New York County Clerk's Index No. 601247-2008

New York State Supreme Court

Appellate Division – First Department

AMAZON.COM, LLC and AMAZON SERVICES, LLC,

Plaintiffs-Appellants,

—against—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; ROBERT L. MEGNA, in his Official Capacity as Commissioner of Taxation and Finance; THE STATE OF NEW YORK; and DAVID A. PATERSON, in his Official Capacity as the Governor of the State of New York,

Defendants-Respondents.

BRIEF OF THE TAX FOUNDATION
AS *AMICUS CURIAE*
IN SUPPORT OF PLAINTIFFS-APPELLANTS

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INTEREST OF THE *AMICUS CURIAE*

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., the Foundation's economic and policy analysis is guided by the principles of neutrality, simplicity, transparency, and stability. The Tax Foundation seeks to make government finance more understandable, such as with the annual calculation of "Tax Freedom Day," the day of the year when taxpayers have earned enough to pay for the nation's tax burden and begin earning for themselves.

The Tax Foundation's Center for Legal Reform educates the legal community and the general public about economics and taxpayer protections and advocates that judicial and policy decisions on tax law promote principled tax policy. Recent federal and state tax-related cases in which the Tax Foundation has participated as *amicus curiae* include *Department of Revenue of Kentucky v. Davis*, 128 S. Ct. 1801 (2008); *CSX Transportation, Inc. v. Georgia State Board of Equalization*, 128 S. Ct. 467 (2007); *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2005); *Bonner v. Indiana*, 907 N.E.2d 516 (Ind. 2009); and *Weisblat v. City of San Diego*, 2009 WL 2506286 (Cal. Ct. App. Aug. 18, 2009).

This case involves an important issue of tax policy. By addressing whether contracts with in-state affiliates creates substantial nexus for an out-of-state business, the opinion of this Court will not only have an impact on one of the largest states in the Union, but its rationale will likely aid other states confronting similar questions.

The Tax Foundation is in a unique position to assist this Court because it has conducted extensive legal research into nexus cases involving Commerce Clause challenges, as well as economic research on the nationwide impacts of expansive state nexus standards. This research goes directly to the issues raised in this case. Accordingly, the Tax Foundation has an institutional interest in this case.

SUMMARY OF ARGUMENT

For a company to be required by a state to collect that state's sales and use taxes, to satisfy the U.S. Constitution's Commerce Clause, the company must have "substantial nexus" with the state through having established a non-*de minimis* physical presence there. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

This requisite physical presence may be established in one of two ways. *See id.* at 306-07 (describing two lines of cases). First, physical

presence can be established by the company having in-state employees, offices, or retail outlets, so long as they constitute more than a slightest presence, irrespective of the nature of those instances of physical presence. Second, physical presence can be established by the company maintaining arrangements with independent persons physically present in the state who are engaged in local solicitation or sales support vital to the establishment and operation of the company's in-state market.

In this case, because all parties agree that Amazon.com does not have in-state employees, offices, or retail outlets in New York, the question is whether Amazon.com has arrangements with independent persons physically present in the state who are engaged in local solicitation or sales support vital to the establishment and operation of Amazon.com's New York market.

Instead of answering this question, the court below limited its analysis to summarily concluding that Amazon.com "benefits" from in-state independent persons. The court below conducted no inquiry as to whether their activities are *significant* for maintaining Amazon.com's market in New York, and given that they represent only 1.5% of the company's in-state sales, this is doubtful. In short, the court treated the

independent persons as company employees, finding nexus based on their presence regardless of the nature and magnitude of their activities.

The lower court's unprecedented and expansive standard for substantial nexus goes far beyond any standing precedent. It would go beyond the "furthest extension" (the U.S. Supreme Court's own words) of the standard established by the U.S. Supreme Court (in *Scripto* and *Tyler Pipe*), into new territory, essentially where any company that is subject to personal jurisdiction in a state also has substantial nexus. Such a conclusion would be in contravention of Supreme Court holdings that differentiate between the "minimal connection" Due Process standard and the Commerce Clause "substantial nexus" standard.[1]

[1] Whether Amazon.com has sufficient nexus for due process purposes is not the subject of this brief.

ARGUMENT

I. SUBSTANTIAL NEXUS IS ESTABLISHED WITH A STATE IF AN OUT-OF-STATE COMPANY HAS MORE-THAN-SLIGHT IN-STATE EMPLOYEES, ASSETS, OR FACILITIES, OR IN-STATE INDEPENDENT CONTRACTORS CRUCIAL TO ESTABLISHING AND MAINTAINING THE COMPANY'S IN-STATE MARKET.

A. Physical Presence Can Be Established With In-State Employees, Assets, or Facilities, So Long as They Constitute More Than the Slightest Presence.

If an out-of-state company has employees, assets, or facilities in a state, so long as they have more than a "slightest presence," the company has substantial nexus with the state. *See Quill* 306-07; *Nat'l Geographic Soc. v. Cal. Bd. of Equalization*, 430 U.S. 551, 556 (1977) (rejecting a "slightest presence" standard as insufficient and establishing that there must be "a much more substantial presence than the expression 'slightest presence' connotes").

Physical presence based on the in-state presence of the company's employees, assets, or facilities exists even if the employees or offices are not directly involved in soliciting sales in the state. *See Standard Pressed Steel Co. v. Department of Revenue of Washington*, 419 U.S. 560, 562 (1975) (company employees); *Matter of Orvis Co. v. Tax Appeals*

Tribunal, 86 N.Y.2d 165, 178 (1995) (company employees); *Nat'l Geographic*, 430 U.S. at 560-61 (company offices); *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941) (company offices); *Nelson v. Montgomery Ward*, 312 U.S. 373 (1941) (company offices).

B. Physical Presence Can Be Established Through Independent Persons, But Only If Such Persons Engage in Local Solicitation or Sales Support Activity Crucial to the Establishment and Maintenance of the Company's In-State Market.

In addition to having its own employees or property in a state a company may be physically present in a state through attribution, if the company maintains arrangements with independent persons who are physically present in the state and if the in-state activities of those persons are crucial to the establishment and maintenance of the company's in-state market. *See Tyler Pipe Indus. v. Washington Dep't of Revenue*, 482 U.S. 232, 250 (1987) (stating that the non-employee's activity must be "significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for [its] sales."); *Quill Corp.*, 504 U.S. at 249.

The U.S. Supreme Court has acknowledged that this "attributional nexus" standard, outlined in *Scripto* and *Tyler Pipe*, is

the "furthest extension" of the physical presence rule. *Quill Corp.*, 504 U.S. at 306, *citing Scripto, Inc. v. Carson*, 362 U.S. 206 (1960); *Tyler Pipe*, 482 U.S. at 250. Consequently, under settled law, the non-employees' "local function" activities must be "significantly associated" to the establishing and maintaining the company's in-state market, either through (1) in-state solicitation or (2) in-state sales support. *See, e.g.*, *Scripto,* 362 U.S. at 211 (finding physical presence where 10 independent contractors engaged in a "local function of solicitation" that was "effective[] in securing a substantial flow of goods into [the state]"); *Tyler Pipe*, 482 U.S. at 251 (finding physical presence where in-state independent contractors "acted daily on behalf of [an out-of-state company] in calling on [in-state] customers and soliciting orders," rendering them "necessary for maintenance of [the company's] market and protection of its interests.").

Courts around the country have recognized that substantial nexus does not exist if the in-state activities of independent persons are "*de minimis* local activities or proof that the local activities do not generate any significant proportion of local sales." *Borders Online, LLC v. Cal. Bd. of Equalization*, 129 Cal. App. 4th 1179, 1200 (2005). *See also St.*

Tammany Parish Tax Collector v. Barnesandnoble.com, 481 F. Supp. 2d 575 (E.D.L.A. 2007) (finding no substantial nexus where in-state company was not a "marketing presence" for the out-of-state company nor provided it with any substantial operational benefit); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 833, 841 (Tenn. App. 1999) (finding no substantial nexus where mail solicitation and credit card processing conducted by independent contractors did not "substantially contribute[] to the taxpayer's ability to maintain operations in the taxing state," nor did the contractors "actually perform[] any services on behalf of [the credit card company] in the State.").

C. Physical Presence Cannot Be Established if the Out-of-State Company Has Neither Employees or Property in the State, Nor Independent Persons Engaged in Local Activity Crucial to the Establishment and Maintenance of the Company's In-State Market.

Substantial nexus does not exist if a company has no employees, offices, or outlets in the state, nor independent persons whose activities are crucial for establishing and maintaining the in-state market for the company's sales. *See Quill Corp.*, 504 U.S. at 315 (finding that contact with in-state customers by mail or common carrier, or presence of floppy diskettes owned by the company, did not establish substantial nexus);

National Bellas Hess, 386 U.S. 753 (1967) (finding that an out-of-state company's contact by "mail or common carrier" alone did not establish substantial nexus); *J.C. Penney*, 19 S.W.3d at 840 (finding that in-state presence of credit cards legally titled to the issuing credit card company did not establish substantial nexus.).

II. IN CONCLUDING THAT AMAZON.COM IS PHYSICALLY PRESENT IN NEW YORK, THE LOWER COURT CONFUSED ELEMENTS FROM THE TWO SEPARATE TESTS FOR SUBSTANTIAL NEXUS.

The trial court confused the two tests laid out above. It determined that Amazon.com's affiliates were independent contractors, but did not conduct any evaluation in regard to whether their "local function" is significantly associated with maintenance or establishment of Amazon.com's sales market in New York. *See Amazon.com LLC v. New York State Dept. of Taxation and Finance*, 877 N.Y.S.2d 842, 849 (N.Y. Sup. 2009) ("Amazon further states that Associates' referrals to New York customers are not significantly associated with its ability to establish and maintain a market for sales in New York. . . . None of these allegations, however, sufficiently state a claim for violation of the Commerce Clause."). In doing so, the court did not conduct an evaluation of the significance of the affiliates' activities in the context of

Amazon.com's New York market.

Instead, the court found that Amazon.com was physically present in the state based on the number of contracts it has with in-state affiliates and the total revenue that it collected via those contracts. *See id.* ("Amazon has not contested that it contracts with thousands of New Yorkers and that as a result of New York referrals to New York residents it obtains the benefit of more than $10,000 annually.[2] Amazon should not be permitted to escape tax collection indirectly, through use of an incentivized New York sales force to generate revenue, when it would not be able to achieve tax avoidance directly through use of New York employees engaged in the very same activities.").[3] These observations do not, however, say anything about what activities the affiliates engage in on behalf of Amazon.com. This is an issue because, in regard to independent persons, the evaluation of their "local

[2] Note the extremely low threshold for tax collection obligations in this case as compared to *Quill*, where Quill Corp. had at least $1 million worth of sales annually in North Dakota alone, and where the U.S. Supreme Court found no substantial nexus. If New York's threshold is adjusted for population (New York in 1987 had 27 times the population of North Dakota) and inflation ($1 in 1987=$1.90 in 2009), North Dakota's equivalent threshold in 1987 would have been $194.73. Conversely, North Dakota's threshold (again, one found to be insufficient) today would be the equivalent of $51 million in annual sales in New York.

[3] No claim has been made in this case that Amazon.com is avoiding taxes it owes. This case is about sales and use taxes, which are legally owed by individuals who purchase goods from Amazon.com, not by Amazon.com itself.

function" is the key to determining whether their in-state presence is sufficient to attribute their presence to the out-of-state company and establish the substantial nexus necessary for the state to mandate that the company collect its sales tax.

The trial court relies on *Orvis*, where the Court of Appeals properly stated that an out-of-state company must maintain "demonstrably more than a 'slightest presence'" in the taxing state to be physically present. *Orvis*, 86 N.Y.2d at 178. Because *Orvis* involved the company's own employees who physically solicited customers within New York, that case simply reaffirms the rule that a company with employees engaging in any non-*de minimis* business activity in the state is physically present. *Orvis* provides no support for asserting that substantial nexus can rest merely on having relationships with in-state independent persons.

The trial court's failure to evaluate the nature and magnitude of the affiliates' activities in New York on behalf of Amazon.com is significant because the Plaintiffs-Appellants allege that the affiliates neither (1) engage in direct solicitation nor (2) provide any crucial sales support for Amazon.com in the state. These activities are the only

activities that have been found by the U.S. Supreme Court to be significantly associated with maintaining or establishing the in-state sales market of an out-of-state company. The trial court did not address whether either was present in this case. If Amazon.com's affiliates have not engaged in these activities, then the trial court's ruling was an unprecedented expansion of the "furthest extension" of the physical presence rule.

III. UNCONSTITUTIONALLY EXPANSIVE NEXUS STANDARDS, SUCH AS THE ONE OUTLINED BY THE COURT BELOW, UNDERMINE LEGAL CERTAINTY, INTERSTATE COMMERCE, AND ECONOMIC GROWTH.

Unconstitutionally expansive nexus standards, such as the one at issue in this case, impede the desire and ability of business to use new technology to expand, thereby harming the nation's economic growth potential. Businesses throughout our nation's history could always ply their trade across state lines. Today, with new technologies, even the smallest businesses can more easily reach across geographical borders to sell their products and services in all fifty states. If such sales can now expose these businesses to tax compliance and liability risks in states where they merely have customers, they will be less likely to expand their reach into those states.

The people of the United States adopted the U.S. Constitution in large part because their existing national government had no power to stop states from imposing trade barriers between each other, to the detriment of the national economy. "[States' power over commerce,] guided by inexperience and jealousy, began to show itself in iniquitous laws and impolitic measures . . ., destructive to the harmony of the states, and fatal to their commercial interests abroad. This was the immediate cause, that led to the forming of a convention." *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 224 (1824) (Johnson, J., concurring). In the Commerce Clause of the U.S. Constitution, Congress and the courts thus have the power to strike down laws that discriminate against interstate commerce.

With respect to state taxation, the U.S. Supreme Court has held that a tax on interstate commerce is valid only if (1) there is "substantial nexus" between the taxpayer and the state,[4] (2) the state does not tax beyond its fair share of the taxpayer's income, (3) the state does not impose burdens on out-of-state taxpayers but not in-state taxpayers, and (4) the tax must be fairly related to services provided to

[4] *Complete Auto* as clarified by *Quill*. *See Quill*, 504 U.S. at 312.

the taxpayer by the state. *See Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977). The Supreme Court has stressed that the "Commerce Clause and its nexus requirement are informed . . . by structural concerns about the effects of state regulation on the national economy." *Quill*, 504 U.S. at 312.

The economic and technological developments of the past few decades make preserving a bright-line physical presence nexus rule for state taxation all the more vital. The importance of the Commerce Clause and its protections for interstate business is only enhanced in an age of economic integration. "Today's more integrated national economy presents far greater opportunities than existed in 1787 for states in effect to reach across their borders and tax nonconsenting nonbeneficiaries." Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH L. REV. 895, 902 (1992). Regrettably, because economic integration is greater now than it was in 1780, the economic costs of nexus uncertainty are also greater today and can ripple through the economy much more quickly.

Widespread adoption of vague and expansive nexus standards will expand these compliance costs and cause adverse impacts on interstate

commerce. *See generally* Joseph Henchman, *Why the Quill Physical Presence Rule Shouldn't Go the Way of Personal Jurisdiction*, 46 STATE TAX NOTES 387 (2007), *available at* http://tinyurl.com/quillnexus. Compliance costs for businesses engaged in interstate commerce will increase. Businesses that merely expand their sales into such states will have to understand the local tax base, any applicable tax rates, available tax incentives, and differing apportionment formulas. Differing nexus standards among the states means businesses will have to guess about whether to file and pay taxes or not.

Concerns about the cost of complying with multiple state tax systems, and the resulting economic harm, was at the heart of the *Quill* decision. The Court specifically recognized that economic harm that would come from requiring *Quill* to potentially collect tax in over 6,000 (now 8,000) separate tax jurisdictions, all with different tax systems. *See Quill*, 504 U.S. at 313 n.6. Such concerns are equally pressing in this case, where an unconstitutional and breathtakingly expansive nexus standard will lead either to a decrease in economic expansion or a lower rate of return for those that choose to press ahead. This Court can—and should—act to ensure that interstate commerce is not unduly

burdened.

There are many reasons why New York seeks to impose tax obligations on those who, like the Plaintiffs-Appellants, have no physical presence there. New York's action is part of a larger trend in state and local tax policy: an attempt to export tax collecting obligations to non-residents and non-voters. Utilizing a wide scope of mechanisms—from increases in hotel and rental car taxes, to the rediscovery of gross receipts taxes, to expansive nexus schemes like those employed in this case—states are increasingly trying to place more of the tax burden on outsiders.

Exporting the tax burden is not a new idea. States were attempting to do so in the 1780s when the Constitution was adopted. However, even if exporting the tax burden constitutes good local politics, the national economy must take precedence. Courts should "more consistently and coherently bar [unconstitutional] tax exportation." Shaviro, 90 MICH. L. REV. at 897. Otherwise, states will be emboldened in their effort to tax outsiders and retaliate against other states doing the same.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that the decision of the court below be reversed.

Respectfully submitted,

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