

Desperate Times Call for Desperate Measures: States Lead Misguided Offensive to Enforce Sales Tax Against Online Retailers

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I. INTRODUCTION

It is a near universal experience. An individual wants to purchase an item. He shops around to find the best price. After a

diligent search, he realizes that if he makes the purchase online, he can avoid being charged sales tax on the item. Depending on the price of the item and the tax rate, the savings can be substantial—sometimes enough to justify paying for shipping. But many consumers fail to consider another consequence: choosing an online retailer effectively denies tax revenue to a buyer's home state.

In the United States, state governments have three basic options for generating tax revenue: an income tax, a consumption tax, or some combination of the two.¹ Nearly every state in the country imposes a sales tax that accounts for a large (often the largest) portion of its revenue.² Yet, since the advent of online ordering, many sales have gone untaxed, leaving a source of revenue that many states are desperate to tap.³

Online retailers enjoy an advantage over traditional brick-and-mortar stores: most states cannot force the online retailer to collect a sales tax. In *Quill Corp. v. North Dakota*,⁴ the Supreme Court held that the Dormant Commerce Clause does not allow a state to force an out-of-state retailer to collect sales tax unless that retailer has a physical presence within the state.⁵ *Quill*'s holding is still controlling despite fundamental changes to the economy resulting from the rapid expansion and commercialization of the Internet.⁶

With the economic downturn forcing states to find innovative ways to balance their budgets, it is not surprising that many states are looking to online retailers as a source of new revenue. Some states have passed state-specific legislation, while others have tried to work with each other to find a common solution. But to this point, all

1. Herwig Schlunk, *Why Every State Should Have an Income Tax (and a Retail Sales Tax, Too)*, 78 MISS. L.J. 637, 648 (2009). There are a few states that are able to make do with narrowly defined income or consumption taxes, but these states are rare and those options are not viable alternatives for the majority of states. *Id.* It is arguable that having a combination of both is the only efficient way to maximize state revenues. *See id.*

2. *See infra* Part II.B (detailing how important the sales tax is to state budgets).

3. *See infra* Part II.A (noting the rapid rise of e-commerce); *infra* Part II.B.2 (discussing websites run by separate legal entities); *infra* Part II.B.3 (discussing *purely* online retailers); *infra* Part II.C (outlining several ways states have tried to collect sales tax from online retailers).

4. 504 U.S. 298 (1992).

5. *See id.* at 315; *see also infra* notes 53–66 and accompanying text (detailing the *Quill* case).

6. *See* N.M. Taxation & Revenue Dep't v. Barnesandnoble.com, L.L.C., 303 P.3d 824, 826 (N.M. 2013) (citing *Quill*, 504 U.S. at 309); *see also* Overstock.com, Inc. v. Dep't of Taxation & Fin., 987 N.E.2d 621, 625 (N.Y. 2013), *cert. denied*, 134 S. Ct. 682 (2013) (citing *Quill*, 504 U.S. at 314).

attempts to impose a sales tax on online retailers have failed to capture meaningful amounts of additional revenue.⁷

Part II.A describes how e-commerce has fundamentally changed the economy. Part II.B discusses the origins of the *Quill* physical presence test, the rationales behind it, and the uncertainty it can cause in an economy with a large segment of remote sellers. Part II.C looks at New York's Amazon law, the state's attempt to collect tax revenue that *Quill's* physical presence test would exclude if applied literally. Part II.D discusses the Streamlined Sales and Use Tax Agreement ("SSUTA"), a collective attempt by states to entice online retailers to voluntarily collect sales tax. Finally, in Part III, this Note analyzes the problems with prior attempts to unlock online sales-tax revenue, namely that they prevent an efficient tax regime and subject online retailers to unfair burdens. In Part IV, this Note concludes that if online transactions are to be taxed,⁸ Congress must take action to reduce the burden on online retailers.

II. THE MODERN ERA: LIMITATIONS ON THE STATES' ABILITY TO TAX ONLINE TRANSACTIONS AND ATTEMPTS TO COLLECT SALES-TAX REVENUE

A. The Rise of E-Commerce

After nearly two decades of limiting Internet usage to select government personnel and academics, Congress finally permitted the general public to go online in 1992.⁹ Within two years, businesses began commercializing the Internet.¹⁰ The Internet offered retailers a perfect extension of the catalog model, allowing for giant inventories while eliminating the need to continuously print and update catalogs.¹¹ While traditional retailers are restricted by the need to sell in multiple locations, store size, and the number of employees

7. See *infra* Part III.A (discussing the problems with laws similar to New York's Amazon law); *infra* Part III.B (discussing the problems with the Streamlined Sales and Use Tax Agreement).

8. Whether or not online retailers should be subjected to state sales tax authority as a normative matter is an issue beyond the scope of this Note. Instead, I am working under the assumption that online retailers will inevitably find themselves subjected to such authority in some form. This Note argues that any tax regime applied to online retailers must avoid overburdening interstate commerce.

9. See THE INTERNET AND AMERICAN BUSINESS 3, 4 (William Aspray & Paul E. Ceruzzi eds., 2008).

10. *Id.*

11. See CHRIS ANDERSON, THE LONG TAIL: WHY THE FUTURE OF BUSINESS IS SELLING LESS OF MORE 47 (2008).

necessary to maintain those stores, online retailers need only one large warehouse and a website to make sales across the country or even around the world.¹² Online retailers do not need to expand into new marketplaces in the traditional sense; as long as the Internet is available in a given location, the online retailer has access to that location's customer base.¹³

This new forum for retailers has several advantages. Specifically, online retailers can focus their efforts on objectives different from those of traditional retailers; for example, many online retailers pride themselves on carrying a selection that would be physically impossible for traditional retailers to carry.¹⁴ This new marketplace also allows online retailers to keep their overhead costs lower than traditional retailers, which can lead to lower prices for consumers.¹⁵ Despite these advantages, traditional retailers were slow to transition to e-commerce. Instead, venture capitalists backed a host of new businesses in the formative years of e-commerce, leading to the formation of online retail giants such as Amazon and Netflix.¹⁶

Over the last decade, e-commerce has proven to be a dominant force in the economy. From 2002 to 2009, e-commerce grew at an average yearly rate of 18.1 percent while retail sales as a whole only grew 2.2 percent.¹⁷ Today, most major retailers have a website where customers can browse their inventories and make purchases. This fundamental change to the economic landscape has created problems in many areas, particularly sales tax.¹⁸

12. See *id.* at 49.

13. See *id.* at 47. Theoretically, without the ability to ship their products, online retailers would be limited in their reach. But with the number of available shipping options in the United States, online retailers essentially experience no such limitations. *Id.*

14. See Netflix, Inc., Annual Report (Form 10-K) (Mar. 31, 2003) (noting that, at the time, Netflix carried almost every available DVD title, excluding adult movies, and that its massive selection is what makes the company successful); see also ANDERSON, *supra* note 11, at 168–76 (noting that providing greater choice than traditional retailers drives the economics of the online retailers).

15. See ANDERSON, *supra* note 11, at 49.

16. See Ward Hanson, *Discovering a Role Online: Brick-and-Mortar Retailers and the Internet*, in THE INTERNET AND AMERICAN BUSINESS, *supra* note 9, at 233.

17. U.S. CENSUS BUREAU, E-STATS 3 (May 26, 2011) available at <http://www.census.gov/econ/estats/2009/2009reportfinal.pdf>, archived at <http://perma.cc/Z5F2-JYJP>. Nonstore retailers—which includes online units of traditional retailers that operate as separate legal entities, such as walmart.com—made up the largest segment of retail e-commerce, accounting for 80.3 percent or \$117 billion in 2009. *Id.* E-commerce has continued to grow faster than the retail sector as a whole. See *infra* notes 22–23 and accompanying text.

18. See Emily Patch, Note, *Online Retailers Battle with Sales Tax: A Physical Rule Living in a Digital World*, 46 SUFFOLK U. L. REV. 673, 680 (2013); see also Pamela Swidler, Note, *The Beginning of the End to a Tax-Free Internet: Developing an E-Commerce Clause*, 28 CARDOZO L.

B. Sales Taxation and Use Taxation

A quick glance at state- and local-government revenue streams shows that sales tax is vital for many of those governments.¹⁹ In fact, general sales taxes are the largest single source of tax revenue for states, accounting for nearly a third of all tax revenue and approximately 14 percent of total revenue.²⁰ While property taxes account for the bulk of local tax revenue, sales tax contributed over \$65 billion to local governments in 2011—nearly 11 percent of all tax revenue.²¹

In 2011, e-commerce retail sales increased by 16.4 percent year over year.²² E-commerce's growth rate represents more than twice that of total sales, which means that e-commerce is accounting for a larger portion of the retail-sales pie.²³ Because the vast majority of these online transactions are exempt from sales tax under the current rule, state and local governments are not seeing a corresponding increase in revenue as a result of this growth.²⁴ With such a dependence on sales taxes, the continuing increases in online retail sales without any corresponding increase in tax revenue pose a threat to the balance sheets of many states.

However, e-commerce is simply the newest iteration of a long-existing problem that has manifested itself in other forms in the past. There are 9,646 jurisdictions with a sales tax in the United States,²⁵ and significant discrepancies between the sales-tax rates of

REV. 541, 543 (2006) ("One problem precipitated by the surge in Internet use is the application of tax laws to e-commerce and electronic transactions.").

19. *Revenue by Government Level 2000-2011*, TAX POL'Y CTR., available at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=328>, archived at <http://perma.cc/V75R-CDSY> (last visited Feb. 19, 2014) (based on statistics from 2011).

20. *Id.*

21. *Id.*

22. U.S. CENSUS BUREAU, E-STATS 2 (May 23, 2013), available at <https://www.census.gov/econ/estats/2011/2011reportfinal.pdf>, archived at <http://perma.cc/U5N6-JKSY>. This growth is in line with the average rate of growth seen for retail e-commerce over the past decade. See U.S. CENSUS Bureau, *supra* note 17, at 3.

23. U.S. CENSUS Bureau, *supra* note 17, at 3. E-commerce accounted for \$194 billion in 2011, which was 4.7 percent of total retail sales. *Id.* In 2008, e-commerce only accounted for 3.6 percent of total retail sales. *Id.*

24. See generally *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (holding that a business must have a physical presence within a state to be subjected to that state's taxing authority).

25. Joseph Henchman, *House Chairman Goodlatte Releases Principles for Taxing Internet Sales*, TAX FOUND. (Sept. 20, 2013), <http://taxfoundation.org/blog/house-chairman-goodlatte-releases-principles-taxing-internet-sales>, archived at <http://perma.cc/CJG7-F62F>. Local jurisdictions often have their own tax rules which augment the rules of the states in which they are located. See *id.*

neighboring jurisdictions may create problems.²⁶ If an individual lives in a jurisdiction with a sales-tax rate higher than a neighboring area—for example, a city surrounded by suburbs with lower sales-tax rates or a state border with a significantly lower rate on one side—and if transportation to the lower-tax rate jurisdiction is economically feasible, the consumer can effectively choose a sales-tax rate for his or her purchase.²⁷ Evidence suggests that consumers do indeed consider sales-tax rates when deciding where to make their purchases.²⁸ Every time a consumer travels to a different jurisdiction for a preferential rate, that consumer's home jurisdiction loses revenue.

Similarly, purchasers can circumvent sales tax through remote purchases made either by mail or phone.²⁹ In many ways, e-commerce is simply a natural outgrowth of the mail-order catalog, except e-commerce only requires the company to set up a website, not to print and mail catalogs.³⁰ Courts have recognized this similarity, applying the standards developed for catalog retailers to online retailers.³¹

In an attempt to recover some of this lost revenue, many states have enacted use taxes.³² The use tax was created “to complement the sales tax, i.e., to fill in gaps where the States could not constitutionally tax interstate arrivals or departures.”³³ Specifically, a use tax applies to purchases that would have been subject to sales tax had they occurred within the state itself. As the name suggests, the state is actually taxing the use of the product within the state, not the sale.³⁴

26. Mehmet Serkan Tosun & Mark Skidmore, *Cross-Border Shopping and the Sales Tax: A Reexamination of Food Purchases in West Virginia* (Reg'l Research Inst., Working Paper, 2005-7 2005), available at <http://rri.wvu.edu/wp-content/uploads/2012/11/Tosunwp2005-7.pdf>, archived at <http://perma.cc/HQ3H-SASG>; see also Randolph T. Beard, Paula A. Gant & Richard P. Saba, *Border-Crossing Sales, Tax Avoidance, and State Tax Policies: An Application to Alcohol*, 64 S. ECON. J. 293 (1997) (noting potential problems posed by smuggling, arbitrage, and camouflaging activities between neighboring jurisdictions).

27. Susan Chandler, *The Sales Tax Sidestep*, CHI. TRIB., July 20, 2008, http://articles.chicagotribune.com/2008-07-20/business/0807190001_1_sales-tax-tax-avoidance-tax-landscape, archived at <http://perma.cc/TR2A-66P3>.

28. See *id.*

29. See *Quill*, 504 U.S. at 311.

30. See ANDERSON, *supra* note 11, at 47.

31. See *Overstock.com, Inc. v. Dep't of Taxation & Fin.*, 987 N.E.2d 621, 621 (N.Y. 2013), *cert. denied*, 134 S. Ct. 682 (2013) (applying the *Quill* standard to an online retailer); see also *infra* Part II.B.1 (summarizing the legal standard for forcing remote retailers to submit to taxing jurisdiction).

32. See Swidler, *supra* note 18, at 544 (noting that every state with a sales tax also has a use tax).

33. *United Air Lines, Inc. v. Mahin*, 410 U.S. 623, 638 (1973); see also *Use Tax*, BLACK'S LAW DICTIONARY 1688 (10th ed. 2014) (stating that use taxes are meant to discourage purchases which are not subject to sales tax).

34. *United Air Lines*, 410 U.S. at 638.

For example, if a resident of Tennessee were to make tax-free purchases in Delaware, he would still be subject to Tennessee's use tax.³⁵ Although the purchaser is always legally responsible for paying either the sales tax or the use tax on a purchased item,³⁶ in transactions occurring within Tennessee, the seller collects the sales tax and remits it to the state. This process, however, does not occur when the seller is located outside of Tennessee and is not subject to Tennessee's taxing authority. In such cases, the seller cannot be compelled to collect any tax on behalf of Tennessee, so the use tax applies, creating an obligation on the part of the purchaser to pay the tax.³⁷ This means that compliance with state use taxes is essentially voluntary because, with the exception of certain big-ticket items, keeping track of state citizens' out-of-state purchases would be a potentially cost-prohibitive administrative nightmare.³⁸

As a result of the conflict between the states' dependence on sales taxes and the growing popularity of e-commerce, the states, which are seeking to recover their lost revenues in a legal regime that does not allow them to tax out-of-state retailers directly, must push for change. To effectively accomplish this change, reformers must understand the current rule, its origins, and the reasons it prevents the states from simply applying their sales taxes to all purchases made by their residents.

1. The Dormant Commerce Clause and the Establishment of the Physical Presence Standard

The Constitution grants Congress the power to regulate interstate commerce.³⁹ And it has become a hallmark of constitutional law that this allocation of power to Congress limits the states' ability to regulate interstate commerce, essentially forbidding any state action seeking economic protectionism.⁴⁰ The Supreme Court has

35. *See id.* (“[G]oods may be taxed at the end of their interstate journey . . .”). If the purchaser pays a sales tax in another state, then he typically is not subject to a use tax in his home state; however, if the sales tax paid was less than what would have been paid in his home state, some states would require him to pay the difference as a use tax. *Id.*

36. *See* Arthur R. Rosen & Walter Nagel, *The Duties and Obligations of the Seller and the Purchaser*, 1300 Tax Mgmt. Sales & Use Tax Portfolios (BNA) No. 1300-2d, at 1300:03.

37. Swidler, *supra* note 18, at 544.

38. *Id.* at 545.

39. U.S. CONST. art. I, § 8.

40. *See, e.g.,* Wyoming v. Oklahoma, 502 U.S. 437 (1992) (“It is long established that, while a literal reading evinces a grant of power to Congress, the Commerce Clause also directly limits the power of the States to discriminate against interstate commerce.”); Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978) (“[W]here simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected.”); Bibb v. Navajo Freight Lines,

noted that “regulating interstate commerce in such a way as to give those who handle domestic articles of commerce a cost advantage over their competitors handling similar items produced elsewhere constitutes such protectionism.”⁴¹ Called the Dormant Commerce Clause, this prevents states from requiring out-of-state retailers to collect sales or use taxes directly.⁴²

The Supreme Court established a bright-line rule for collecting use taxes from retailers in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*.⁴³ Bellas Hess was a mail-order business headquartered in Missouri and licensed to do business both in Missouri and Delaware.⁴⁴ The business did not own property, operate facilities, or employ any person in the State of Illinois.⁴⁵ Bellas Hess’s only business activities within Illinois involved mailing catalogs and fliers to Illinois residents.⁴⁶ Illinois customers placed orders with Bellas Hess’s Missouri office, and Bellas Hess shipped the merchandise to its customers through U.S. mail.⁴⁷

At some point, Illinois sent Bellas Hess a tax bill, claiming that the mailings were sufficient to allow Illinois to exercise its taxing authority over the company.⁴⁸ Not surprisingly, Bellas Hess disagreed, arguing the tax violated the Dormant Commerce and Due Process Clauses of the Constitution.⁴⁹ In deciding whether to sustain Illinois’s claim for the sales-tax revenue, the Court considered whether there was “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.”⁵⁰ The Court held that if the business’s only contact with the taxing state is through common carrier or U.S. mail, then it cannot be subjected to the state’s taxing authority.⁵¹ Instead, the Court’s inquiry required the would-be

Inc., 159 F. Supp. 385, 392 (1958) (“[A] state may not regulate interstate commerce so as to substantially affect its flow or deprive it of needed uniformity in its regulation . . .”).

41. *Or. Waste Sys. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 106 (1994); *see also* *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273–74 (1988) (“This ‘negative’ aspect of the Commerce Clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.”).

42. *See* *Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992).

43. 386 U.S. 753 (1967), *overruled by* *Quill*, 504 U.S. 298.

44. *See id.* at 753–54.

45. *Id.* at 754.

46. *Id.*

47. *Id.* U.S. Mail was the only method of shipping used by Bellas Hess to Illinois residents. *Id.* It did not make special deliveries within the state. *Id.*

48. *Id.* at 755.

49. *Id.* at 756.

50. *Id.* (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

51. *Id.* at 758.

taxing state to show that the business had some sort of physical presence within the state.⁵²

Twenty-five years later, the Supreme Court considered a case with almost identical facts when North Dakota tried to collect sales tax from Quill Corporation.⁵³ North Dakota required all qualified “retailers”—defined as those involved in “regular or systematic solicitation” of North Dakota residents—to collect sales tax and remit such tax to the state.⁵⁴ Quill, a Delaware corporation that sold office supplies remotely, did not own property within North Dakota. It did not have any stores, warehouses, offices, or employees there. And just like the company in *Bellas Hess*, Quill delivered items within the state through a common carrier.⁵⁵ However, Quill did solicit business from North Dakota residents through catalogs and national advertisement campaigns.⁵⁶ Not surprisingly, Quill refused to pay North Dakota’s tax bill, citing *Bellas Hess* for the proposition that such a burden violated the Due Process and Commerce Clauses.⁵⁷ Although the trial court agreed that *Bellas Hess* controlled, the North Dakota Supreme Court declined to follow *Bellas Hess* in light of changes that had occurred in both the economy and the legal world over the intervening twenty-five years.⁵⁸ But the Supreme Court of the United States disagreed.⁵⁹

While the Supreme Court overruled *Bellas Hess* with respect to the Due Process Clause in its opinion in *Quill*, it noted that the Due Process and Commerce Clauses, while both limiting states’ taxing authority, required distinct analyses.⁶⁰ Justice Stevens’s majority opinion admitted that the Court had not clearly distinguished its analyses of the two clauses in the past, but he reasoned that considering each clause individually, whenever possible, would consistently lead to better results.⁶¹ Essentially, Justice Stevens

52. *Id.*

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

54. *Id.* at 302. At the time, the North Dakota law defined “regular or systematic solicitation of a consumer market in the state” to mean advertising within the state three or more times in a year. *Id.* at 303. Practically speaking, this had the effect of making nearly every remote seller who did business nationally subject to North Dakota’s taxing authority. *Id.*

55. *Id.* at 302.

56. *Id.* Sales to North Dakota residents amounted to less than one-half of one percent of Quill’s total sales in the United States. *Id.* Quill was the sixth-largest office supply vendor in North Dakota with about three thousand customers located within its borders. *Id.*

57. *Id.* at 303.

58. *See State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 217, 219 (N.D. 1991), overruled by *Quill*, 504 U.S. 298.

59. *Quill*, 504 U.S. at 318.

60. *See id.* at 305.

61. *Id.* at 305–06.

concluded that while the Due Process Clause could be satisfied without finding that there was a physical presence, the Commerce Clause could not.⁶² As a result of this analytical framework, the Court held that although Quill had enough “minimum contacts” with North Dakota to satisfy due process requirements, without a physical presence in North Dakota, the Commerce Clause did not allow the state to force Quill to collect sales tax.⁶³ Therefore, the application of North Dakota’s statute placed an unconstitutional burden on interstate commerce.⁶⁴ The Court noted that if Congress disagreed with the *Quill* standard, it had the power to grant states the ability to tax companies like Quill.⁶⁵

While no case law or statutes have directly addressed the issue of e-commerce, it does not take a great deal of imagination to see how the physical presence test in *Quill* prevents states from collecting sales taxes from online retailers.⁶⁶

2. Physical Presence and Distinct Legal Entities

The physical presence test appears easy to apply on its face: either the company has a physical presence within the state, in which case it is subject to the state’s taxing authority, or it does not have such a physical presence, in which case the company is not subject to the state’s taxing authority.⁶⁷ Despite the seeming simplicity of the standard, like many bright-line rules, clever individuals have found ways to exploit it.

Consider a retailer like Wal-Mart that has stores in every state and also makes sales over the Internet. Wal-Mart almost certainly meets the physical presence requirements of the Court’s Commerce Clause jurisprudence and thus should be required to collect sales tax

62. *Id.* at 313. The Court noted that it was established law that simply lacking a physical presence was not enough to avoid personal jurisdiction within a state where a commercial actor has “purposefully directed” its efforts. *Id.* at 308; see *Int’l Shoe Co. v. Washington*, 326 U.S. 310 (1945) (establishing the “minimum contacts” test).

63. See *Quill*, 504 U.S. at 309–18.

64. See *id.* at 314–15 (returning to the bright-line test of *Bellas Hess*, which exempts vendors “whose only connection with customers in the [taxing] State is by common carrier or United States mail” from state sales tax).

65. *Id.* at 318. The Court was also quick to point out that in the twenty-five years since *Bellas Hess*, Congress had taken no such action and, therefore, must respect the holding to some degree. See *id.*

66. See *supra* Part II.B (explaining why use taxes are a futile endeavor for states).

67. See *supra* Part II.B.1 (explaining that the physical presence test is required under the Dormant Commerce Clause).

for the purchaser's home state when it makes online sales.⁶⁸ This obligation seems straightforward until you consider that Walmart.com is actually a subsidiary of Wal-Mart, making it a legally distinct entity.⁶⁹ *Quill* is silent as to whether the physical presence of a parent company is enough to subject the subsidiary to a state's taxing authority. This silence is likely because most retailers with physical locations did not participate in mail-order business and vice versa when the Court decided *Quill* in 1992.⁷⁰ Today, almost every major retailer has a website where customers can place orders instead of traveling to a physical retail location. If separate legal entities actually operate those retailers' websites, as in the case of Walmart.com, are they subject to taxing authority in the states where their parents have a physical presence? And should they be?

The California Appellate Division confronted these questions in *Borders Online v. State Board of Equalization*, when the State of California attempted to collect a use tax on items sold by Borders Online to California residents.⁷¹ Borders Online and Borders Inc. were both subsidiaries of the same parent company, making them separate legal entities.⁷² Borders Online sold books and music over the Internet, while Borders Inc. operated traditional retail stores selling similar items.⁷³ Borders Inc. allowed customers of Borders Online to make returns at its physical locations without additional charge and did so without distinguishing items returned by Borders Online customers from those returned by Borders Inc.'s own customers.⁷⁴ Borders Inc. also directed its customers to Borders Online's website for further retail options without compensation from Borders Online for

68. See *How We Determine Sales Tax*, WARMART.COM, http://help.walmart.com/app/answers/detail/a_id/36/kw/tax, archived at <http://perma.cc/9Q3S-LM5P> (last visited Feb. 20, 2014) (stating that Walmart.com collects sales tax on orders shipped to all U.S. states).

69. See *Walmart.com's History and Mission*, WARMART.COM, http://help.walmart.com/app/answers/detail/a_id/6, archived at <http://perma.cc/LZ7G-YP5A> (last visited on Feb. 20, 2014), (detailing Walmart.com's history and connection to its parent company).

70. The few companies that did have physical stores and solicited mail orders often created difficult questions for courts that were trying to determine the limits of physical presence. See, e.g., *SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693, 698 (Ohio 1995) (holding that the presence of a Saks Fifth Avenue retail location within the state was not enough to subject SFA Folio Collections to taxing authority because it was a separate legal entity); *Bloomington's by Mail, Ltd. v. Dep't of Revenue*, 567 A.2d 773, 778–79 (Pa. Commw. Ct. 1989) (applying the same reasoning to deny Pennsylvania taxing authority over Bloomington's by Mail).

71. *Borders Online, L.L.C. v. State Bd. of Equalization*, 29 Cal. Rptr. 3d 176 (Ct. App. 2005).

72. *Id.* at 176.

73. *Id.*

74. *Id.* at 180.

such referrals.⁷⁵ The California Appellate Division found that these practices established that Borders Inc. had acted as an agent for Borders Online.⁷⁶ Because Borders Inc.'s physical presence enhanced Borders Online's ability to maintain a customer base within the state, Borders Online could be subjected to the state's taxing authority.⁷⁷

St. Tammany Parish Tax Collector v. Barnesandnoble.com, on facts similar to those in *Borders Online*, clarifies when one subsidiary of a parent company should be taxed based on the physical presence of another subsidiary.⁷⁸ Barnes & Noble, Inc. owned both Barnesandnoble.com, LLC and Barnes & Noble Booksellers, Inc.⁷⁹ Barnes & Noble Booksellers allowed Barnesandnoble.com's customers to return merchandise to Barnes & Noble Booksellers' stores in Louisiana—though it limited such returns to merchandise that Barnes & Noble Booksellers also carried.⁸⁰ The court emphasized that Barnes & Noble Booksellers accepted returns from any other bookstore—not just Barnesandnoble.com—and that customers received only store credit for such returns.⁸¹ The court held that Barnes & Noble Booksellers' return policy for Barnesandnoble.com did not sufficiently establish a physical presence within the state for Barnesandnoble.com; the return policy was not adopted to promote Barnesandnoble.com but rather to “generate goodwill and to serve the convenience of [Barnes & Noble Booksellers'] customers.”⁸² Therefore, Barnesandnoble.com could not be subjected to the taxing authority of the state based on Barnes & Noble Booksellers' presence.⁸³

Thus, the issue of when online retailers should be subjected to taxing authority based on the physical presence of a sister company

75. *Id.* at 179.

76. *Id.* at 185.

77. *Id.* 190–91.

78. 481 F. Supp. 2d 575 (E.D. La. 2007).

79. *Id.* at 576. Barnes & Noble, Inc. owned both Barnesandnoble.com and Barnes & Noble Booksellers through a wholly owned subsidiary; however, it did not own one hundred percent of Barnesandnoble.com for the entire period for which Louisiana was trying to collect taxes. *Id.* at 581. The opinion notes this as a reason for denying taxing authority to the state, but the issue of complete ownership could not have been determinative because the court refused to subject Barnesandnoble.com to Louisiana taxing authority for the period when it was wholly owned by Barnes & Noble, Inc. *See id.*

80. *Id.* at 580.

81. *Id.* Barnes & Noble Booksellers would give a full refund if the customer had a receipt from Barnesandnoble.com, while it was at the discretion of the store manager whether to give a full or partial refund if presented with a receipt from a competitor. *Id.* The manager of the store at issue here testified that she would give a full refund in such a case in order to keep the customer happy. *Id.*

82. *Id.* at 582.

83. *Id.*

was already murky when, in 2013, the Supreme Court of New Mexico added a new twist to this area of jurisprudence. In *New Mexico Taxation & Revenue Department v. Barnesandnoble.com LLC*, the state high court departed from the federal district court's decision in *St. Tammany* and held that Barnesandnoble.com was subject to the State of New Mexico's taxing authority. The dispute involved the exact same time period and corporate setup as *St. Tammany*.⁸⁴ The New Mexico Supreme Court looked beyond the return policies of the companies and instead considered how both companies made use of the same trademarks.⁸⁵ The court held that because both companies used their parent company's trademarks, a reasonable consumer would be justified in assuming that they were the same company.⁸⁶ In this way, Barnesandnoble.com was benefiting from brand loyalty created by Barnes & Noble Booksellers' stores.⁸⁷ Barnes & Noble Booksellers' activities therefore subjected Barnesandnoble.com to New Mexico's taxing authority.⁸⁸

New Mexico's interpretation of the physical presence standard treats companies in a manner consistent with how the company presents itself to customers. If two companies—while technically distinct legal entities—nevertheless promote themselves by using the same trademarks, running the same promotions, having similar return policies, or engaging in other similar acts as if they were in fact a unified company, then it makes sense for a state to treat them as one company when applying the *Quill* standard. If the rule from *New Mexico* is not overturned on appeal, other states will likely adopt it, because it allows states to recapture lost revenue and treats online retailers in a way that is consistent with their own actions. But the *New Mexico* rule is problematic in that it is limited to situations in which sister companies are acting like one entity and one of the companies satisfies the physical presence standard in the state trying to exercise its tax authority.

3. Physical Presence and Pure Online Retailers

The rule in *Quill* makes it nearly impossible for states to tax online retailers who do not also sell from physical retail locations. Companies like Amazon, which were created specifically to operate online, had no physical stores before their online presence, have no

84. 303 P.3d 824, 829 (N.M. 2013).

85. *Id.* at 827.

86. *Id.*

87. *Id.*

88. *Id.* at 829.

physical stores today, and generally have no interest in ever opening physical stores.⁸⁹ However, once online companies reach a certain size, they are unable to function without *some* sort of physical presence.⁹⁰

These companies use a tactic known as “entity isolation” to avoid having to collect sales tax in the majority of states.⁹¹ By establishing and contracting with legally distinct subsidiaries to carry out specific tasks, such as order fulfillment, a company gains the physical support it needs within a state without establishing a physical presence there itself.⁹² The *Quill* standard does not allow the state to tax the parent corporation based on the presence of a subsidiary alone.⁹³

Amazon has some sort of physical presence in twenty-two states.⁹⁴ In five of these states, Amazon owns and operates subsidiaries but has no other physical presence.⁹⁵ Amazon has been able to avoid collecting sales tax in the vast majority of these twenty-two states.⁹⁶ But in the last few years, Amazon has begun to collect sales tax in almost every state in which it has any sort of physical presence.⁹⁷ Two factors caused this sudden change in course by the world’s largest pure online retailer: the Court of Appeals of New

89. See generally ANDERSON, *supra* note 11 (explaining that the business model for online retailers requires keeping their overhead low through the use of large warehouses of varied inventory instead of small stores with limited selections dispersed across the country).

90. See Michael R. Gordon, Recent Development, *Up the Amazon Without a Paddle: Examining Sales Taxes, Entity Isolation, and the “Affiliate Tax,”* 11 N.C. J.L. & TECH. 299, 306 (2010) (describing how companies make use of “entity isolation”).

91. See *id.* at 306–09.

92. See *id.* at 306.

93. See *id.* But see *supra* Part II.B.2 (detailing how parent or sister companies may be subjected to taxing authority based on the physical presence of their subsidiaries or sister companies).

94. See *Global Locations*, AMAZON.COM, <http://www.amazon.com/Locations-Careers/b?ie=UTF8&node=239366011>, archived at <http://perma.cc/TG99-QUF5> (last visited Feb. 6, 2015) (listing Amazon’s locations). Amazon has its own facilities in seventeen states and owns subsidiaries in eleven states. *Id.*

95. *Id.*

96. See Patch, *supra* note 18, at 687 n.98 (noting that as of March 22, 2013, Amazon only charged sales tax in nine states).

97. See *About Sales Tax on Items Sold by Amazon.com*, AMAZON.COM, <http://www.amazon.com/gp/help/customer/display.html?nodeId=468512>, archived at <http://perma.cc/A9QA-SKYK> (last visited Jan. 19, 2015) (detailing states where Amazon collects sales tax). Amazon currently collects sales tax in twenty-three states: Arizona, California, Connecticut, Florida, Georgia, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Minnesota, Nevada, New Jersey, New York, North Carolina, North Dakota, Pennsylvania, Tennessee, Texas, Virginia, Washington, West Virginia, and Wisconsin. *Id.*

York's decision upholding New York's new tax laws and the proposed Marketplace Fairness Act.⁹⁸

Despite this apparent victory for proponents of applying sales tax to online retailers, it should be noted that Amazon makes sales in all fifty states but is only collecting sales tax for twenty-three of them.⁹⁹ In fact, Amazon owns subsidiaries in Michigan and has its own facilities in South Carolina, yet it collects zero dollars in sales taxes in both states.¹⁰⁰ Thus, it might be premature to call this a victory for the states. However, the states have other options at their disposal.

C. *New York's Amazon Law*

With states losing revenue as commerce shifts from traditional to online retailers, legislatures across the country have tried to find ways to tax online transactions.¹⁰¹ Since the *Quill* physical presence requirement prevents most states from taxing a particular online retailer directly, the most common "solution" for collecting this lost revenue involves taxing the individual purchaser directly through a use tax.¹⁰² This method is impossible to enforce effectively and essentially amounts to a voluntary payment by the purchaser since

98. See Greg Bensinger, *New Year Rings in Sales Tax for Amazon Shoppers in Three States*, WALL ST. J. DIGITS (Jan. 1, 2014, 8:40 AM), <http://blogs.wsj.com/digits/2014/01/01/new-year-rings-in-sales-tax-for-amazon-shoppers-in-three-states/> (noting that Amazon was making deals with states to collect sales tax in the wake of the Supreme Court denying certiorari in its case against New York and also noting Amazon's support for the Marketplace Fairness Act); *infra* Part II.C (outlining New York's "Amazon Law"); *infra* Part II.D (detailing the Marketplace Fairness Act).

99. See *About Sales Tax on Items Sold by Amazon.com*, *supra* note 97 (listing the twenty-three states where Amazon collects sales tax); *Overview*, AMAZON.COM, <http://phx.corporate-ir.net/phoenix.zhtml?c=176060&p=irol-mediaKit>, archived at <http://perma.cc/M3P5-5PUD> (last updated June 2013) (noting that Amazon had made sales to all fifty states within its first thirty days of business).

100. See *About Sales Tax on Items Sold by Amazon.com*, *supra* note 97; *Global Locations*, *supra* note 94 (stating that Amazon owns Brilliance Audio in Grand Haven, Michigan and CreateSpace in Charleston, South Carolina). Amazon also owns facilities in Delaware and New Hampshire, but neither state has a sales tax for Amazon to comply with. See *State and Local Sales Tax Rates, 2011-2013*, TAX FOUND. (Mar. 14, 2013), <http://taxfoundation.org/article/state-and-local-sales-tax-rates-2011-2013>, archived at <http://perma.cc/YU9Y-95GD> (listing Michigan and South Carolina as each having a sales tax rate of six percent); see also *Frequently Asked Questions*, N.H. DEP'T OF REVENUE ADMIN., <http://www.revenue.nh.gov/faq/general-information.htm>, archived at <http://perma.cc/WZ9T-9FM4> (last visited Oct. 7, 2014) (stating that New Hampshire has no sales tax).

101. See *supra* Part II.A (describing how e-commerce accounts for a larger piece of the economy every year); *supra* Part II.B (describing theories under which online retailers can be held to meet the physical presence requirements).

102. See *supra* Part II.B (describing the use tax and why it fails).

the states have almost no recourse if the purchaser chooses to ignore the requirement.¹⁰³ New York has developed a new method for taxing these transactions—one that arguably satisfies the physical presence requirement laid out in *Quill*.¹⁰⁴ This represents the first attempt by a state to satisfy *Quill* by statute in order to collect online sales-tax revenue.¹⁰⁵

New York's solution redefines the legal term "vendor" to include anyone who solicits business within the state "by employees, independent contractors, agents or other representatives."¹⁰⁶ New York's statute creates a presumption that a company solicits business within the state if the company employs affiliates there. This presumption, along with the presence of the affiliate itself, establishes a physical presence that satisfies the *Quill* standard.¹⁰⁷ Not every use of an affiliate triggers the presumption. For example, if the online retailer employs the affiliate only to provide a link from the affiliate's own website to the website of the out-of-state retailer, the presumption does not arise.¹⁰⁸ Instead, for the presumption to arise, the out-of-state retailer must enter into an agreement under which a New York resident refers potential customers to the retailer in exchange for some type of consideration, and the total gross receipts combined from all New York affiliates must amount to more than \$10,000.¹⁰⁹

103. See *supra* Part II.B.

104. See N.Y. TAX LAW § 1101(b)(8) (McKinney 2014) (creating a presumption to solicit business within the state under certain circumstances); *Amazon.com, LLC v. Dep't of Taxation & Fin.*, 913 N.Y.S.2d 129, 139–40 (2010) (holding that the statute satisfies the *Quill* standard).

105. See Sam Zaprzalka, Note, *New York's Amazon Tax Not out of the Forest Yet: The Battle over Affiliate Nexus*, 33 SEATTLE U. L. REV. 527, 540 (2010) ("What makes the Statute unique and controversial is its novel definition of what constitutes a physical presence in New York.").

106. See N.Y. TAX LAW § 1101(b)(8)(i)(C).

107. *Id.* §§ 1101(b)(8)(i)(C)(I), 1101(b)(8)(iv).

108. See N.Y. STATE DEPT OF TAXATION & FIN., OFFICE OF TAX POLICY ANALYSIS, TAXPAYER GUIDANCE DIV., TSB-M-08(3)S 1 (May 8, 2008), available at http://nystax.gov/pdf/memos/sales/m08_3s.pdf, archived at <http://perma.cc/JGT3-268N> ("The new law provides that a seller is presumed to be a vendor if the seller enters into agreements with residents of this state to refer customers to the seller."). If the affiliate is paid based on the sales made by clicking through the link, then the presumption will arise. *Id.*

109. See N.Y. TAX § 1101(b)(8)(vi):

[A] person making sales . . . shall be presumed to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state . . . if the cumulative gross receipts from sales by the seller . . . is in excess of ten thousand dollars.

The ten thousand dollars is the sum of all sales made through the actions of any affiliate within the state for the preceding twelve months calculated on the last day of either February, May, August, or November. *Id.*

Proving that the resident did not actually solicit business within New York on behalf of the out-of-state retailer rebuts the presumption.¹¹⁰ Specifically, the out-of-state retailer must show that it prohibited the affiliate from soliciting business within the state and that the affiliate did, in fact, refrain from such solicitation.¹¹¹ Establishing that the affiliate has refrained from soliciting business within the state could be problematic, as it is often difficult to provide evidence that an affiliate never acted in a particular manner; thus, New York allows the out-of-state retailer to collect signed certifications from its affiliates asserting that they have not participated in solicitation within the state.¹¹² The affiliates must make the certifications annually, and the business can only accept them in good faith; if the out-of-state retailer knows, or has reason to know, that the certification is false, it will not be able to rebut the statutory presumption.¹¹³

Both Amazon and Overstock.com immediately challenged the constitutionality of this statute.¹¹⁴ The Supreme Court of New York, Appellate Division found that there was insufficient evidence to evaluate the companies' as-applied challenges, asserting that the case required further discovery.¹¹⁵ Rather than proceed on to discovery, both Amazon and Overstock.com withdrew their as-applied challenges, instead focusing their efforts on arguing that the statute

110. *See 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 . . .").

111. *See* N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, TAXPAYER GUIDANCE DIV., TSB-M-08(3.1)S, 1 (June 30, 2008), http://nystax.gov/pdf/memos/sales/m08_3_1s.pdf, archived at <http://perma.cc/7CSU-SQSR> ("Tax Department will deem the presumption rebutted where the seller is able to establish that the only activity of its resident representatives in New York State on behalf of the seller is placing a link on the resident representatives' Web sites to the seller's Web site.")

112. *See id.* ("Each resident representative must submit to the seller, on an annual basis, a signed certification stating that the resident representative has not engaged in any prohibited solicitation activities in New York State . . .").

113. *See id.* ("[T]he seller accepts the certifications in good faith . . .").

114. *See* *Overstock.com, Inc. v. Dep't of Taxation & Fin.*, 987 N.E.2d 621, 625 (N.Y. 2013), cert. denied, 134 S. Ct. 682 (2013) (analyzing whether the New York tax violated the Commerce Clause); *Amazon.com, LLC v. Dep't of Taxation & Fin.*, 913 N.Y.S.2d 129, 133 (App. Div. 2010) (suggesting a short time period between enactment and the lawsuit by noting that "[s]hortly after the statute became effective, and Amazon instituted its lawsuit, DTF issued two memoranda . . .").

115. *Amazon.com*, 913 N.Y.S.2d at 143–44 ("We are also unable to determine on this record whether the in-state representatives are engaged in activities which are 'significantly associated' with the out-of-state retailer's ability to do business in the state . . .").

was facially unconstitutional.¹¹⁶ Because the statute requires that the affiliate be involved in active solicitation and “not [merely] passive advertising,” and that the affiliate be a New York resident, it does not subject all online retailers to New York’s taxing authority but rather only those that are deemed to have created a sales force within the state.¹¹⁷ Therefore, the court held that the statute was not facially unconstitutional, because it satisfied the requirements of the Commerce Clause by applying only to companies that attempted to establish a physical presence within New York.¹¹⁸

D. Federal Legislation

Because there are 9,646 sales-tax jurisdictions in the United States, each with its own set of rates and rules, forcing online retailers to comply with each jurisdiction’s individual rules creates a serious burden on interstate commerce.¹¹⁹ To help alleviate this burden, the National Governors Association and the National Conference of State Legislatures created the Streamlined Sales and Use Tax Agreement (“SSUTA” or the “Agreement”)¹²⁰ to develop and promote a “simpler, business-friendly sales-tax system.”¹²¹ A group that included forty-four states, the District of Columbia, and many local governments, as well as members of the business community, worked together to develop the SSUTA.¹²² The SSUTA minimizes costs and encourages online

116. *Overstock.com*, 987 N.E.2d at 624 (“Having elected to forgo their as-applied challenges, plaintiffs now confront the substantial hurdle of demonstrating that the Internet tax is unconstitutional on its face.”).

117. *Amazon.com*, 913 N.Y.S.2d at 138 (“Of equal importance to the requirement that the out-of-state vendor have an in-state presence is that there must be solicitation, not passive advertising.”).

118. *Id.*

119. See *supra* Part II.B (discussing how the large number of taxing jurisdictions in the United States burdens online retailers); see also *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992) (“Congress has the power to protect interstate commerce from intolerable or even undesirable burdens.” (quoting *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 637, (1981) (White, J., concurring))).

120. STREAMLINED SALES & USE TAX AGREEMENT (“SSUTA”) (2014), www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20as%20Amended%20Through%20October%208,%202014.pdf, archived at <http://perma.cc/775T-CP7R>.

121. *Why Was the Streamlined Sales Tax Created?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_2, archived at <http://perma.cc/8XMT-V4WF> (last visited Feb. 11, 2015).

122. See *What Is the Streamlined Sales and Use Tax Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_1, archived at <http://perma.cc/NWR9-DTEA> (last visited Feb. 11, 2015) (“This Agreement is the result of the cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify sales and use tax collection and administration by retailers and states.”).

retailers to collect sales tax on customers residing in states that have adopted the Agreement.¹²³ It aims to reduce the burden on interstate commerce that sales-tax regimes can create by simplifying sales-tax statutes across the country; providing for uniform tax definitions, exemption administration, and rate simplification; and maintaining state-level administration of all sales taxes, uniform sourcing, and state funding of the administrative cost.¹²⁴ To date, twenty-four states have passed legislation conforming with the SSUTA, representing nearly a third of the country's population, and almost 1,400 companies have agreed to collect sales tax in those states, despite a lack of physical presence.¹²⁵

The SSUTA imposes a laundry list of requirements for a state to achieve membership.¹²⁶ When a state believes it has complied with the Agreement's requirements, it may petition the governing board, which decides whether to grant the state membership.¹²⁷ Once a state becomes a member, it is entitled to collect sales tax from all registered

123. *See id.* (“The Agreement minimizes costs and administrative burdens on retailers that collect sales tax . . .”).

124. *See How Does the Agreement Simplify Sales Tax Administration?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_4, archived at <http://perma.cc/QXQ7-WZA7> (last visited Feb. 11, 2014) (“Sales tax administration is improved through tax law simplification, more efficient administrative procedures, and emerging technologies.”).

125. *See How Many States Have Passed Legislation Conforming to the Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_3, archived at <http://perma.cc/6RNN-LWUQ> (last visited Feb. 11, 2014) (stating that Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming have all passed conforming legislation); *Why Must There Be a Federal Solution?*, STREAMLINED SALES TAX GOVERNING BD., INC., <http://www.streamlinedsalestax.org/index.php?page=alias-19>, archived at <http://perma.cc/5JS4-Y5AU> (last visited Oct. 9, 2014).

126. *See* SSUTA, *supra* note 120, at art. III (listing the “requirements each state must accept to participate”). The requirements are listed in thirty-five sections of article III, amounting to approximately fifty pages of text. *Id.* Thus, the requirements are too extensive to list here in their entirety; however, highlights include state-level administration, harmonization of state and local tax bases, uniform tax returns, and uniform rules for remittances of funds. *Id.*

127. *See id.* § 804 (“A three-fourths vote of the entire governing board is required to approve a state’s petition for membership.”). A state may also be granted associate membership if the governing board finds that the state is in substantial compliance with the Agreement. *See id.* (“The governing board shall determine if a petitioning state is in compliance with the Agreement.”). Currently Tennessee is the only associate member state. *See Streamlined State Status 01-01-14*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/uploads/images/state%20map%202014_1_1.jpg, archived at <http://perma.cc/DC2R-BE32> (last visited Oct. 9, 2014).

sellers on purchases made by its residents, regardless of whether that seller has a physical presence within the state.¹²⁸

The SSUTA would be useless without the cooperation of online retailers, so the Agreement offers incentives for online retailers to voluntarily submit to the tax authority of the member states.¹²⁹ These incentives include amnesty for a limited time, the use of sales-tax administration software (which may be subsidized by the states), a single identification number for filing and paying taxes in all of the registered states, and the ability to catalog data with all registered states in a single location.¹³⁰ The online retailers also benefit from the requirement that member states maintain simplified sales-tax policies under the Agreement.¹³¹

Of all the incentives, amnesty is what stands out because it allows any company fearful that it has inadvertently created a physical presence in a particular state to avoid liability for any sales tax that should have been collected in that state.¹³² The amnesty applies to all retailers who agree to follow the terms of the SSUTA without regard to physical presence as long as the retailer was not registered in the state offering amnesty for the twelve-month period preceding the state adopting the SSUTA or has not received notice of an unresolved audit.¹³³ This means that even traditional brick-and-mortar retailers, who have a potential liability arising from failure to collect or to pay sales tax, may take advantage of the incentive by registering under the Agreement.¹³⁴

128. See SSUTA, *supra* note 120, § 301 (“The state level authority of a member state shall provide for collection of any local taxes and distribution of them to the appropriate taxing jurisdictions.”).

129. See *What Are the Benefits of Registering Under the Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., <http://www.streamlinedsalestax.org/index.php?page=alias-31>, archived at <http://perma.cc/GHR5-QXXM?type=source> (last visited Oct. 9, 2014).

130. *Id.*

131. See SSUTA, *supra* note 120, §§ 301–35 (outlining the many requirements a state must meet before it is granted membership).

132. See *What Are the Amnesty Limitations?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_23, archived at <http://perma.cc/F3T5-0LPV> (last visited Feb. 16, 2015) ([A]mnesty precludes an assessment for uncollected or unpaid sales or use taxes together with interest or penalty for sales made during the period the seller was not registered in the state, provided registration occurs within 12 months of the effective date of the state's participation in the Agreement.”).

133. *Id.* (“The amnesty will be granted regardless of ‘nexus’ of the seller if all other requirements are met.”)

134. Given the otherwise weak nature of the incentives offered by the SSUTA, this could explain why 1,400 companies have volunteered to its terms. Unfortunately, there does not appear to be documentation regarding why these companies would volunteer to collect sales tax if they do not have to do so. It may be that these 1,400 companies were subject to sales tax

The SSUTA attempts a national solution to the physical presence issue without actually involving the federal government.¹³⁵ Last year, the United States Senate decided to get involved, passing a piece of legislation known as the Marketplace Fairness Act (“MFA”).¹³⁶ The House Subcommittee on Regulatory Reform, Commercial and Antitrust Law is currently considering the bill.¹³⁷

If the House passes the bill, the MFA will essentially overrule *Quill* and *Bellas Hess* and allow a state to tax every sales transaction where the online retailer ships merchandise to a buyer located within its borders.¹³⁸ But in order to exercise this new power, a state must first simplify its sales-tax code under one of two options outlined in the bill.¹³⁹ The state may either join the SSUTA or meet five criteria: (1) give advance notice of all sales-tax rate changes, (2) designate a single state organization to handle all matters related to collection of the sales tax, (3) establish a uniform sales-tax base throughout the state, (4) use destination sourcing to determine the rate for out-of-state purchases, and (5) provide free software and hold retailers harmless for any errors caused by reliance on the software.¹⁴⁰ The second option amounts to a watered-down version of the SSUTA that tries to replicate the aspects of the Agreement that simplify sales-tax codes the most without forcing states to actually become members of the SSUTA.¹⁴¹ Once a state has met the requirements of either option outlined in the statute, the MFA authorizes the state to force online

liability in a member state (or at least, were worried that they might be) and subjected themselves to the SSUTA to avoid that liability. However, this is pure conjecture.

135. See *What Is the Streamlined Sales and Use Tax Agreement*, *supra* note 122 (noting who was involved in the creation of the agreement); *Why Must There Be a Federal Solution?*, *supra* note 125 (explaining why the states cannot act in their individual capacities if they want to be able to collect sales taxes from online retailers).

136. Marketplace Fairness Act of 2013, S.743, 113th Congress (2013).

137. *Id.*

138. See *What is the Marketplace Fairness Act of 2013?*, MARKETPLACEFAIRNESS.ORG, <http://www.marketplacefairness.org/what-is-the-marketplace-fairness-act/>, archived at <http://perma.cc/PB4Z-KFLX> (last visited Feb. 12, 2014) (“The Marketplace Fairness Act grants states the authority to compel online and catalog retailers . . . to collect sales tax at the time of a transaction . . .”).

139. See *id.* (“[S]tates seeking collection authority have two options for simplifying their sales tax laws.”).

140. See *id.*

141. Compare *id.* (listing the five requirements for the second option under the Marketplace Fairness Act), with SSUTA, *supra* note 120, §§301–35 (outlining the laundry list of requirements to become a member state under the Agreement).

retailers to collect sales tax on transactions where the seller ships goods into the state.¹⁴²

The MFA carves out an exception for online retailers that qualify as “small sellers.”¹⁴³ The statute defines a “small seller” as any business with gross annual receipts for all remote purchases across the country of less than \$1,000,000 for the preceding calendar year.¹⁴⁴ The MFA does not authorize states, even if they meet the requirements of the Act, to collect sales tax from “small sellers” absent a physical presence within the state.¹⁴⁵ But even with this carve-out for small sellers, the MFA still would create burdens for online retailers that traditional retailers do not have. Part III.C of this Note considers these burdens in detail.

III. WHY ATTEMPTS BY INDIVIDUAL STATES TO TAX ONLINE TRANSACTIONS ARE DOOMED TO FAIL

With states seeing their budgets dip deep into the red during the economic downturn, it is no surprise that they have become more aggressive in their attempts to collect sales taxes from online retailers.¹⁴⁶ Nearly every state has some sort of sales tax that it cannot enforce against online retailers and a use tax that it cannot enforce against its own residents.¹⁴⁷ Additionally, the price advantage given to online retailers over competitors in physical retail locations,

142. See *What is the Marketplace Fairness Act of 2013?*, *supra* note 138 (“With states adhering to these provisions or the similar measures in SSUTA, retailers . . . will find collecting sales tax for multiple states much easier . . .”).

143. See Marketplace Fairness Act of 2013, S.743, 113th Congress § 2(c) (2013) (providing an exception for “small sellers”).

144. See *id.* (defining a “small seller” as a remote seller who had “gross annual receipts in total remote sales in the United States in the preceding calendar year” of \$1,000,000 or less). The bill also contains provisions forcing persons or businesses to be treated as one entity for the purpose of collecting sales tax if they meet certain IRS guidelines or appear to be trying to avoid application of the MFA. See *id.* § 4(4) (defining “person” to include a “legal entity”).

145. See *id.* § 2(a) (“Each Member State under the [SSUTA] is authorized to require all sellers not qualifying for the small seller exception . . . to collect and remit sales and use taxes . . .”).

146. See Phil Oliff et al., *States Continue to Feel Recession's Impact*, CTR. ON BUDGET AND POL'Y PRIORITIES (Jan. 27, 2012), <http://www.cbpp.org/cms/?fa=view&id=711>, archived at <http://perma.cc/8XYP-8Q4Z> (discussing the continued impact of the recession on state budgets); *supra* Part II.C (explaining New York's Amazon law); *supra* Part II.D (detailing both the SSUTA and the MFA). For fiscal year 2012, thirty-one states had budget gaps that amounted to fifty-five billion dollars. Oliff et al., *supra*. These gaps are smaller than those seen during the economic downturn but are large by historical standards. *Id.*

147. See *supra* Part II.B.1 (outlining the physical presence requirement); *supra* Part II.B (explaining why the use tax cannot be practically enforced).

who are required to collect sales tax from their customers, raises normative fairness concerns.¹⁴⁸

Quill's physical presence test was meant to be simple to apply and to protect interstate commerce from the administrative nightmare of having to conform to thousands of tax jurisdictions. However, lower courts have interpreted the test inconsistently, leading to uncertainty for some online retailers.¹⁴⁹ The rise of e-commerce over the last twenty years has fundamentally changed the economic landscape, creating an entirely new segment of interstate commerce that takes place over the Internet.¹⁵⁰ The physical presence test has allowed online retailers to offer lower prices by means of tax avoidance.¹⁵¹ However, states' attempts to collect lost sales-tax revenue streams from online retailers have proven problematic.¹⁵² In *Quill*, Justice Stevens was quick to note that Congress has the ultimate authority to resolve this issue, and with the Senate's passage of the MFA, Congress finally may be taking the Court's cue.¹⁵³ Yet, as this Note discusses in detail below, even the MFA fails to solve this problem adequately.¹⁵⁴

A. *The Flaws in New York's Amazon Law*

New York's Amazon Law represents an attempt by a state to take advantage of the broad *Quill* standard.¹⁵⁵ The physical presence test does not stand for the proposition that a retailer has to have a

148. See *What Is the Streamlined Sales and Use Tax Agreement*, *supra* note 122 (stating that the SSUTA "levels the playing field" for online retailers and traditional retailers); *Questions*, MARKETPLACEFAIRNESSACT.ORG, <http://www.marketplacefairness.org/questions-and-answers/>, archived at <http://perma.cc/723K-GZSG> (last visited Feb. 12, 2014) (arguing that traditional businesses are at a competitive disadvantage with online retailers because they must charge sales tax while the online retailers do not).

149. See *supra* Part II.B.2 (outlining the various rationales courts have used to decide whether physical presence exists for online retailers).

150. See *supra* Part II.A (describing the rise of e-commerce).

151. Black's Law Dictionary defines tax avoidance as "the act of taking advantage of legally available tax-planning opportunities in order to minimize one's tax liability." BLACK'S LAW DICTIONARY 1689 (10th ed. 2014).

152. See *infra* Part III.A; *infra* Part III.B (detailing the flaws in two instances of state action attempting to collect these revenue streams).

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

154. *Infra* Part III.C (explaining how the MFA comes up short of its full potential by creating a substantial burden on online retailers that is not shared by traditional retailers).

155. See *supra* Part II.B.1 (detailing the physical presence test); see also *Quill*, 504 U.S. at 314–15 (reaffirming the bright-line physical presence test from *Bellas Hess*).

location within the state; any sort of physical presence will suffice.¹⁵⁶ This includes a small sales force.¹⁵⁷ New York's statute treats affiliates of online retailers as it would a traditional sales force, establishing the online retailer's physical presence within the state and allowing the state to subject it to sales tax.¹⁵⁸

Despite the combined efforts of two of the world's largest online retailers, the statute has survived state-level constitutional challenges.¹⁵⁹ In December 2013, the Supreme Court denied petitions of certiorari to review these challenges.¹⁶⁰ New York's success has led several other states to pass their own Amazon-style laws.¹⁶¹ Many of these laws capture more activity than New York's, allowing for lower threshold amounts or making irrebuttable the presumption that a company is soliciting business within the state if it employs an affiliate there.¹⁶² But all subsequent copycat laws suffer from the same flaws as the original.

First, the law is easily avoidable. Once New York passed its law, Overstock.com simply suspended all of its affiliates within the state.¹⁶³ These programs are generally not necessary for the online retailer to survive, so if a state passes an Amazon-style law, online retailers can easily shut down their affiliate programs to avoid the sales tax in that jurisdiction.¹⁶⁴ This has two effects on the state's tax

156. See *Quill*, 504 U.S. at 315 (describing how *Bellas Hess* created a safe harbor from state taxation for businesses whose only contact with the state was through mail, but noting that other kinds of physical presence may suffice).

157. *Id.*; see also *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 759–60 (1967) (declining to subject an out-of-state company to a state's taxing authority partially because it had no sales force present within the state).

158. See N.Y. TAX LAW § 1101 (McKinney 2014).

159. See *Amazon.com, L.L.C. v. Dep't of Taxation & Fin.*, 913 N.Y.S.2d 129, 132 (App. Div. 2010) (dismissing facial challenges to the statute's constitutionality because they failed to state a cause of action), *aff'd sub nom. Overstock.com, Inc. v. Dep't of Taxation & Fin.*, 987 N.E.2d 621 (N.Y. 2013), *cert. denied*, 134 S. Ct. 682 (2013).

160. *Id.* But see *Zaprzalka*, *supra* note 105, at 555–56 (arguing that the statute's definition of "affiliates" does not satisfy the physical presence test).

161. Joseph Henchman, *Will the Supreme Court Hear the Online Tax Case?*, TAX FOUND. (Dec. 2, 2013), <http://taxfoundation.org/blog/will-supreme-court-hear-online-tax-case>, archived at <http://perma.cc/SC9X-DFBF>. Eleven states have passed laws similar to New York's: Arkansas, California, Connecticut, Georgia, Illinois, Maine, Minnesota, North Carolina, Rhode Island, Texas, and Vermont. *Id.* One state, Illinois, has already seen its statute struck down by the state supreme court. *Id.*

162. *Id.*

163. *Amazon.com*, 913 N.Y.S.2d at 134.

164. See Joseph Henchman, *California Becomes Seventh State to Adopt "Amazon" Tax on Out-of-State Online Sellers*, TAX FOUND. (July 1, 2011), http://taxfoundation.org/article/california-becomes-seventh-state-adopt-amazon-tax-out-state-online-sellers#_ftn3, archived at <http://perma.cc/SWL5-N5TF> (noting North Carolina and Rhode Island as examples of states whose laws purportedly caused online retailers to stop their affiliate programs).

revenue. First, the state gains no additional sales-tax revenue because the affiliate program no longer exists, and therefore the state no longer has authority to tax the online retailer.¹⁶⁵ Second, state residents participating in the affiliate program lose a source of income, meaning the state could see a decrease in the amount of income tax it collects.¹⁶⁶ In effect, unless the online retailer *chooses* to keep its affiliate program running—essentially voluntarily submitting to the taxing authority of the state—passing an Amazon law will, at best, have no impact on the amount of tax revenue a state collects and could very well reduce it.¹⁶⁷

States that have passed these copycat laws have had this exact experience, proving such consequences are more than theoretical. Rhode Island collected no additional sales-tax revenue from online retailers within six months of passing an Amazon-style law.¹⁶⁸ Even the State Treasurer called for the law's immediate repeal because it hurt Rhode Island businesses.¹⁶⁹ Like Rhode Island, North Carolina did not receive any additional revenue after passing an Amazon-style law. And worst of all, Illinois actually saw Internet-related businesses leave the state after it passed its version of the Amazon Law.¹⁷⁰

If forcing online retailers to collect sales tax is meant to create a level playing field with traditional retailers, Amazon-style laws also fail in that endeavor.¹⁷¹ Amazon-style laws allow each state to create its own law, but this creates uncertainty¹⁷² and places the online retailer at a competitive disadvantage with traditional retailers for two reasons. First, every state will have its own rules regarding when

165. *See id.*

166. *See id.* Shutting down the affiliate program may have other consequences, such as increasing unemployment. *Id.*

167. *See id.* (describing how online retailers have voluntarily ended their affiliate programs in jurisdictions with Amazon-style laws). Note that these affiliate programs account for a very small percentage of revenue for companies like Amazon and Overstock.com, so even if they were forced to shut down their affiliate programs in every state, it would have minimal effects on their bottom lines. *See, e.g., id.* (noting that Amazon's online referrals in New York account for only 1.5 percent of Amazon's total sales within the state).

168. Ted Nesi, "Amazon Tax" Has Not Generated Revenue, PROVIDENCE BUS. NEWS (Dec. 21, 2009), http://www.pbn.com/detail.html?page=1&sub_id=2976531d0961, archived at <http://perma.cc/Z96D-JJLW>.

169. David Sims, *Virginia Advances Online Sales Tax Despite Track Record*, TMCNET (Feb. 11, 2010), <http://voice-quality.tmcnet.com/topics/phone-service/articles/75297-virginia-advances-online-sales-tax-despite-track-record.htm>, archived at <http://perma.cc/334Y-8QZA>.

170. Henchman, *supra* note 164.

171. *See id.* (arguing that online retailers must account for where their customers, rather than their business operations, are located in determining their state tax obligations).

172. *See id.* (pointing out that online retailers must keep track of an increasing number—currently over eight thousand—of sales-tax jurisdictions with different requirements and exemptions).

an affiliate has a physical presence in the state. This creates the potential for fifty rules that an online retailer would have to keep track of that a traditional retailer would not, creating administrative and regulatory costs unique to the online retailer.¹⁷³ Second, and more importantly, the tax structure itself creates inequalities. If an online retailer is subjected to an Amazon-style law in every state, it will find itself trying to comply with nearly 10,000 different taxing jurisdictions. This means the company will have to follow nearly 10,000 different sets of rules (which are constantly changing), all based on where the customer is located.¹⁷⁴ Compare this burden to that of the traditional retailer who only has to collect sales tax based on the business's physical location, and it is clear that the online retailer is at a competitive disadvantage.¹⁷⁵

B. The Flaws of the Streamlined Sales and Use Tax Agreement

While more uniform and therefore more predictable than state-specific Amazon-style laws, the SSUTA does not offer a complete and viable solution to this problem either. Under the SSUTA, online retailers voluntarily subject themselves to the state's taxing authority.¹⁷⁶ The SSUTA's solution to this glaring deficiency is to offer incentives for online retailers who submit to collecting sales tax voluntarily.¹⁷⁷ However, the SSUTA's incentives are lackluster at best.¹⁷⁸ While small businesses may find the offer of subsidized tax administration software compelling, larger companies like Amazon and Overstock.com are not concerned about software prices; these costs would barely register on their massive balance sheets. And while the SSUTA makes compliance easier, if companies do not believe they

173. Traditional retailers with locations in many states obviously have to keep track of the tax rules in those states. The difference from online retailers is that once a physical location has been built, the traditional retailer knows for certain that it is subject to the taxing authority of the state and in fact has chosen to be subjected to that authority. Amazon-style laws force online retailers to determine, on a state-by-state basis, if they are subject to the taxing authority of each state based on that state's unique Amazon-style law.

174. Henschman, *supra* note 164. Jurisdictions have wildly different rules concerning what they do and do not tax, and these rules are constantly changing within the jurisdictions. *Id.* Also, jurisdictions are not laid out in a manner that matches up with zip codes—of neither five nor nine digits—so determining which jurisdiction a customer is actually located in can be extremely costly. *Id.*

175. *Id.*

176. See SSUTA, *supra* note 120, § 303A (requiring that “sellers” register in each participating state).

177. See, e.g., *id.* § 402 (providing registered sellers with amnesty for unpaid sales tax prior to a state's adoption of the SSUTA).

178. See *supra* Part II.D (outlining the incentives contained in the SSUTA).

have a legal obligation to collect sales tax in the first place, they should see any compliance costs as a deadweight loss and essentially voluntary additions to operating costs. Even the SSUTA's biggest incentive—amnesty—begs the question: Amnesty from what? If the states need online retailers to voluntarily submit to collecting sales tax, what recourse do the states have if the companies refuse? *Quill* prevents the states from forcing these retailers to collect sales tax. Offering to “forgive” the fact that online retailers were acting in a lawful manner before entering into the Agreement barely seems like an incentive at all—especially not one that would entice retailers to voluntarily increase operating costs and relinquish a competitive pricing advantage.¹⁷⁹

Just as problematic as that, despite being a collaborative effort of forty-four states, only twenty-four states have actually altered their tax codes to gain membership.¹⁸⁰ The largest states in the country are not currently members.¹⁸¹ This rejection of the SSUTA by the largest states indicates that membership is not in their economic best interests.¹⁸² These states may have determined that the cost of altering their sales-tax codes to comply with the SSUTA would negate any gains they may receive from collecting taxes from participating retailers.¹⁸³ It may be that the costs of altering their sales-tax codes for all transactions to capture a minority of currently tax-free transactions outweighs the revenue gains that such a minority could provide.¹⁸⁴ When a majority of both vendors and states choose not to participate, the SSUTA fails. This lack of participation is exactly the problem that has plagued the SSUTA to this point.

179. This analysis depends on the online retailer's not having inadvertently created a physical presence in a member state. If an online retailer had created such a presence within a member state, then amnesty might be a cost-effective option given a large enough liability. If we assume that online retailers want to keep their price advantage from not having to collect sales tax, and that few of the major online retailers are likely to have inadvertently created a physical presence in a state, then it is unlikely that many online retailers would need amnesty, supporting the above analysis.

180. See *Why Was the Streamlined Sales Tax Created?*, *supra* note 121 (detailing who was involved in the creation of SSUTA); see also *How Many States Have Passed Legislation Conforming to the Agreement?*, *supra* note 125 (listing member states).

181. See *How Many States Have Passed Legislation Conforming to the Agreement?*, *supra* note 125 (listing member states). California, Florida, Illinois, New York, Pennsylvania, and Texas are not members. *Id.*

182. Patch, *supra* note 18, at 698.

183. *Id.* at 697.

184. See *id.* (noting that changes in a state's tax code may have adverse consequences such as a drop in income taxes).

C. The Flaws of the Marketplace Fairness Act

Because the MFA incorporates the SSUTA, it carries with it many of the same problems. However, because it is actual federal legislation, the MFA can cure one problem with the SSUTA: it can *force* online retailers to comply.¹⁸⁵ Despite this, the MFA fails to address the SSUTA's second flaw: it is not economically favorable for the larger states to alter their tax codes to subject online retailers to sales tax. The MFA attempts to reduce this burden by offering an alternative to joining the SSUTA, but that alternative is merely a watered-down version of the Agreement that leaves in place the SSUTA's most costly measures.¹⁸⁶ If the larger states are fiscally unable or unwilling to alter their sales-tax codes, then they will be unable to collect revenue in the same manner as the smaller states, and online retailers will still be able to sell the bulk of their products in tax-free transactions. Residents in smaller states who live adjacent to larger ones could ship their items to locations in the larger states and thus hinder the smaller states' ability to collect sales tax.¹⁸⁷

The MFA also may have a negative impact on small businesses. While the MFA contains an exemption for companies with revenues less than \$1 million, that number does not align with criteria other agencies use to classify small businesses.¹⁸⁸ The cutoff for a small business is usually significantly higher than the MFA's definition: the Small Business Administration uses \$32.5 million in revenue as its threshold, while the Treasury uses \$10 million.¹⁸⁹ This means that businesses we ordinarily think of as "small" that operate over the Internet could be subjected to massive administrative costs.¹⁹⁰ Of

185. See Marketplace Fairness Act of 2013, S. 743, 113th Cong. § 2(a) (2013).

186. See *id.* § 2(b).

187. Generally a use tax would apply in this situation. See *supra* Part II.B (explaining why use taxes are a losing proposition for states).

188. See U.S. SMALL BUS. ADMIN., TABLE OF SMALL BUSINESS SIZE STANDARDS MATCHED TO NORTH AMERICAN INDUSTRY CLASSIFICATION SYSTEM CODES 25 (Jan. 1, 2012), available at http://www.sba.gov/sites/default/files/Size_Standards_Table.pdf, available at <http://perma.cc/77B4-PLN3>.

189. *Id.*; Matthew Knittel et al., *Methodology to Identify Small Businesses and Their Owners* 13 (Dep't of the Treasury, Office of Tax Analysis, Technical Paper No. 4, 2011), available at <http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2011-04-Small-Business-Methodology-Aug-8-2011.pdf>, archived at <http://perma.cc/YCQ8-VXB3> ("We set the small business threshold at \$10 million of total income.")

190. See Kevin Hickey, *The Marketplace Fairness Act's Audit Risk*, DAILY CALLER (Aug. 20, 2013, 6:07 PM), <http://dailycaller.com/2013/08/20/the-marketplace-fairness-acts-audit-risk/>, archived at <http://perma.cc/WV25-6GXG> (noting that the MFA as it is currently written will expose small businesses to the threat of audits in over fifty jurisdictions, in the vast majority of which the businesses will have no representation).

course, this is the easiest of the MFA's flaws to remedy: Congress could simply change the definition of a small business by raising the threshold revenue amount. However, since the threshold amounts of other agencies were in effect before the MFA was drafted, it seems likely Congress intentionally chose such a radically different amount for the new statute, though the reasons for such a choice remain unclear.

The MFA's largest flaw is that it does not level the playing field between online retailers and traditional retailers and actually gives a huge advantage to traditional retailers.¹⁹¹ While the law does attempt to ease the burden on online retailers by forcing states to create single tax bases within their borders, it does nothing to reduce the number of local rates present within the states.¹⁹² Whereas traditional retailers will only have to consider the tax rates of the jurisdictions where they are physically located, online retailers would have to comply with as many as 9,646 different rates that are constantly changing and arranged without regard to zip codes or other easily identifiable delineations.¹⁹³ There is no doubt that the current rule favors online retailers, but the burden placed on traditional retailers in the current system is significantly less strenuous than what the MFA proposes to place on online retailers.¹⁹⁴

IV. HOW TO COLLECT SALES TAX ON ONLINE TRANSACTIONS WITHOUT CREATING AN UNDUE BURDEN FOR ONLINE RETAILERS

Solving the problem of online retail sales-tax collection requires a federal solution that accomplishes what the MFA failed to do: reduce the burden to online retailers of complying with the country's 9,646 unique tax jurisdictions. There are several ways federal legislation could accomplish this. First, it could simply mandate a federal online sales-tax rate that the online retailer would remit to the state where it ships the merchandise.¹⁹⁵ For example, if Company A only had a

191. See Henchman, *supra* note 25 (arguing that brick-and-mortar retailers benefit from having fewer jurisdictions in which they must remit sales tax).

192. *Id.*

193. *Id.* While zip codes are defined by the post office, tax jurisdictions are based on the boundaries of entities that create the tax laws such as states and cities. Cities in particular can grow or shrink in or out of zip codes. Because of this, a single zip code could find itself with multiple tax jurisdictions within its borders.

194. See *id.*

195. Of course, a state may choose not to participate, in which case it would only be allowed to collect sales tax from businesses meeting the physical presence test. Given that participation would allow states to collect currently unavailable revenue, it seems likely that most states with a sales tax would participate.

physical presence in New York, whenever it shipped goods to California, those goods would be taxed at the new federal rate, and that money would be remitted to California. Company A would still have to comply with collecting New York's sales tax on in-state purchases because of its physical presence in that state. If the federal government created its own rate and base, online retailers would be subject to a single set of federal rules applicable to out-of-state purchases, plus the rules for whatever states it had a physical presence in. The federal government could go a step further and create a centralized auditing mechanism to prevent companies, particularly small businesses, from facing the prospect of multiple audits every year. This would create an almost identical burden for online and traditional retailers, both of which would be subject to the tax rules of any state in which the physical presence test was satisfied and the federal rules for all transactions occurring within states where the test was not satisfied.

This first option—mandating a single federal online sales-tax rate to be remitted to the states—is the most efficient solution to this issue, protecting online retailers while allowing states to collect sales tax. It would, however, create serious federalism issues because it would require the federal government to dictate what states charge for sales tax on remote transactions. Currently, states create their own tax rules and collect the money themselves. The federal government would arguably be infringing on the states' rights to exercise these powers, at least as they pertain to remote sellers. A supporter of this option might counter that because the Dormant Commerce Clause already prevents states from taxing these sorts of transactions, any new regime proposing to tax such transactions would not infringe upon traditional state power at all. Instead, it would grant a new taxing power—one that the federal government has restricted to a certain rate.

The first option also presents a potential fairness problem. The national rate for online purchases would logically have to differ from the sales-tax rate in the majority of states since each state controls its own rate. This would create a windfall for states where tax rates were lower than the federal rate, as well as for retailers selling to residents of states where tax rates were higher than the federal rate. The opposite problem would occur in states with rates higher than the federal rate, as well as for retailers selling to residents of states where tax rates were lower than the federal rate. However, in the aggregate, these discrepancies might offset each other for the retailers, while all states would see a positive impact because they would be able to collect tax revenue currently outside of their reach.

The simplicity of such a unified federal rate could outweigh the costs discussed above, but there is another way to reduce the number of taxing jurisdictions. Federal legislation could compel each state to enforce only a single statewide set of tax rules for online retailers. This would eliminate the myriad rules found at the local level and subject online retailers to tax compliance costs for about fifty jurisdictions instead of nearly 10,000. Under this rule, the hypothetical New York company, Company A, would always collect the same sales-tax rate when shipping to California, even if the shipments were to various parts of the state with different local rates.¹⁹⁶

This second option would avoid potential federalism concerns and level the playing field for online and traditional retailers.¹⁹⁷ However, it would still subject small businesses to multiple audits every year—a cost that could cripple many small businesses.¹⁹⁸ A simple solution would be to offer an amnesty program similar to the SSUTA’s if the online retailer uses certified software designed to track the tax rules of all fifty states. Such software would likely be costly, but it would be less expensive than the audits or compliance with the MFA.

Both options presented here have the ability to give states access to revenues to which they feel entitled but which they are unable to collect, and both keep the online retailers’ burdens to a minimum while still “leveling the playing field.” The first option, however, is the simpler and more efficient one. That option allows for all remote transactions to be taxed but keeps the burdens on retailers to a minimum.

V. CONCLUSION

Twenty years ago, the Supreme Court established a physical presence test for subjecting out-of-state retailers to a state’s taxing authority. In the last two decades, e-commerce has completely changed the landscape of the economy. E-commerce often occurs in such a way that a company has a national reach but satisfies the

196. The New York company would still be treated the same way as it is today for shipments within New York.

197. Traditional retailers would still be subjected to local rates, potentially subjecting them to more tax jurisdictions than online retailers, thus putting them at a disadvantage. However, the state rate is by far the bulk of the sales tax, so online retailers, which are currently collecting zero dollars in sales tax, would, under the plan, have to start collecting an amount similar to what traditional retailers collect.

198. Hickey, *supra* note 190.

physical presence test in only a handful of states, meaning most states are unable to tax any online sales the company makes. Because they also realistically cannot collect these revenues from the purchaser via a use tax, states consider this lost revenue. Given the current deficits many states face, it is not surprising that states have become more aggressive in their attempts to reclaim this revenue. They have developed new approaches for satisfying the physical presence test, entered into agreements with each other and online retailers, and pushed for federal legislation. All of these methods have been ineffective to this point.

If the goal of a tax regime is to treat like transactions in a similar fashion, and to do so without creating a substantial burden that affects different groups disproportionately, then the taxing regime needs to remain as simple as possible. Simplification, in this case, can only be done at the federal level. Congress must reduce the number of taxing jurisdictions and eliminate the risk that sweeping compliance costs will put some online retailers out of business. If Congress acts in an appropriate manner, then the growth of online retailers will continue without fear of the administrative burden of complying with nearly 10,000 taxing jurisdictions, and the states will be able to tap a new, growing revenue stream at a time when many state budgets could use every penny.

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