Amazon Agreement, *supra* note 224, § 4. The Overstock Terms & Conditions state that "[e]ach party is an independent contractor vis-à-vis one another. Neither party has authority to act on behalf of the other or to bind the other by any promise or representation." Overstock Master Agreement §§ 4.2, 10.1, http://www.overstock.com/20810/static.html (last visited Oct. 6, 2009).

229. Chainani v. Bd. of Educ., 87 N.Y.2d 370, 380–81 (1995).

230. *See id.*

231. *See id.*

on their website. Any solicitation activity the affiliates may engage in has not been authorized by the plaintiffs and thus, does not form a sufficient basis to impose a tax collection obligation. For these reasons, the affiliates' activities do not create the substantial nexus required by the Commerce Clause and the Statute should be found unconstitutional.

VI. THE EFFECTS OF TAXING E-COMMERCE

In addition to the unconstitutional burdens imposed on the plaintiffs, the Statute has had one very noteworthy side effect and is likely to result in several more.

The most noteworthy side effect of the Statute is the impact it has had on the local businesses it was meant to protect—namely, the New York affiliates themselves. Many of the affiliates are small, independent businesses.[232] In order to avoid the tax collection obligation, many of the companies that maintain affiliate programs have simply cut all ties with their New York affiliates.[233] One website, purporting to maintain a complete record of companies taking this measure, lists sixty such companies.[234] The list includes some leading companies such as Overstock, CafePress, and Fingerhut.[235] Another website, NY Affiliate Voice, estimates that New York affiliates have lost between 20% and 90% of their income since the Statute took effect.[236] Consequently, it is unlikely that New York will collect the $47 million in annual revenue it had anticipated collecting as a result of the Statute.[237]

New York might meet its revenue collection goal, however, if every other state enacted a similar statute. Many other states are carefully watching the developments in New York and will likely impose their own tax obligations on e-tailers.[238] Some already have: Rhode Island and

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232. *See, e.g.*, Squidoo.com, *New York State Sales Tax Negatively Impacts NY Affiliates*, http://www.squidoo.com/newyorkstatetaxlaw (last visited Mar. 24, 2009).

233. Shari Claire Lewis, *A Taxing Online Issue Out of New York*, N.Y.L.J., Jan. 8, 2009, *available at* http://www.law.com/jsp/legaltechnology/pubArticleLT.jsp?id=1202427278716.

234. NYAffiliates.com, Merchants Removing NY Affiliates, http://forum.abestweb.com/showthread.php?t=105869 (last visited Oct. 5, 2009).

235. *Id.*

236. Stephen T. Watson, *New Tax Law Sends Valore Books Packing*, BUFFALO NEWS, Nov. 23, 2008, *available at* http://www.buffalonews.com/145/story/502441.html.

237. *Id.* (noting that while Valore Books had been considering moving out of Buffalo, the Statute was the "tipping point" that prompted them to do so). In addition, it is likely that the affiliates will now pay less New York income tax, which will further reduce the amount of revenue the state collects as a result of the Statute. *Id.*

238. Laura Kennedy, KIPLINGER BUS. RESOURCE CTR., OTHER STATES MAY COPY NEW YORK'S AMAZON TAX LAW, *available at* http://www.kiplinger.com/businessresource/forecast/archive/Copying_New_York_Amazon_Law_080513.html; *see also* NY Affiliate Voice, Many States Adding Internet Tax, March 10, 2009, http://nyaffiliatevoice.com/2009/03/many-states-adding-

North Carolina have both passed "Amazon provisions" modeled on the Statute.[239] And more states are likely to follow as they see the results in Rhode Island and New York.[240] In a report examining the impact of the New York and Rhode Island laws, the Center for Budget and Policy Priorities recommended that other states seriously consider adopting similar measures.[241] Should every state adopt the same type of measure, e-tailers would face a difficult choice between entirely eliminating their affiliate programs or collecting use tax in all fifty states.[242] However, because "[t]he ubiquity of affiliate programs and the amount of money that retailers spend on them suggest that they are highly valuable to retailers,"[243] it is quite likely that e-tailers would refuse to drop the programs.[244] If this were the case, e-tailers would have to collect use tax on internet sales in all fifty states.[245] This would allow all of the states to meet their revenue generation forecasts for the new laws.

If many states require collection and remittance of sales tax, companies will be subject to an additional reporting burden. This additional reporting burden, in turn, could have a chilling effect on the growth of e-commerce.[246] Furthermore, what is there to stop other states from imposing more onerous tax burdens on smaller e-tailers with even more tenuous connections to the states? Where do we draw the line?

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internet-tax/ (noting that Minnesota, Connecticut, California, Illinois, Tennessee and Hawaii all have proposed or pending bills to change the definition of nexus or to require sales tax to be collected).

239. Martha Kessler, *State Taxes: States Should Seriously Consider Enacting 'Amazon' Sales Tax Law, CBPP Report Says*, BUREAU OF NAT'L AFF. E-COM. TAX REP., July 24, 2009, at d4; Andrew M. Ballard, *North Carolina Passes Budget Bill With 'Amazon,' Other Provisions*, BUREAU OF NAT'L AFF. E-COM. TAX REP., Aug. 6, 2009, at d2.

240. Kennedy, *supra* note 238.

241. Ballard, *supra* note 239.

242. Michael Mazerov, CTR. ON BUDGET & POLICY PRIORITIES, NEW YORK'S "AMAZON LAW": AN IMPORTANT TOOL FOR COLLECTING TAXES OWED ON INTERNET PURCHASES 7 (2009) http://www.cbpp.org/files/7-23-09sfp.pdf. However, there is a danger that companies would simply move their affiliate networks overseas. *See* Mike Pearson, *Amazon Turns Gears of Internet Tax War*, E-COM. TIMES, July 1, 2009, *available at* http://www.ecommercetimes.com/story/67489.html?wlc=1253824991&wlc=1254773253. Due to the geographically untethered nature of the internet, internet advertising can be done by anyone, anywhere. *See id.* Thus, should every state decide to enact an Amazon Tax, companies may simply ban any affiliates who are located in the United States and thus avoid any tax collection obligations based on affiliates location.

243. Maserov, *supra* note 242, at 9.

244. *Id.*

245. *Id.*

246. *See* Grant Gross, *Congress Votes to Extend Internet Tax Ban*, PC WORLD, Oct. 31, 2007, *available at* http://www.pcworld.com/article/139112/congress_votes_to_extend_internet_tax_ban.html.

VII. CONCLUSION

Of course, the ultimate question in this Amazon Tax saga is, "Who cares? How does this affect me personally?" Residents of New York who shop with Amazon or other major e-tailers have already been affected; they now pay a tax charge on all of their purchases. If the Statute is upheld, residents of every other state will most likely have a similar experience.[247] On a more positive note, states will be better able to provide the services we all depend on as the reduction of their revenues is slowed or even stopped. Nonetheless, your days of tax-free shopping on the internet are likely numbered.

Ultimately, the Amazon Tax represents just one more way that states have attempted to circumvent the *Quill* substantial nexus standard. Until a determination of what constitutes a substantial nexus is resolved and Congress develops a policy on how to tax internet sales, e-tailers will continue to operate in a very uncertain tax landscape. Whether Congress will enact a federal statute to clear up the situation or whether states will continue to enact piecemeal attempts to circumvent *Quill* remains to be seen. The court battle over the Statute has the potential to play a key role in this determination. But, as long as internet sales continue to grow and states continue to feel they are losing out on revenue, the Amazon Tax is only the first of many attempts to tax internet sales.

247. *See* Kennedy, *supra* note 238.