

THE “AMAZON TAX” ISSUE: WASHING AWAY THE REQUIREMENT OF PHYSICAL PRESENCE FOR SALES TAX JURISDICTION OVER INTERNET BUSINESSES

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I. INTRODUCTION

“No taxation without representation” was the rallying cry of revolutionary Americans before the great schism with England and remains an iconic phrase to the American public today.¹ Times have changed drastically since the days of stamp taxes, replaced by a bustling economic landscape that our forefathers could have scarcely imagined. However, it seems as though this axiomatic principle of our founding is still implicated in modern jurisprudence. Sales giant Amazon.com (“Amazon”) has essentially taken up the same cry—that it is being unfairly taxed in states where it does not have the requisite presence to support jurisdiction for taxation.² Amazon argues that businesses taxed in states where they do not physically operate are being deprived of due process and are being regulated in a way that violates the Commerce Clause of the

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1. See generally Grant Dorfman, *The Founders’ Legal Case: “No Taxation Without Representation” Versus Taxation No Tyranny*, 44 HOUS. L. REV. 1377 (2008) (explaining the founders’ motivations and providing background on the political ideas of the American Revolution).

2. See *Amazon.com, LLC v. N.Y. Dept. of Taxation & Fin.*, 913 N.Y.S.2d 129, 134 (App. Div. 2010) (describing Amazon’s allegation that it has been taxed in violation of the Due Process and Commerce Clauses in a state in which it has no physical presence).

United States Constitution.

As this Recent Development will make clear, the modern economic environment is one where buyers and sellers can reach one another from any two points on the globe in seconds, connected by the Internet in spite of great physical distances. Because of this, a jurisdictional rule focused on physical presence rather than practical effects does not accurately gauge when due process has been offended through the application of taxes to out-of-state Internet retailers. This is inherently a commercial market where the players are largely disembodied, free from the typical constraints of retail businesses pertaining to location, overhead costs, and advertising reach. Physical presence is not a determinative factor in making sales for Amazon, and basing taxation on a criterion that is ancillary to its operations will produce unsatisfactory results.

Part II of this Recent Development provides background on Amazon's business and how it differs from an ordinary retail experience. Part II also covers Amazon and Overstock.com's ("Overstock") legal action against the State of New York, as well as recent negotiations for the collection of sales taxes by agreement. Part III discusses how jurisprudence applies to the issue of state taxation of Internet businesses. Part III also introduces the antitrust law concepts that will be used in Part IV to create a more workable framework for determining taxation jurisdiction. Part IV includes a recommendation for how these kinds of taxes should be handled in the future, incorporating legal concepts from a variety of fields. Part IV also discusses the inadequacy of bright-line rules as proposed by the U.S. Congress as a solution to this sales tax issue. Part V concludes this Recent Development, summarizing the issue and reviewing the suggested solutions to the problem of the "Amazon Tax."

II. BACKGROUND

Amazon.com is an Internet sales giant, earning \$631 million in net income in 2011.³ In the fourth quarter of 2011 alone, Amazon took in \$17.4 billion in gross revenue, capitalizing off the Christmas season and the introduction of new Kindle products to the already popular line of e-reader devices.⁴ Amazon's impact on the North American market in that quarter amounted to \$9.9 billion, compared to sales of \$7.53 billion in the rest of the world.⁵ These numbers represent a huge sales presence in the United States—which is achieved by offering an extremely large selection of products from a broad range of subsidiary retailers and from its own sizeable inventory.⁶

Through the use of the Internet, Amazon extends its sales capacity

3. Amazon.com, Inc., Annual Report (Form 10-K) 17 (Jan. 31, 2012).

4. Todd Haselton, *Amazon Reports \$17.4B in Revenue, Sales up 35% but Misses Street Estimates*, BGR (Jan. 31, 2012), <http://www.bgr.com/2012/01/31/amazon-reports-17-4b-in-revenue-sales-up-35-but-misses-street-estimates/>.

5. *Id.*

6. This is observable by browsing the Amazon.com website. It has several hundred unique product categories for shopping by Internet customers, and offers millions of products for sale that originate from its own warehouse inventory. AMAZON.COM, <http://www.amazon.com> (last visited Feb. 12, 2013).

beyond the capabilities of traditional means of sales and advertising,⁷ uninhibited by the need for physical presence to spread the Amazon brand. As retail revenues continue to decline, many companies are finding it difficult to keep their doors open, broadening the appeal of abandoning a traditional storefront and maintaining an online-only business with lower fixed costs.⁸ Also, the positive effects of maintaining a physical location, such as showcasing a product to consumers and offering customer service, indirectly benefit Internet retailers creating a “free riding” issue.⁹

Initially, Amazon’s physical network was limited to a few U.S. states.¹⁰ Amazon is incorporated in the state of Delaware, with its operational nexus located in Washington.¹¹ It collected sales taxes in these states due to *physical* presences, such as offices and distribution centers.¹² Pennsylvania and California, for example, have Amazon distribution centers operated by fully-owned Amazon subsidiaries; yet, Amazon only began collecting sales tax in these states after negotiation with state governments, leaving its policy on sales tax collection far from uniform.¹³ In 2008, New York amended its tax law to require that out-of-state businesses, in this context, Internet sellers, are subject to tax jurisdiction if they receive referrals from in-state agents or affiliates.¹⁴

7. See, e.g., Serge G. Avakian, *Global Unfair Competition in the Online Commerce Era*, 46 UCLA L. REV. 905, 909–11 (1999) (describing the unique effects of Internet advertising in an unfair competition context and displaying the capabilities of Internet advertising beyond traditional advertising).

8. Niall McKeown, *Blame the Web, Not Rates on Retail Decline*, ION (Mar. 2012), <http://www.ionology.com/blog/blame-the-web-not-rates-on-retail-decline>; see Brad Plumer, *Driving, Gas Prices and the End of Retail*, WASH. POST (Feb. 18, 2012, 3:00 PM), http://www.washingtonpost.com/blogs/wonkblog/post/driving-gas-prices-and-the-end-of-retail/2012/02/18/gIQAkAXxLR_blog.html (describing retail sales decline for various reasons such as lack of leisure capital, web availability, and convenience). See generally Jill Krasny, *Holiday Shoppers Staying Online This Year, as Bricks-and-Mortar Sales Decline*, BUS. INSIDER (Dec. 6, 2011), http://articles.businessinsider.com/2011-12-06/news/30480984_1_consumers-bricks-and-mortar-retailers-holiday-purchases (describing surveys detailing how consumers, in an attempt to find deals, are staying home and shopping online).

9. See Jordan A. Dresnick & Thomas A. Tucker Ronzetti, *Vertical Price Agreements in the Wake of Leegin v. PSKS: Where Do We Stand Now?*, 64 U. MIAMI L. REV. 229, 237–41 (describing how Internet businesses who do not invest in physical locations or showrooms can still count on inquisitive customers to seek out the products that they are offering at physical stores in order to inspect them in person, ask questions of sales representatives, and compare prices). This article is important because it describes the important problem of free riding in great detail, while at the same time providing some background for the antitrust arguments made later in this Recent Development. See *infra* Part IV (providing recommendations using antitrust analysis framework).

10. See Jeanine Poggi, *Amazon Sales Tax: The Battle, State-by-State*, STREET (Oct. 24, 2011, 3:05 PM), <http://www.thestreet.com/story/11052898/amazon-sales-tax-the-battle-state-by-state.html> (showing the states in which Amazon collects sales tax and which states it has a physical presence in, either through the affiliates program or otherwise).

11. *Id.*

12. See *Sales Tax Requirements*, AMAZON.COM, <http://www.amazon.com/gp/help/customer/display.html?nodeId=468512> (last visited Feb. 12, 2013) (showing states to which orders are shipped that will have sales tax collected, subject to the state laws of the receiving state).

13. David Streitfeld, *Amazon, Forced to Collect a Tax, Is Adding Roots*, N.Y. TIMES (Sept. 11, 2012), http://www.nytimes.com/2012/09/12/technology/amazon-forced-to-collect-sales-tax-aims-to-keep-its-competitive-edge.html?_r=0; see Michael R. Gordon, *Up the Amazon Without a Paddle: Examining Sales Taxes, Entity Isolation, and the “Affiliate Tax,”* 11 N.C. J. L. & TECH. 299, 307 (2010) (discussing the corporate subsidiary structure of Amazon’s distribution centers and whether they should be considered agents of the corporation).

14. N.Y. TAX LAW § 1101(b)(8)(vi) (Consol. 2012).
The statute reads as:

The tax amendment applied to Amazon by connecting them to New York through its affiliate program. The affiliate program uses a variety of independent website owners working on commission to place hyperlinks on their own websites directing customers to buy Amazon goods or services.¹⁵ If a consumer clicks on a link from that affiliate's website, Amazon pays that affiliate a percentage of the consumer's shopping total.¹⁶ Amazon had, at the time of the amendment, "thousands" of affiliates within New York, allowing the New York Tax Code to apply to the online retailer.¹⁷ The amendment, applied to Amazon's affiliates within the state, creates a "substantial nexus" within New York that allows the state taxes to apply so long as the tax is also "fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State," meeting the standards set forth in the Supreme Court's holding in *Complete Auto Transit, Inc. v. Brady*.¹⁸ This standard sets a fairly low bar, as it only requires that the tax satisfy constitutional limitations on interstate commerce already in place.¹⁹

Ultimately, the court upheld the tax, relying on the affiliate program²⁰ as a physical hook for taxation under section 1101(b)(8)(vi) of the New York Tax Law, and not because of the saturation of New York markets by Amazon's Internet presence generally.²¹ Facially, this is not a wholly inappropriate way to bind Amazon, as physical presence in a state is often seen as a way to properly exercise jurisdiction.²² The court's decision was a win for the state,

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

Id.

15. See Sam Zapralka, *New York's Amazon Tax Not Out of the Forest Yet: The Battle Over Affiliate Nexus*, 33 SEATTLE U. L. REV. 527, 551–54 (2010) (describing the Amazon Affiliates program, its purposes, and its goals related to taxation).

16. *Program Overview*, AMAZON.COM ASSOCIATES, <https://affiliate-program.amazon.com/gp/associates/join/landing/referralfees.html> (last visited Feb. 12, 2013).

17. See *Amazon.com, LLC v. N.Y. Dep't of Taxation & Fin.*, 913 N.Y.S.2d 129, 188–89 (App. Div. 2010) (noting that the 2008 amendment to the tax code was designed to collect sales tax from out-of-state sellers that solicited business from New York residents through websites).

18. *Complete Auto Transit, Inc. v. Brady*, 403 U.S. 274, 279, 287–89 (1977) (containing the test used to determine fairly apportioned taxes on out-of-state actors).

19. U.S. CONST. art I, § 8, cl. 3. The Commerce Clause of the U.S. Constitution prohibits the several states from exercising control over interstate commerce, as this is the sole province of the federal government. *Id.* It reads that Congress alone shall have the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." *Id.*

20. See Zapralka, *supra* note 15, at 554 (noting that the affiliate program represented nearly a 1.5% increase in sales in New York, which is a significant impact considering the sheer volume of Amazon's business).

21. *Amazon.com*, 913 N.Y.S.2d at 206–07.

22. *Id.* at 137.

but because the court had relied on a physical presence as the means for attaching the sales tax to Amazon’s activities it left Amazon with a way out should it lose on appeal—it could simply discontinue its use of the affiliate program in-state, severing the physical tether.²³ In the short term, it gave up a 1.5% increase in sales to avoid having to apply sales tax to New York customers, but this was certainly not a total loss. Amazon’s decision was based in strategy: it hoped that the absence of sales tax would entice more consumers to shop there—despite the loss of the affiliate program’s advertising efforts—and eventually pave the way for favorable tax negotiation.²⁴

Amazon and Overstock filed suit over the constitutionality of the tax amendment, arguing that the statute violated the commerce clause (both facially and as applied to Internet retailers), violated due process of law by creating an improper statutory presumption, and specifically targeted Amazon and Overstock.²⁵ The New York courts found Amazon and Overstock’s arguments unpersuasive upon appeal, again relying on the physical presence provided by the affiliate program to affirm the trial court’s determinations.²⁶ The physical presence hook, which provides an easy escape for Amazon and other Internet retailers, is out of place in a modern Internet-inclusive economy that deemphasizes physical location in order to serve a wider number of consumers.

III. ANALYSIS

Presently, for a state to apply a sales tax to a retailer, the Supreme Court requires that there exists a “substantial nexus” between the retailer and the state.²⁷ The substantial nexus does not have to be a massive physical foothold, and the *Amazon* appellate decision plainly states that some activity within the state by agents or employees is enough.²⁸ The court relied on *Orvis Co. v. Tax Appeals Tribunal of State of New York*,²⁹ stating: “the Quill decision cannot be substantively construed as other than a somewhat begrudging retention of the . . . physical presence requirement”³⁰ and the presence “must be

23. *Id.*

24. See Gordon, *supra* note 13, at 315–16 (discussing, in a very straightforward way, why Amazon is motivated to fight against collecting sales tax). He writes that the motivation is simply economical, and has nothing to do with convenience, unfairness, or notice issues. *Id.* Any hypothetical consumer would prefer a product with a substantial discount off of the purchase price to one that has been inflated by the addition of sales tax, and Amazon sees this as an opportunity to outmaneuver in-state businesses by being able to offer the “discount” of not collecting sales taxes. *Id.* Without comment from Amazon proving the contrary, I have to agree that this is the correct perspective.

25. *Amazon.com, LLC*, 913 N.Y.S.2d at 132–37.

26. *Id.* at 133–36.

27. See *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298, 298–99 (1992) (describing the substantial nexus requirement in the specific context relevant to this Recent Development, although the term arises from the Constitution). The substantial nexus language in *Quill* is Supreme Court language that speaks directly to the kinds of disembodied businesses that are at issue with Amazon and Overstock.com.

28. *Amazon.com*, 913 N.Y.S.2d at 138–39.

29. *Orvis Co. v. Tax Appeals Tribunal of State of N.Y.*, 86 N.Y.2d 165 (1995) (illustrating the reluctance of courts to abandon a physical presence requirement, no matter how nominal or ancillary it is, and evidencing a judicial willingness to abandon a constraining physical standard).

30. *Id.* at 177.

demonstrably more than a ‘slightest presence.’”³¹ The *Orvis* court ruled that this standard was met when Orvis’s employees made systematic sales calls in the state.³² The admission that a physical connection so minute as to barely exceed a “slightest presence”³³ standard raises issues about the necessity for forming such a standard—if the court is only concerned with having a nominal physical anchor for jurisdiction, why have a physical requirement at all? Amazon’s proposed termination of the affiliates should be clear evidence that circumventing a physical presence requirement is possible, even with such light standards.³⁴

Behind the existing standards from these cases,³⁵ the underlying issue is not whether the company or party in question is physically setting foot on the land of the state in order to open itself to taxation. It is that the company is having some impact (or intends to produce one) on the activities of the state’s markets and exerting influence on the local economy through the operation of its business, but is still not susceptible to the operation of the law in that state.³⁶ These effects can be felt without resorting to, in the Internet age, an archaic concept of corporeal presence in the forum state. The physical viewpoint is held by most courts today, and is represented well by the New York court’s use of the affiliates program implemented by Amazon in the present case as the means to uphold taxation.³⁷

A. *Physical Presence Requirements for Taxation*

The current judicial viewpoint regarding sales taxation is found in the Supreme Court’s *Quill* opinion alluded to above.³⁸ In this case, the Supreme Court held that mail-order businesses did not need to have a physical presence in state in order to permit states to require businesses to collect use taxes from their in-state customers, but a physical presence in state was necessary to meet the substantial nexus requirement within the taxing state required by the Commerce Clause.³⁹ The Court explains that the physical presence

31. *Id.* at 178.

32. *See id.* (“This sales activity in New York would presumptively suffice as a nexus to impose a use tax collection responsibility . . .” (citation omitted)).

33. *Id.* at 178.

34. Jacqui Cheng, *Amazon to Shut Down California Affiliates Over New Sales Tax Law*, ARS TECHNICA (June 30, 2011, 12:32 PM), <http://arstechnica.com/tech-policy/news/2011/06/amazon-to-shut-down-calif-affiliates-over-new-sales-tax-law.ars> (describing how Amazon takes retaliatory action against states who implement sales tax provisions contingent on the physical presence requirement with the exception of the New York affiliate program because it was too large of a market to lose).

35. *See generally* *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298 (1992); *Orvis Co.*, 86 N.Y.2d 165; *Amazon.com, LLC v. N.Y. Dept. of Taxation & Fin.*, 913 N.Y.S.2d 129 (App. Div. 2010) (forming a clear line of physical presence jurisprudence and illustrating how courts gradually became more progressive regarding the exercise of jurisdiction over more remote physical presences, despite some displayed reluctance to deviate from this established path).

36. *See Calder v. Jones*, 465 U.S. 783, 783–84 (1984) (describing a potential impacts-based intentionality test rather than a test focused solely on physical presence).

37. *Amazon.com*, 913 N.Y.S.2d at 196–98.

38. *Quill*, 504 U.S. at 299.

39. *Id.* at 298–99 (establishing the need for a physical presence to uphold substantial nexus within a state, relative to taxation). While a lot of the *Quill* opinion is progressive, and examines effects broadly, this standard is considerably narrower than it could potentially be. By having a physical hook on the books, it

requirements for taxation are “formalistic” and that courts ought to use a more “flexible inquiry” into whether a tax can attach to an out-of-state operator without offending due process and the Commerce Clause.⁴⁰ Importantly, the Court points to *Burger King v. Rudzewicz*,⁴¹ a landmark civil procedure case, to show that purposeful availment of the benefits and protections of a state’s laws could be used to satisfy jurisdiction for parties out of state.⁴² The synthesis of these cases into an applicable test occurred in *Kulko v. Superior Court*.⁴³ The *Quill* court determined that Quill, as a large-scale business taking advantage of a market for its goods in the state of North Dakota, was not being denied due process by the application of the sales tax.⁴⁴ It did not require Quill to maintain a physical presence, by salesmen, offices, or showrooms, but did require that the claim must arise from the contacts held with the forum state.⁴⁵

This situation bears a critical resemblance to the nature of the Amazon tax—that the operation of an out-of-state business, taking advantage of a product market within the taxing state, can be taxed in-state without violation of due process.⁴⁶ The requirements from *Kulko*, while representing a test for exercise of jurisdiction for claims and not for taxes, bear this out persuasively. Even with this differentiation, the Court does not go all the way in eliminating physical presence as a factor that weighs heavily in the *Complete Auto* test for whether a tax will not violate the Commerce Clause.⁴⁷

The *Quill* court decided that because there was no physical presence, and only a passive presence in the state through use of a catalog and mail service, that the tax did not pass the Commerce Clause test.⁴⁸ The New York tax

becomes extraordinarily easy to defeat jurisdictional issues on due process grounds if there is actually *some* activity taking place in the state. It seems plausible that courts did not want to deal with opening a huge can of worms regarding findings of jurisdiction without physical presence. At the time, this made sense because catalogs and phone ordering were realistically the only kinds of businesses (apart from outside sales work) that could have existed at the time the opinion was authored.

40. *Id.* at 298.

41. See *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985) (establishing the “purposeful availment” test, which held that jurisdiction could be based upon the fact that the party had acknowledged that they were in some way benefitting from the state’s laws, regardless of physical presence). In many respects this comports with the recommendation of this Recent Development, from the standpoint that if a party wishes to receive an economic gain from a state, it should readily follow that they expect to be subjected to those laws given a significant enough connection with that state on some level. See *infra* Part IV.

42. *Quill*, 504 U.S. at 307–08.

43. See *Kulko v. Superior Court*, 436 U.S. 84, 91–92 (1978) (synthesizing several jurisdictional cases, resulting in a concise, multi-part test that is extraordinarily useful in determining if personal jurisdiction can attach). The importance to the Amazon issue is that, again, it shows clearly the kinds of factors that courts consider when deciding whether to allow states to legally reach beyond their boundaries. *Id.* This case was drawn upon in *Burger King*, representing a progressive trend away from rigid, bright line tests that focus solely on physical presence or involvement to determine proper jurisdiction. See *Burger King*, 471 U.S. at 474 (“[T]he Due Process Clause [is not] a territorial shield to avoid interstate obligations.”).

44. *Quill*, 504 U.S. at 298–300.

45. *Id.* at 298 (“Thus, to the extent that this Court’s decisions have indicated that the Clause requires a physical presence in a State, they are overruled. In this case, Quill has purposefully directed its activities at North Dakota residents, the magnitude of those contacts are more than sufficient for due process purposes, and the tax is related to the benefits Quill receives from access to the State.”).

46. See *Amazon.com, LLC v. N.Y. Dept. of Taxation & Fin.*, 913 N.Y.S.2d 129, 139–40 (App. Div. 2010) (explaining the difference of the Due Process Clause on the state taxing authority vis-à-vis the Commerce Clause).

47. *Complete Auto Transit v. Brady*, 403 U.S. 274, 287–89 (1977).

48. See *Quill*, 504 U.S. at 298–300 (demonstrating that the lack of physical presence was an issue).

amendment likely would have suffered the same fate had it not been for the presence of the Amazon affiliates program, which allowed the court to sustain the tax's validity because it constituted a physical presence in the state.⁴⁹ The New York court held that "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."⁵⁰ It is interesting that the court reasoned through its holding in this way, because the Amazon affiliates program does resemble a campaign of passive advertising.⁵¹ The affiliates themselves do not actively solicit users to Amazon's website, but place banners or advertisements that link to Amazon.⁵² Even though this seems like a poor fit, there are no other options for maintaining taxation jurisdiction. The New York court does not have the authority to overturn the physical presence hook, so this is where the Supreme Court, in the future, must change its thinking.⁵³

The use of personal jurisdiction jurisprudence as a guidepost for the degree of physical presence required to assert jurisdiction over Internet businesses displays notable trends.⁵⁴ Courts initially struggled with how to deal with the new and different nature of Internet communications, as the U.S. mail did not represent such an interactive and consistently available medium of contact. The Internet functions at the intersection of the telephone and the newspaper, an effective advertising tool that requires conscious access on the consumer side in order for the buyer to make a purchase.⁵⁵ The interactivity of a website was involved with jurisdictional analysis in *Zippo* where jurisdiction was held to be proper "[i]f defendant enters into contracts . . . that involve knowing and repeated transmission of computer files over the Internet . . ."⁵⁶ This effectively demonstrates the courts' ability to assert jurisdiction over matters conducted solely over the Internet if their *target* is present in the forum state—and this extends readily to the concept of Internet sales.⁵⁷ "Knowing

49. *Amazon.com*, 913 N.Y.S.2d at 142–43.

50. *Id.* at 138.

51. *See Program Overview*, *supra* note 16 (outlining the tenants of Amazon's Affiliate Program).

52. *Id.*

53. *See Amazon.com*, 913 N.Y.S.2d at 145 (holding that further discovery was needed before a determination on Commerce Clause claim can be made).

54. *See generally* *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298 (1992) (demonstrating unwillingness to part with the physical presence requirement for a mail order business); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985) (presenting unwillingness to part with physical presence requirement in a franchisor-franchisee suit); *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977) (showing general unwillingness to completely part with a physical presence requirement); Charles W. Rhodes, *Clarifying General Jurisdiction*, 34 SETON HALL L. REV. 807, 849–50 (2004) ("Of course, corporations did not fit comfortably within such a regime, because a corporation has no tangible physical presence. Unlike an individual, a corporation's 'presence' could 'be manifested only by activities carried on in its behalf by those who are authorized to act for it.' Thus, the pre-*International Shoe* jurisdictional formula for corporations typically depended on the corporation's deemed presence through its business activities in the forum." (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945))).

55. *See Amazon.com*, 913 N.Y.S.2d at 133–35 (explaining that Internet-based sellers such as Overstock and Amazon require consumers to consciously access the companies' websites in order to purchase a listed item).

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

57. The standards brought forward in *Zippo* are applicable to *Amazon* because of directed transmissions at the target state. *See generally id.*; *Amazon.com*, 913 N.Y.S.2d at 133–35. Amazon had the choice to refrain from accessing the New York market, but chose to continue operation of its webstore regardless of tax

and repeated transmission” does not fundamentally differ from presenting a website that customers may interact with without restriction because there is no limit to the degree of interaction that a consumer may have with any website on any day.⁵⁸ This standard, if expanded to encompass the existing standards for taxation jurisdiction, would bring Internet-based businesses within the reach of state sales taxation statutes.

Interestingly, the court in *Zippo* cites *Burger King* and offers words of support for Internet jurisdiction to be expanded, holding that “[t]raditionally, when an entity intentionally reaches beyond its boundaries to conduct business with foreign residents, the exercise of specific jurisdiction is proper. Different results should not be reached simply because business is conducted over the Internet.”⁵⁹ The court recognizes that this is not an anomalous zone where rules of law should be handled differently. This is representative of a different attitude than the *Quill* holding, where a distinction was made between advertising and solicitation, virtually segregating types of commerce based upon the degree of intention presented by the seller.⁶⁰ In the view of the *Zippo* court, a store is a store, regardless of the physical presence of that store.⁶¹ A more effective approach for dealing with website jurisdiction is one that also expands to incorporate the intended effects the actor wishes to achieve. Such a test is embodied by the *Calder v. Jones* “effects test,” which considers the intended effects of the defendant’s operations on the jurisdiction.⁶²

This approach, the *Calder* test, supports the position of jurisdiction over an Internet business if it is as large and far-reaching as Amazon. Such a business clearly intends to make sales and modify existing markets in the target jurisdiction. Even though Amazon would likely be considered a highly interactive website under *Zippo* with existing integrated search features, suggestions to specific shoppers, regional or demographic specific offers (such as Amazon Student), these factors should not be solely dispositive of the presence question, because the website’s design and interface alone should not dictate taxation. Undoubtedly, the interactivity of Amazon’s site influences the volume of its sales, but application of the *Calder* test correctly renders that criterion individually less important than intended or objective impacts on the local jurisdiction.

The strongest counterargument to this position is one based on the degree of analysis that would be required by courts to gauge the impacts or effects of websites as opposed to a readily-observable criterion like interactivity. In this area, there are many similarities to the operation of antitrust law, where the court must weigh expert testimony on the behavior of a market in response to particular economic conduct.⁶³ Potential impact factors could mirror factors

ramifications. That Amazon shuttered its affiliates program in the state only after a tax was proposed, despite substantial increases in sales, shows the inefficiency associated with this distinction.

58. *Zippo*, 952 F. Supp. at 1124.

59. *Id.* at 1124 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985)).

60. *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298, 298–300 (1992).

61. *Zippo*, 952 F. Supp. at 1124.

62. *Calder v. Jones*, 465 U.S. 783, 788–90 (1984).

63. *See generally* *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 8 (1979) (describing the

considered by courts for analyses in antitrust litigation. In cases such as *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the Court turned to “rule of reason” analysis, which examines the broad economic and competitive circumstances surrounding particular economic conduct.⁶⁴ The “rule of reason” analysis often requires the court to scrutinize market research and analysis presented by the parties through amicus briefs or expert testimony.⁶⁵ The rule of reason represents a paradigm shift in antitrust jurisprudence, because it requires a court to determine if an activity was an unreasonable restriction on competition through evaluating the economic effect of that action.⁶⁶ Prior to the promulgation of this rule, courts had flatly deemed certain types of economic activity to be anticompetitive and illegal regardless of the circumstances.⁶⁷ In *Leegin*, the Court had to hear testimony and read briefs about the specific economic and competitive consequences of vertical price restraints within an interbrand distribution system.⁶⁸ As with any area where judges must weigh expert testimony, their familiarity with the material becomes relevant to the outcome of the case.⁶⁹ Well-reasoned arguments might not be found persuasive by judges unfamiliar with the material being presented, and trials might devolve into battles of the experts that consume government resources for questionable positive advances in terms of case outcome.⁷⁰ Despite these potential shortcomings, a market analysis-driven approach could accurately gauge whether Internet businesses ought to be subject to sales taxes, looking at specific effects of that business on a given market. *Quill* supports a case-by-case analysis of circumstances which may not require a physical presence within a state to apply taxation.⁷¹

Incorporating antitrust concepts into the analysis of tax jurisdiction has the benefit of eliminating the need for bright line rules about which businesses and websites have enough sales volume to cause major effects on the forum state. Antitrust jurisprudence underwent a similar evolution throughout its history, initially condemning broad ranges of conduct based upon ill-fitting bright line rules and per se classifications, but eventually arriving at better reasoned approaches that examined in detail (if necessary) the totality of the circumstances and effects of an activity.⁷² This may be time-consuming in the

Court’s approach in applying “rule of reason” antitrust analysis, with a fine degree of detail in how the Court develops its position on whether conduct is anticompetitive in violation of the Sherman Act through amicus curiae and expert testimony).

64. *E.g.*, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885 (2007).

65. *See id.* (showing the general framework for antitrust analysis under “rule of reason” and “per se” approaches, highlighting general pros and cons of each approach).

66. WILLIAM HOLMES & MELISSA MANGIARACINA, ANTITRUST LAW HANDBOOK § 2:10 (2012).

67. *Id.*

68. *Leegin*, 551 U.S. at 891.

69. *See, e.g.*, *Till v. SCS Credit Corp.*, 541 U.S. 465, 466 (2004). This case is a prime example of judges who have no experience in the particular field of the case being litigated, issuing a verdict that is contrary to prevailing wisdom. The implementation of an arbitrary “prime-plus” rate for bankruptcy cram down is not economically popular, and unfairly favors the debtor at the expense of the creditor. *Id.* However, judges did not recognize this and rendered a verdict even in the absence of expertise. *Id.*

70. *E.g., id.*

71. *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298, 315 (1992).

72. HOLMES & MANGIARACINA, *supra* note 66, § 2:10.

The following is an excellent description of the rule of reason, generally, as applied to antitrust

short run, as there will initially be very few guiding principles for determinations; but as more websites are analyzed in this way, the process will become efficient. In the antitrust context, "quick look" is an abbreviated version of the rule of reason analysis, relying on past case analysis where an anticompetitive effect can easily be ascertained, or seem obvious from a "quick look" at the situation.⁷³ As similar businesses challenge taxes, the courts will be able to see the impacts that different websites have had in the past, and use quick look analysis based upon similar circumstances (both in the market and in the type of website being evaluated) to expedite the process of making a tax validity determination for a particular seller.⁷⁴

IV. RECOMMENDATION

This Recent Development expresses a simple proposition with far reaching consequences: that an Internet business with Amazon's sales volume should require no greater connection than the ability to ship goods to the taxing state to be legally taxed on sales made to that state. This requires that courts alter their current analysis for tax collection of Internet businesses and a drastic paradigm shift in the present state of Internet jurisprudence.

Courts should view an Internet website's aggregate impact on the forum state as the determinative factor for whether jurisdiction exists for taxation. This would not underestimate, as current jurisprudence does, the effects of large Internet businesses, who offer a major volume of goods and replace local retailers, from being outside of a state's jurisdiction to generate revenue through sales tax simply because the transaction does not involve communicating with a salesperson who happens to live in that state.

The effects test should be conducted through an antitrust analysis framework, employing market definition and examination of competitive and economic conditions imposed on and accepted by any given business.⁷⁵ More

challenges:

This so-called "rule" is not really so much a set standard of behavior as it is a general inquiry into whether, under "all the circumstances," the challenged practice "impos[es] an unreasonable restraint on competition." Relevant circumstances can include such diverse factors as the defendants' intent and purpose in adopting the restriction; the structure of and competitive conditions within the affected market; the relative competitive positions and market power of the defendants; the presence of economic or legal barriers inhibiting the ability of actual or potential competitors to respond and offset the challenged practice; and apparent justifications for the restriction such as enhanced efficiencies, protection of product or service goodwill, and inducing dealer loyalty. No single such factor is decisive. Rather, the factfinder "weighs all of the circumstances" in deciding whether the challenged practice is, on balance, competitively unreasonable. Courts commonly phrase the inquiry in terms of shifting burdens of proof.

Id.

73. See *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 759 (1999) (setting out the quick look analysis and explaining that it applies when the agreement is flatly anticompetitive or when anticompetitive effects are almost certain to arise because in such cases a rule of reason analysis would be a waste of time and effort).

74. *Id.*

75. See generally HOLMES & MANGIARACINA, *supra* note 66 (explaining how a typical antitrust analysis begins).

detailed antitrust analysis, such as the rule of reason,⁷⁶ requires thorough research, scrutiny, and market analysis in order to determine whether anticompetitive conduct has taken place. This approach takes into account the effects that a market participant has on that market and other markets. Geographic market definition is as important as defining the relevant product market, and geography is the key element courts are interested in when determining whether an Internet business has affected a state to the point where extension of tax jurisdiction is proper. As mentioned *supra* Part III, initially this requires a great deal of effort on behalf of courts,⁷⁷ but as the general impacts of large Internet sales businesses become clearer, a more succinct “quick look” analysis can take place without losing any of its effectiveness.⁷⁸ In addition to abbreviating subsequent analyses, as case law begins to form around this framework, fewer cases are likely to see trial. With increased predictability from similar market situations having gone to trial, courts and prospective litigants will both be able to make more informed decisions regarding dismissal, pursuit of a claim, or proceeding to mediation.

Under this analysis, the Amazon tax is constitutional as applied to major Internet retailers without employing a fragile argument based on a substantial *physical* nexus, resulting in benefits to states without applying an unfair or unconstitutional tax to businesses. Additionally, there is no requirement for Amazon and other large e-retailers to offer shipment to all states, and it is easy to control which states are able to make purchases from their websites through IP restrictions if they wish to terminate service to states with disagreeable taxes. However, if Amazon wants to realize a profit by selling to a state, it does not offend the notion of free interstate commerce that it may be taxed for its gains. The Commerce Clause does not preclude a state from taking affirmative measures to tax the economic activity of national and global businesses within its borders as long as its motivation is not to grant an advantage to in-state enterprises through economic protectionism.⁷⁹

The absence of economic protectionism is the keystone for constitutional regulation of interstate commerce.⁸⁰ A statute may be presumptively constitutional if the purpose is to generate revenue or achieve a public policy

76. *Id.* § 2:10 (summarizing the rule of reason test).

77. However, this burden may not be borne entirely by the courts. As in antitrust cases, federal agencies and private counsel should actively participate in developing market analyses to avoid bias and create a more complete picture of the economic impact of any given website.

78. HOLMES & MANGIARACINA, *supra* note 66, § 2:10 (“For the quick look to apply, the conduct at issue and context in which it arises must have likely anticompetitive effects that are so intuitively obvious as to be clear without a detailed market analysis, *i.e.*, from just a ‘quick look.’”). Holmes’ description of the “quick look” rule of reason analysis for established markets supports the idea that the courts would need to first hold ideas about an established market in order to employ it. A court would initially be unable to use the quick look, because it might not be plainly obvious what effects an Internet business would have on a given jurisdiction. However, over time, a record would develop and judicial understanding of the Internet economy would hopefully expand to allow this test to become applicable in as-applied tax challenges.

79. See *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273–74 (1988), cited with approval in *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994) (describing the Commerce Clause’s economic protectionism prohibition).

80. *W. Lynn Creamery*, 512 U.S. at 192–93; *New Energy Co. of Ind.*, 486 U.S. at 273–74.

goal and it is an “even-handed”⁸¹ regulation. The protectionism test is a significant impediment to a tax’s constitutionality, because the case law bears out that even a tax written in an even-handed fashion is not constitutional if the impact is one that creates an undue discriminatory burden on an out-of-state actor.⁸²

Opponents to taxation may argue that this tax furthers an economically protectionist goal, because by charging a business who resides out of state an in-state tax, the government is attempting to “level the playing field” for domestic businesses. This argument would likely fail by simple reference to existing Commerce Clause jurisprudence such as *New Energy Co. of Indiana v. Limbach*, because the purpose of the regulation—generation of revenue on a large market participant who has so far avoided taxation—appears to be facially unrelated to economic protectionism.⁸³ This is the intended purpose, and is not “merely an occasional and accidental effect of achieving what is its purpose, favorable tax treatment” for in-state businesses.⁸⁴

The argument for New York’s tax amendment as unduly discriminatory may still persist even though it is unlikely to be found economically protectionist on its face. Because this tax only realistically applies to online sellers with large volume and limited physical hooks in-state such as Amazon and Overstock, this could appear discriminatory against large Internet businesses. Under the proposed method of classifying Internet businesses based upon the scale of their economic effects within a jurisdiction, state taxation would be handled in a way that is not *unduly* discriminatory. Discrimination always exists in the function of a regulation, but it is only when it is unduly or disproportionately discriminatory that an issue arises.⁸⁵ Amazon is a larger company and does more business, and more greatly affects the economy of the several states, and therefore is not unduly discriminated against by regulation in keeping with its stature. This is similar to how income tax regulations affect citizens who earn different levels of income on a basis that is scaled as opposed to uniform, a common practice among states.

Whether a regulation is even-handed depends if its “practical operation” will “work discrimination against interstate commerce,”⁸⁶ and it seems unlikely that a law governing similarly-situated businesses equally offends the Constitution. Issues would arise if similarly-situated businesses were taxed differently.

Some critical issues exist that must be resolved to move forward with this approach, and these issues require careful line-drawing to ensure that small businesses or individual sellers of goods (in the vein of eBay sellers or people crafting goods for sale on websites such as Etsy.com) do not have to deal with

81. *W. Lynn Creamery*, 512 U.S. at 214.

82. *Id.* at 214–15.

83. *See New Energy Co. of Ind.*, 486 U.S. at 277–79 (examining states’ intent behind cash subsidy programs for the sake of determining whether the programs violate the Commerce Clause).

84. *Id.* at 280.

85. *See id.* at 279 (explaining that a discriminatory statute may be nonetheless valid if it “advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives”).

86. *W. Lynn Creamery*, 512 U.S. at 201.

a complex taxation process that is meant to return revenue to a state where they had no expectation of taxation.⁸⁷ Sites like eBay, which offer sellers the opportunity to sell goods over the Internet, do not even broach the issue of sales tax to their users or to their customers, as the entire concept is more of an online garage sale than that of an ongoing business that is making a consistent stream of income. This is not the case for all users, however, and many eBay sellers operate stores with large inventories and proportionally large amounts of revenue.⁸⁸ Whether these sellers should be taxed has been the source of much disagreement, and some conflict exists between eBay and Amazon over why the eBay business has been largely tax-free.⁸⁹ Naturally, this comes down to who the sellers actually are—if Amazon was not the primary retailer in most instances of online sales from its web domain (acting only as a facilitator for market participants, as eBay functions) the individual sellers would likely be the target of taxation, not Amazon. If the users were not “businesses” themselves, like the average eBay user who is reselling goods that he may have already paid sales tax on, taxation would be unlikely to attach.⁹⁰ This discrepancy makes it important to craft an accurate test to determine which businesses are large and sophisticated enough to be subject to taxation within a state.

Parties opposing or supporting tax jurisdiction in court should be prepared to show how the Internet business affects the commercial landscape in the market or markets that their businesses are part of. This can be done through antitrust-style market definition frameworks, examining which kinds of products are sold, how the business is viewed relative to other businesses by consumers, how the business markets itself, and who the business views as its competitors.⁹¹ After determining the appropriate market that a website participates in, economic analysis of sales volume figures or net profits gained is necessary to show that the business exerted an economic effect great enough to support jurisdictional coverage for sales taxation.

Current events in this area have raised new concerns among Internet retailers and state legislations that make the development of a new method of upholding sales tax jurisdiction necessary. Amazon, since November 2011, has reversed course on its position regarding sales taxation, and now has been pushing the government to implement blanket sales taxes, with local collection measures, that affect all Internet retailers, or to submit to jurisdiction in exchange for building variances or other tax incentives.⁹² Initially, this seems

87. See Jennifer Liberto, *Amazon and eBay Brawl Over Web Sales Tax*, CNNMONEY (Dec. 2, 2011, 6:03 PM), http://money.cnn.com/2011/11/30/technology/onlines_sales_tax/index.htm (describing the contentious nature of classifying Internet sellers as large or small).

88. Janet Novack, *Academic Study: eBay Sellers Shirk Sales Tax Law*, FORBES.COM (July 13, 2010, 10:30 AM), <http://www.forbes.com/2010/07/13/internet-sales-tax-ebay-amazon-personal-finance-ebay-sellers-flout-law.html> (interpreting a study of how few eBay “power sellers” who have sold thousands of goods on eBay fail to pay sales tax to the state).

89. Liberto, *supra* note 87.

90. Novack, *supra* note 88.

91. See 15 U.S.C. § 1 (2006) (describing how litigants and courts undertake the tasks of market definition and analyzing competitive conduct).

92. See Liberto, *supra* note 87 (discussing Amazon’s support for taxes at a congressional hearing).

to be exactly what this Recent Development is calling for—Internet businesses that benefit from doing business in a state have to pay that state’s sales tax. But this plan does not solve the problem in an appropriate way. By submitting to state sales tax, Amazon insinuates itself into the lawmaking discussion.⁹³ By suggesting a blanket tax, given its already litigious behavior in New York, it would seem that as long as the tax is fair in its view, it would not continue to litigate against the government’s efforts. This is more strategy; as a larger competitor it is likely to be more resilient against the sales lost from the “increased price” now associated with sales tax being charged on purchases.⁹⁴ This could be a cagey move to try and capture the sales from other online competitors in the face of dwindling physical retail competition.⁹⁵ Taking the tax issue out of the hands of Amazon and other large retailers with a test that can fairly and broadly apply jurisdiction to appropriately situated businesses will result in a beneficial outcome for states and Internet commerce as a whole.⁹⁶

V. CONCLUSION

The courts’ current approach is rather dated. They cite cases as far back as the 1960s using things like catalog advertising and traveling salesmen to support some underlying contentions about the nature of “out of state” commercial action. The nature of the Internet renders such an analysis largely irrelevant. Broadening the “nexus” framework to accompany the impact/effect websites have on consumers from different states will address more progressive viewpoints that advocate taxation and jurisdiction over Internet websites without need for an almost ancillary physical presence.

A focus on the effects is a more wholesome approach to evaluating Internet business at large, rather than something based on physical location—which is a restriction that the Internet intrinsically defeats. It would make little sense to have a corporation that seeks to reach beyond territorial boundaries be immune from taxation in that state because it lacks a physical presence in the new market. With a logical approach of assessing the commercial effects of particular websites before condemning taxation that may affect them despite a lack of presence, there needs to be some analysis undertaken to see if jurisdiction is proper before a blanket, per se condemnation occurs.

The world of commercial and legal interaction has rocketed past an age where someone needs to be standing within a state’s border to be subjected to its taxes or its laws. If those taxes and laws are applied fairly, narrowly, and

93. See Phil Villarreal, *Arizona Bows to Amazon, Ditches Plan to Collect Sales Tax*, CONSUMERIST (Mar. 12, 2012), <http://consumerist.com/2012/03/arizona-bows-to-amazon-ditches-plan-to-collect-sales-tax.html> (describing how Amazon works with states either to intimidate them into dropping sales tax or to develop a structure that they prefer).

94. Liberto, *supra* note 87.

95. See Krasny, *supra* note 8 (stating that physical retail sales are declining because consumers are choosing to shop online instead); Liberto, *supra* note 87 (stating that Amazon is in a better position than its competitors to absorb a tax increase).

96. See *supra* Part IV.

correctly, physical presence is an obsolete requirement.