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The Questionable Constitutionality of Amazon's Distribution Center Deals

by *John A. Swain and Walter Hellerstein*

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If we imagine a world in which the states were unconstrained by constitutional limitations, the states might impose sales and use taxes only on purchases from remote sellers while exempting purchases from local sellers. In other words, they might impose what would in effect amount to a tariff on imported goods in an effort to protect in-state sellers and to induce other sellers to migrate to the state.[1] The dormant commerce clause, however, prohibits states from discriminating against interstate commerce in this fashion.[2] Moreover, the dormant commerce clause's substantial nexus requirement, as articulated by the U.S. Supreme Court in *Quill Corp. v. North Dakota*,[3] has created a world that effectively forces states to discriminate *against* local commerce. The physical-presence test established in that case grants a de facto tax exemption for sales from non-physically present remote vendors.[4] Thus, if a state chooses to impose a sales and use tax, the state is effectively required to grant a tax advantage to non-physically present remote sellers because it has no practical mechanism for compelling collection of the tax.

> ***The dormant commerce clause's substantial nexus requirement, as articulated by the U.S. Supreme Court in* Quill*, has created a world that effectively forces states to discriminate* against *local commerce.***

One economically rational response to this constitutional conundrum is for states to test the limits of the physical-presence test, narrowing its scope if possible and minimizing the damage to both in-state business interests and the fisc. However, there is a paradox embedded in this approach. Because a state's power to require a remote seller to collect sales or use taxes[5] turns on its physical presence in the state, remote sellers have a strong incentive to arrange their operations to avoid in-state physical presence in order to maintain their competitive advantage of making de facto exempt sales. Thus, states might rationally choose to weigh the economic development costs of aggressively testing the limits of *Quill*, and thereby discouraging any in-state activity by or on behalf of remote vendors, against the benefits to the state treasury and competing in-state sellers. An important consideration in this balancing of interests is the mobility of the nexus-creating activity. For example, if a particular business model compels the remote seller to send traveling salespersons into the state, to perform in-state warranty work, or to conduct in-state training, a state's "aggressive" position in treating those in-state contacts

[1]The suggestion that states would actually pursue this tax policy is simplistic and ignores, for example, the principle of comparative advantage and other arguments for free trade.

[2]*See generally* 1 Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, para. 14.14 (3d ed. 2011 rev.).

[3]504 U.S. 298 (1992).

[4]We say "de facto" because purchasers have an obligation to self-report and pay the use tax typically due on such transactions, but, as a practical matter, they rarely do so. Accordingly, in the absence of power to require the vendor to collect the use tax, there is a de facto exemption from the sales or use tax, at least with respect to business-to-consumer transactions.

[5]We discuss the distinction between the seller's obligation to collect the tax and the purchaser's obligation to pay the tax later in this article.

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as giving rise to substantial nexus costs the state little in terms of economic development.

When potentially nexus-creating business activities are relatively mobile, however, assertion of nexus based on the in-state occurrence of those activities may simply drive those activities outside the state. A Maine statute illustrates this tension. On the one hand, the Maine statute flatly imposes a sales or use tax collection obligation on "every seller of tangible personal property or taxable services that has a substantial physical presence in this State sufficient to satisfy the requirements of the due process and commerce clauses of the United States Constitution."[6] On the other hand, the following activities are deemed not to constitute "substantial physical presence":

> ...
>
> (2) Attending trade shows, seminars or conventions in this State;
>
> (3) Holding a meeting of a corporate board of directors or shareholders or holding a company retreat or recreational event in this State;
>
> (4) Maintaining a bank account or banking relationship in this State; or
>
> (5) Using a vendor in this State for printing, drop shipping or telemarketing services.[7]

The common thread running through these exceptions is that they all address highly mobile economic activities that the state fears might be lost to competing jurisdictions if the state took a more aggressive approach to the physical-presence test. These exceptions also address gray areas in the law of nexus, and so the state undoubtedly is also trying to give bright-line guidance so that businesses have some certainty in planning their affairs.

Some states have adopted similar nexus legislation that protects remote sellers using unaffiliated in-state fulfillment houses, and taxing authorities in at least two states have issued private rulings assuring remote sellers that their relationships with wholly owned subsidiaries operating in-state fulfillment houses do not give rise to a use tax collection obligation.[8] More recently, South Carolina adopted a nexus exemption statute as part of a deal to ensure that Amazon.com builds a distribution center in the state,[9] and Tennessee Gov. Bill Haslam (R) recently struck a similar deal, giving Amazon a two-year tax moratorium in exchange for establishing an in-state distribution center.[10]

> ***South Carolina's Amazon exemption statute is a clear example of an economic development nexus statute, and not a nexus-clarifying statute.***

The attentive reader may be sensing that something is amiss. After all, if the commerce clause prohibits favoring in-state over out-of-state interests and activities, can it at the same time countenance legislation that goes beyond merely clarifying *Quill*'s boundaries and instead provides a de facto tax exemption for sales by taxpayers that undertake specified — and, indisputably nexus-creating[11] — in-state activities? This article explores that question. First, we posit a hypothetical nexus statute that relieves sellers with which the state clearly has "substantial nexus" from sales or use tax collection obligations. Second, we identify the class of persons engaged in interstate commerce against whom the statute discriminates. Third, we analyze whether this discrimination is unconstitutional under existing dormant commerce clause jurisprudence. Finally, we consider the extent to which the gray area nuances of affiliate nexus or administrative tax enforcement discretion undercut any of our conclusions.

Hypothetical Economic Development Nexus Statute

In developing a hypothetical statute to evaluate, we start with South Carolina's "Amazon exemption." It provides that

> owning, leasing, or using a distribution facility, including a distribution facility of a third party or an affiliate, within South Carolina is not considered in determining whether a person has a physical presence in South Carolina sufficient to establish nexus with South Carolina for sales and use tax purposes.[12]

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[6]Maine Rev. Stat. Ann. section 1754-B (Westlaw 2011). We note in passing that the constitutional test is "substantial nexus," not "substantial physical presence," as the Maine statute appears to assume. *See* 2 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 19.02[5][a] (discussing case law).

[7]Maine Rev. Stat. Ann. section 1754-B(2) - (5) (Westlaw 2011).

[8]2 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 19.02[2][b][v].

[9]S.C. Code Ann. section 12-36-2690 (Westlaw 2011). South Carolina also adopted a companion income tax nexus exemption. S.C. Code Ann. section 12-6-60 (Westlaw 2011). The focus of this article is limited to sales and use tax nexus.

[10]Karen Setze, "Tennessee Governor Announces Amazon Agreement," *State Tax Notes*, Oct. 10, 2011, p. 72, *Doc 2011-21192*, or *2011 STT 195-22*

[11]In a constitutional sense, that is, substantial nexus under the commerce clause.

[12]S.C. Code Ann. section 12-36-2690 (Westlaw 2011).

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In order to qualify for this exemption, however, the taxpayer must make a capital investment of at least $125 million and initially create at least 2,000 full-time jobs (and maintain at least 1,000 jobs after 2013). The statute sunsets after January 1, 2016.[13]

Unlike the Maine nexus statute, the South Carolina Amazon exemption obviously is not intended to clarify the uncertainty regarding the precise limits of *Quill*.[14] An in-state distribution center plainly satisfies the physical-presence test. Moreover, the statute produces the bizarre result of treating taxpayers who own in-state distribution centers but make capital investments of *less than* $250 million and create *less than* 2,000 full-time jobs as having a nexus-creating footprint, while taxpayers wearing the same shoes — but several sizes larger — are treated as *not* having nexus. Thus, the statute is a clear example of an economic development nexus statute, and not a nexus-clarifying statute.

Accordingly, for purposes of our constitutional analysis, we posit the core of the South Carolina statute, while stripping out the affiliate ownership, minimum investment, and sunset provisions. Such a statute would provide:

> **Model Distribution Center Nexus Statute**. Ownership of a distribution facility within the state is not considered in determining whether a person has a sufficient nexus with the state for the purpose of imposing on that person a sales or use tax collection obligation.

Constitutionality of the Hypothetical Model Statute

Under this model statute, a class of remote sellers would be exempt from collecting sales or use tax: all sellers whose in-state physical presence is limited to ownership of a distribution facility (Distribution-Center-Nexus Sellers). This class of sellers would enjoy a competitive advantage over two other classes of sellers: (1) local sellers making in-state sales (In-State Sellers), and (2) remote sellers who have nexus with the state other than through ownership of a distribution facility (Nexus Remote Sellers). Both of those classes of taxpayers would be required to collect sales or use tax, while the favored class of Distribution-Center-Nexus Sellers would not.

As always, remote sellers without a physical presence (Non-Nexus Remote Sellers) would have no sales or use tax collection obligation because they are protected by *Quill*. Although this is certainly a favored class, the state is constitutionally powerless to eliminate the discrimination in favor of this class and against In-State Sellers and Nexus Remote Sellers. Moreover, to favor remote sellers with *no* in-state physical presence over those with *some* physical presence in a state would generally not be discrimination *against* interstate commerce, because it is the out-of-state interest that is being favored in this instance.

> ***We do not believe that in-state sellers have a persuasive discrimination claim under the dormant commerce clause, because the discrimination is* in favor of *a class of interstate sellers.***

Returning to the classes of sellers over which the state does have sales or use tax collection jurisdiction, we do not believe that In-State Sellers have a persuasive discrimination claim under the dormant commerce clause, because the discrimination is *in favor of* a class of interstate sellers, that is, interstate sellers who qualify for the distribution center exemption. As noted, the dormant commerce clause restraint is directed at discrimination *against* interstate commerce. States generally can discriminate against in-state actors and activities without running afoul of the dormant commerce clause. An often cited rationale for this result is that "to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state."[15] In other words, in-state interests are presumed to be able to protect themselves adequately through the political process. Moreover, discrimination against local products, activities, or enterprises is not ordinarily viewed as burdening interstate commerce in the constitutional sense.[16]

Does the discrimination against Nexus Remote Sellers and in favor of Distribution-Center-Nexus Sellers run afoul of the dormant commerce clause? In our view, there is a strong case to be made that the answer is yes. To begin with, it is clear that there is discrimination against a class of interstate sellers — those with nexus other than distribution center nexus. The remaining question is whether

[13]*Id.*

[14]These uncertainties are examined in detail in 2 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 19.02.

[15]*McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 45-46, n.2 (1940).

[16]The statement in the text is deliberately couched as a generalization rather than a categorical rule. A burden on in-state consumers, for example, could dissuade them from purchasing out-of-state goods, resulting in discrimination against interstate commerce. *See* 1 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 4.14[2][f].

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Distribution-Center-Nexus Sellers can be considered in-state interests that are being unconstitutionally favored. If not, and if instead those sellers are considered "just" another type of interstate business, commerce clause values are probably not offended, because the Supreme Court has held that states may discriminate between two different modes of conducting interstate business without running afoul of the dormant commerce clause.[17] In other words, there generally must be an identifiable local interest that is being favored in order for a claim of discrimination to lie.

Does the discrimination against Nexus Remote Sellers and in favor of Distribution-Center-Nexus Sellers run afoul of the dormant commerce clause? In our view, there is a strong case to be made that the answer is yes.

That appears to be the case here. Assume, for example, two identical retail competitors. The only difference between them is the geographic location of their distribution centers.[18] One locates at least one of its distribution centers within the state while the other locates its distribution centers outside the state. Because one of the businesses locates a distribution center in the state, it is exempt from a sales or use tax collection obligation (and its sales will effectively be exempt from tax), while the other business is not (and its sales will effectively be taxable). Here, the discrimination is occurring *not* because these are two different kinds of businesses (they are identical) or because the businesses operate differently in any way other than geographic location. The Model Distribution Center Statute does not, for example, favor businesses that operate distribution centers wherever located. The statute is instead geographically specific, favoring only businesses that locate distribution centers in the state. Thus, identical businesses are treated differently because of the in-state activities of the favored business. This would appear to be a straightforward case of discrimination against interstate commerce.

To reinforce this point, it may be useful to consider the choices made by local consumers. Consumers have essentially four options: (1) buy locally from an In-State Seller and pay tax; (2) buy from a Nexus Remote Seller and pay tax; (3) buy from a Distribution-Center-Nexus Seller and not pay tax; or (4) buy from a Non-Nexus Remote Seller and not pay tax. As we have noted, options (1) and (4) are not implicated in this analysis. States generally have the prerogative to discriminate against local interests and in favor of out-of-state interests, so the burden of buying locally from an In-State Seller and paying tax is not constitutionally prohibited. Similarly, the favorable treatment that a Non-Nexus Seller enjoys is constitutionally required — the state simply has no jurisdiction over these sellers. The remaining two options for consumers are (1) to buy from a Nexus Remote Seller and have tax added to the purchase price or (2) to buy from a Distribution-Center-Nexus Seller and not have tax collected from them. All things being equal, they will obviously-prefer purchasing "tax free" from the Distribution-Center-Nexus Seller. The favoring of an in-state interest appears undeniable.

One plausible counterargument to this line of reasoning is that despite the discrimination against Nexus Remote Sellers, they are local interests too because they must have an in-state physical presence to be subject to a tax collection obligation. In other words, the Model Distribution Center Nexus Statute simply prefers one flavor of in-state activity (operating a distribution center) over other flavors of in-state activity (all other nexus-creating activities). Thus, one class of sellers is no more in-state or out-of-state than the other.

We are skeptical of that argument. It is based on the assumption that as long as a remote seller has sufficient nexus with a state to be compelled to collect use tax, it has no grounds to assert a claim that the state is discriminating in favor of other remote sellers with more substantial forms of in-state presence. This would prove too much. Courts have found substantial nexus to include a variety of rather insubstantial modes of in-state presence, such as a single employee salesperson, independent contractors soliciting sales, employees selling magazine advertising unrelated to the sales activity subject to tax, and short, periodic in-state sales visits.[19] More substantial instances of physical presence, such as in-state distribution centers, retail outlets, or corporate headquarters, are seldom if ever the focus of litigation because of the clear application of the *Quill* rule in these situations. These differences

[17]*See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125-28 (1978); *Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dept. of Treasury*, 490 U.S. 66, 75-78 (1989).

[18]Another difference will be that the business that is discriminated against will have to have some sort of in-state physical presence (other than a distribution center) for it to be subject to tax, while the business that is exempt because it has a distribution center located in the state cannot have any other in-state physical presence. If it does, it loses its exemption. We address this distinction *infra*.

[19]*See generally* 2 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 19.02.

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among nexus taxpayers can have constitutional significance, and we find no legal basis for the proposition that once a state has jurisdiction to tax, all taxpayers are on equal footing and unconstitutional discrimination within that class of taxpayers is not possible.[20]

Focusing directly on the Model Distribution Center Nexus Statute, we observe that it singles out a clear instance of in-state presence and prefers it over all other types of nexus. In other words, the statute favors a type of "nexus plus" over "mere nexus" of whatever kind. In effect, the state has said to Distribution-Center-Nexus Sellers: *"We will impose an import tariff on goods sold by any seller over whom we have jurisdiction, except goods sold by you, because you operate a distribution center in our state."* Statutes that operate as protective tariffs are "paradigmatic" examples of laws that discriminate against interstate commerce.[21]

We are mindful that the Model Distribution Center Nexus Statute does not give a blanket exemption to enterprises that operate in-state distribution facilities. The exemption applies only if a seller who owns an in-state distribution center has no other nexus-creating physical presence in the state. Thus, this is a limited sort of in-state preference. It is enjoyed only if there is an in-state distribution center, and nothing else. Still, we believe that the contention that the model statute does not confer a preference to in-state interests over out-of-state interests can be reduced to absurdity by considering the following hypothetical economic development nexus statutes:

- an exemption from collecting sales or use tax on remote sales if the seller operates one or more in-state retail establishments and has no other in-state nexus-creating contacts;
- an exemption from collecting sales or use tax on remote sales if the seller establishes a corporate headquarters in the state and has no other in-state nexus-creating contacts; and
- an exemption from collecting sales or use tax on remote sales if the seller manufactures products in this state and has no other in-state nexus-creating contacts.

All these examples are offensive to commerce clause values, and we do not see a meaningful distinction between them and the Model Distribution Center Nexus Statute. In effect, they all allow sellers to receive the benefits of a protective tariff by virtue of engaging in specifically identified in-state activities. To argue that Nexus Remote Sellers are not in a position to allege discrimination because they are in some sense "in-state" would be to ignore the clear, geographically based discriminatory effect of these hypothetical statutes.

The case for unconstitutional discrimination might also be challenged on the theory that it relies on a false premise, namely, that sales by Distribution-Center-Nexus Sellers and sales by Nexus Remote Sellers are taxed differently. In point of fact, the argument would continue, the state statutes tax all such sales alike, because they are all subject to an identical sales or (more likely) use tax. Hence, the argument would conclude, the "only" distinction between the two classes of sales is that Nexus Remote Sellers have an obligation to collect the tax, while Distribution-Center-Nexus Sellers do not, but this is not *tax* discrimination.

There are two responses to this argument. First, even if we take the argument (that "there is no tax discrimination") at face value, there is still a very real burden that the tax regime imposes on Nexus Remote Sellers that Distribution-Center-Nexus Sellers do not bear, namely, the administrative burden of collecting the tax. Moreover, Distribution-Center-Nexus Sellers are not being relieved of this burden because, for example, it is somehow more costly for Distribution-Center-Nexus Sellers than for Nexus Remote Sellers to collect use tax from their customers, or that persons who purchase products from Distribution-Center-Nexus Sellers are for some reason more likely to self-report use tax than are those who purchase from Nexus Remote Sellers.[22] Rather, the burden is being removed as a quid pro quo for making an in-state investment. Thus, discrimination based solely on differential tax collection obligations

[20]Indeed, the Court has taken the opposite position. In *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), the Court considered the constitutionality of a New York stock transfer tax that provided reduced rates for some transfers of stock when the sale of the stock was effectuated through a New York stock exchange. The state had jurisdiction to tax the entire universe of stock transfers with which New York had nexus (that is, any transfer of stock through a New York transfer agent, typically a large financial institution based in New York). Nevertheless, the Court flatly held that the "nexus" with the stock transfer did not permit New York to discriminate in favor of specific transfers associated with greater in-state activity. In so holding, the Court observed:

> There has been no prior occasion expressly to address the question whether a State may tax in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses, but the clear import of our Commerce Clause cases is that such discrimination is constitutionally impermissible.

Id. at 335. *See* 1 Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 4.14[3][b][i] (discussing *Boston Stock Exchange*).

[21]*West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994).

[22]*Cf. Panhandle Producers and Royalty Owners Ass'n v. Oklahoma Tax Comm'n*, 162 P.3d 960 (Okla. App. 2007), *cert. denied* (Okla. Sup. Ct., July 2, 2007), *cert. denied*, 552 U.S. 1062 (rejecting a privileges and immunities clause challenge to a withholding tax regime targeting nonresidents).

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might still give rise to a dormant commerce clause discrimination claim. For a variety of reasons, however, we believe the argument supporting this claim is more complex than the argument that the discrimination is akin to a protective tariff, and we do not further pursue that argument here.[23]

Second, the U.S. Supreme Court has made it clear that state statutes that discriminate in practical effect against interstate commerce are as offensive to the commerce clause as are laws that explicitly discriminate against such commerce. "The Commerce Clause," the Court has observed, "forbids discrimination whether forthright or ingenious."[24] Accordingly, the Court has stated that "in each case it is our duty to determine whether the statute under attack . . . will in its practical operation work discrimination against interstate commerce."[25] Regarding our consideration of the Model Distribution Center Nexus Statute, it is beyond dispute that the decision to exempt a seller from collecting tax on consumer purchases is, in most cases, tantamount to allowing a tax exemption for those purchases. If that were not so, *Quill* would have spawned little controversy, and in fact, may never have arisen because sellers might have routinely collected the tax on a voluntary basis as a service to their customers, thereby relieving their customers of the pesky obligation of filing returns. Moreover, there probably would have been no Streamlined Sales and Use Tax Agreement, one of whose primary goals is to ensure the collection of taxes that are not currently being collected. Further, it is difficult to imagine that, if there were widespread consumer compliance with use tax reporting and remittance obligations, sellers like Amazon would be going to such lengths to protect their right to avoid collection responsibility. Under those circumstances, Amazon would be realizing little, if any, competitive advantage from avoiding a tax collection obligation. Without belaboring the point, we believe there is overwhelming support for the view that the Court would consider the economic reality and practical effects of exemption from sales and use tax collection obligations as constituting, in substance, an exemption from the sales and use tax itself, in determining whether the Model Distribution Center Nexus Statute discriminates against interstate commerce.

The preceding discussion has focused on the practical inquiry as to whether our Model Distribution Center Nexus Statute discriminates against interstate commerce and in favor of an identifiable local interest. This is the legally pertinent inquiry as well. Elsewhere we have presented a full exposition of the Court's dormant commerce jurisprudence, and we will not rehearse that discussion here.[26] Nevertheless, we highlight several of the broad statements of principle that have emerged from the fact-driven cases that the Court has decided.

First, the Court has recognized that "the paradigmatic . . . law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State."[27] Those tariffs are "so patently unconstitutional that our cases reveal not a single attempt by a State to enact one."[28] The Court, of course, has not limited the scope of the discriminatory tax doctrine to the paradigmatic protective tariff, but has invalidated discrimination whether "forthright or ingenious."[29] The Model Distribution Center Nexus Statute comes close to operating as a protective tariff, though not a tariff that protects locally produced goods. Rather, it protects importers of goods who have an identifiable local interest as against all other importers over whom the state has taxing jurisdiction.

> ***It is no defense to the claim of discrimination that the protected transactions — in this case, import sales made by Distribution-Center-Nexus Sellers — have an interstate component.***

Second, it is no defense to the claim of discrimination that the protected transactions — in this case, import sales made by Distribution-Center-Nexus Sellers — have an interstate component. As we have already noted, the Court observed in *Boston Stock Exchange v. State Tax Commission*[30] that despite the absence of prior case law expressly addressing "the question whether a State may tax in a manner that discriminates between two types of

[23]For a detailed analysis of the broader dormant commerce clause theory under which state tax incentives designed to encourage economic development might be challenged, see Walter Hellerstein and Dan T. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 *Cornell L. Rev.* 789 (1996). *See also Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 768 (6th Cir. 2004), *rev'd in part on other grounds sub nom. DaimlerChrysler, Inc. v. Cuno*, 547 U.S. 332 (2006), *cert. denied in part*, 547 U.S. 1147 (2006).

[24]*Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940).

[25]*Id.* at 456.

[26]*See generally* Hellerstein, Hellerstein, and Swain*, supra* note 2, para. 4.14.

[27]*West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994).

[28]*Id.* at 193.

[29]*Best & Co. v. Maxwell*, 311 U.S. 454 (1940).

[30]429 U.S. 318 (1977).

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interstate transactions in order to favor local commercial interests over out-of-state businesses-, . . . the clear import of our Commerce Clause cases is that such discrimination is constitutionally impermissible."[31]

Third, it is also no defense to argue that the discrimination works not only against Nexus Remote Sellers but also against some local interests, that is, In-State Sellers. The Court has found this distinction "immaterial," and that it need not know "how unequal" a tax is before concluding that it unconstitutionally discriminates.[32]

Affiliate Nexus and Settlements of Bona Fide Disputes

Thus far the analysis has assumed that a qualifying distribution center is owned directly by the out-of-state seller. Under this assumption, the attribution of the physical presence of the distribution center to its owner is undisputed. Amazon, however, has (reportedly) separately incorporated its distribution centers throughout the country and taken the position that their physical presence is not attributable to the parent company (or other commonly owned affiliated entity). Under these facts, does our analysis change?

In a word, no, subject to a few qualifications.[33] To begin with, we are skeptical of the legal validity of Amazon's position that it can avoid having substantial nexus with a state by separately incorporating the arm of the enterprise that warehouses and delivers the products it sells. A full analysis of that issue is beyond the scope of this article.[34] We do note, however, that Texas has challenged that position, reportedly causing Amazon to shut down its Texas distribution center.[35] Moreover, the taxing authorities in South Carolina and Tennessee have effectively taken the same position as Texas; otherwise the distribution center nexus deals in those states would have been unnecessary. On the other hand, as we have noted above, taxing authorities in at least two states have issued private letter rulings that approved Amazon's entity isolation technique in the context of in-state affiliated fulfillment centers. Our suspicion is that these rulings were motivated by the same economic development considerations that motivated the South Carolina and Tennessee Amazon deals; therefore, they potentially suffer from the same constitutional infirmities identified in this article.

If we assume, nonetheless, that there is a good-faith dispute over whether — either as a general matter, or under the particular facts of the relationship between the selling and distributing affiliates — the physical presence of an affiliated distribution center can be attributed to the out-of-state selling affiliate, the additional issue arises regarding whether a state can contractually resolve (settle) the matter. Undoubtedly a state can, within broad parameters. Indeed, this is the analysis that the Tennessee attorney general offered in connection the Tennessee-Amazon agreement, and we note that the quid pro quo in both the South Carolina and Tennessee deals is that Amazon will begin to collect tax at a date certain in the future.[36]

That having been said, there is a material difference between a private settlement agreement and exemption legislation of general application. South Carolina has adopted such legislation, and Tennessee appears to be planning on adopting such legislation at the beginning of next year to cement its deal with Amazon. In our view, legislation of general application cannot be protected under doctrines applicable to good-faith settlements of private tax disputes with the government. Indeed, taxpayer-specific legislation would probably run afoul of state constitutional guarantees of equal protection and prohibitions against "special or local laws."[37] Nevertheless, if that legislation could be construed as doing no more than resolving a gray area nexus issue similar to the Maine statute quoted above, it would be much less vulnerable to constitutional attack. A statute such as South Carolina's, however, that exempts both directly owned and affiliate-owned distribution facilities, and imposes minimum investment and job creation thresholds for exemption eligibility, goes far beyond resolving an unresolved issue of affiliate nexus.

Conclusions

1. As a general matter, nexus statutes that seek to do no more than clarify *Quill*'s physical-presence

[31]*Id.* at 335.

[32]*See* Hellerstein, Hellerstein, and Swain, *supra* note 2, para. 4.14[2] (quoting cases).

[33]There are many ways to separately incorporate operations within a corporate group, and we do not speculate on the exact relationship among the various Amazon entities. However, to the extent that there ultimately is common ownership by a single entity, we do not believe, for the reasons that follow, that our analysis would be materially affected by the possible alternative structures, limited only by the scope of the tax lawyer's imagination.

[34]For a detailed consideration of this issue, see John A. Swain, "Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?" 75 *S. Cal. L. Rev.* 419 (2002).

[35]*See* Billy Hamilton, "How Texas's Amazon Deal Unraveled," *State Tax Notes*, July 18, 2011, p. 191, *Doc 2011-14671*, or *2011 STT 137-2*.

[36]Tenn. Att'y Gen. Op. No. 11-71 (Oct. 3, 2011).

[37]*See, e.g.*, Tenn. Const. Article Art I, section 8 (due process and equal protection); Article XI, section 8 (special laws).

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test are probably not constitutionally suspect. The Maine statute is a good example of this genre of a nexus-clarifying statute.

2. Nexus statutes that "look the other way" and ignore specified in-state nexus-creating activity, however, may discriminate against interstate commerce. That is because they have the effect of discharging sellers who establish the legislatively identified in-state presence from their obligation to collect an otherwise generally applicable tax on their sales to in-state customers. In effect, the state is saying, "We will impose an import tariff on goods sold by any seller over whom we have jurisdiction, except goods sold by you, because you have the specified presence or engage in the specified activities in our state."

3. It can in principle be argued that there is no tax discrimination because all in-state consumers have an obligation to report use tax regardless of whether the seller collects it, but we are skeptical that the Court would ignore the practical reality that most consumers do not in fact self-report and that most if not all states have been unwilling or unable to effectively enforce this self-reporting obligation as it pertains to individual consumers. Moreover, even if only the obligation to collect tax (rather than pay the tax itself) could be brought under the dormant commerce clause microscope, there might still be an unlawful discrimination, although the analysis would be more nuanced, and we have not undertaken that analysis here.

4. We are skeptical of the argument that by dropping distribution operations into a separate entity, an affiliated retailer can lawfully avoid collecting sales or use tax in the state in which the distribution activities are located. Nevertheless, to the extent this argument gives rise to a bona fide dispute, state taxing authorities have broad discretion to settle affiliate nexus controversies with individual taxpayers on reasonable terms. Whether nexus *legislation* can serve that purpose relates to our first conclusion. A statute that simply gives clarity to a gray area of nexus law is probably insulated from commerce clause discrimination challenges. A statute (or, for that matter, a determination of a taxing authority) that goes further and carves out an exemption for taxpayers engaged in in-state activities that clearly create nexus, however, would be vulnerable to a dormant commerce clause challenge. The South Carolina distribution center nexus statute appears to fall in this latter category, because it (a) exempts directly owned distribution centers and (b) effectively treats small distribution centers as having nexus while treating large distribution center as not having nexus. In neither case can it be seriously contended that the statute is giving clarity to a gray area nexus controversy.

Although the recent deals regarding Amazon's distribution centers have had the highest profile, our goal here has been to identify a potential constitutional defect in economic development nexus statutes generally. The ultimate solution to this problem, however, is not constitutional litigation. Rather, it is the repeal of the *Quill* physical-presence test. This test has created a large class of remote sellers that benefit from the competitive advantage of not having to collect use tax. At the same time, these entities must engage in physical activities somewhere, yet they are loath to abandon their competitive advantage. Thus it is tempting for states to offer a safe haven for those retailers in the name of economic development. If, however, all retailers were on equal nexus footing and had an obligation to collect sales or use tax regardless of physical presence, we suspect that it would become politically unpalatable to dole out tax collection exemptions to specified subsets of those taxable sellers. Moreover, the constitutional offensiveness of those exemptions would be even more readily apparent, because the class of interstate sellers against whom such statutes discriminate would be much larger and would include sellers who have no in-state physical presence whatsoever. ✰

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