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Constitutional Threats in the E-Commerce Jungle: First Amendment and Dormant Commerce Clause Limits on Amazon Laws and Use Tax Reporting Statutes

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CONSTITUTIONAL THREATS IN THE
E-COMMERCE JUNGLE: FIRST AMENDMENT
AND DORMANT COMMERCE CLAUSE LIMITS
ON AMAZON LAWS AND USE TAX
REPORTING STATUTES*

SCOTT W. GAYLORD & ANDREW J. HAILE**

Internet sales continue to increase as consumers take advantage of the convenience and price competition that e-commerce provides. Yet, as North Carolina and other states have learned, frequently the “lower” prices available online result from the fact that many internet retailers, such as Amazon, do not collect sales tax on such purchases. In fact, under United States Supreme Court precedent, North Carolina and other states cannot require internet retailers such as Amazon, that lack any physical presence in a state, to collect sales tax.

But what many consumers do not know (or choose to ignore) is that they still owe tax on their internet purchases. This tax, known as the “use” tax, is not collected by the retailer; rather, the individual consumer is responsible for paying this tax directly to the North Carolina Department of Revenue. The use tax applies at the same rate as the sales tax. As a result, North Carolinians should pay the same amount in tax whether they buy goods at the local store or over the internet.

As it turns out, though, most North Carolinians are not fulfilling their use tax obligations. Given the state’s ongoing budget shortfalls, the North Carolina Department of Revenue has been actively trying to find new ways to either force internet retailers to collect taxes on internet sales or to increase use tax compliance among consumers. In particular, in 2009, the Department of

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Revenue demanded that Amazon provide the identities of North Carolina purchasers and a list of the products they purchased so that the Department of Revenue could determine each purchaser's use tax liability. Amazon refused and filed a declaratory judgment action in federal court alleging that the information request violated the First Amendment rights of its consumers. The federal district court agreed and granted summary judgment to Amazon.

This article examines that decision and explores (i) the First Amendment issues raised by the federal district court's order in the Amazon case as well as (ii) the First Amendment and Commerce Clause issues that would arise if North Carolina were to enact a statute requiring internet retailers to report to the Department of Revenue the amount of purchases that individual consumers make annually. Such a statute presents significant, though not insurmountable, First Amendment and Commerce Clause issues. In light of the State's budget problems, we propose that the General Assembly seriously consider enacting a use tax reporting statute while at the same time continuing to pursue alternative approaches to increase use tax compliance.

INTRODUCTION	2014
I. BACKGROUND: THE USE TAX COLLECTION PROBLEM.....	2016
A. <i>An Overview of the Use Tax</i>	2018
B. <i>North Carolina's Prior Efforts to Increase Use Tax Compliance</i>	2025
1. North Carolina's Attempt to Inform Taxpayers of Their Use Tax Obligations	2026
2. The Streamlined Sales and Use Tax Agreement	2028
3. North Carolina's "Amazon" Law	2031
4. The Internet Transactions Resolution Program	2034
II. BALANCING USE TAX COLLECTION AGAINST TAXPAYERS' FIRST AMENDMENT RIGHT TO RECEIVE EXPRESSIVE MATERIALS ANONYMOUSLY	2036
A. <i>Anonymity in Purchasing Expressive Materials: The First Amendment Right of Amazon's North Carolina Purchasers</i>	2039
1. The DOR's Initial Information Request Implicates the First Amendment Rights of Amazon's North Carolina Purchasers	2040
2. The DOR's Information Request Fails Heightened Scrutiny and, Therefore, Violates the First	

	Amendment Rights of North Carolinians to Receive Expressive Materials From Remote Retailers Anonymously	2045
B.	<i>The District Court’s Modified Relief, Allowing the DOR to Obtain the Identities of North Carolina Consumers and General Information About Their Purchases, May Also Threaten First Amendment Principles</i>	2051
	1. Does the <i>Amazon</i> Court’s Codified Information Request Implicate the First Amendment?	2053
	2. Does the <i>Amazon</i> Court’s Modified Information Request Violate the First Amendment?	2058
III.	A POSSIBLE NEXT STEP IN NORTH CAROLINA’S USE TAX COLLECTION EFFORTS: A USE TAX REPORTING STATUTE	2060
A.	<i>A Model for North Carolina?—The Colorado Use Tax Reporting Statute</i>	2062
	1. North Carolina and the Dormant Commerce Clause Challenge to a Colorado-Style Reporting Statute	2065
	2. The Dormant Commerce Clause and Discrimination Against Interstate Commerce	2066
	3. An Alternate Approach: Disparate, But Not Discriminatory, Treatment.....	2070
	a. <i>No Discrimination if Not “Similarly Situated”</i>	2071
	b. <i>North Carolina Has a Legitimate, Non-Protectionist Basis for Adopting a Reporting Statute</i>	2073
	4. <i>Pike</i> Balancing—Weighing the Benefits and Burdens of a Colorado-Style Reporting Statute.....	2076
	5. The Second Basis for the <i>DMA</i> Court’s Preliminary Injunction Decision: The Improper Extension of <i>Quill</i> to Use Tax Reporting Statutes....	2081
B.	<i>Possible First Amendment Problems with a North Carolina Reporting Statute</i>	2084
	CONCLUSION	2091

INTRODUCTION

Given the rapid and sustained growth of e-commerce,¹ coupled with continued budget shortfalls,² North Carolina and other states have looked to increase revenues by improving compliance with their tax laws relating to internet sales. In North Carolina alone, the amount of unpaid taxes on internet transactions in 2010 has been estimated at \$160 to \$180 million.³ Nationally, the trend is even more striking. With retail internet sales now exceeding \$142 billion per year,⁴ the total amount of uncollected state and local taxes owed on e-commerce transactions in 2010 has been estimated at between \$8.6 and \$9.9 billion.⁵ Thus, in these difficult economic times, the North Carolina Department of Revenue (the “DOR”) has aggressively sought to increase collection of these taxes. As part of that effort, the State of North Carolina has been engaged in a long-standing dispute with Amazon.com LLC (“Amazon”), the well-known internet retailer, over the collection and remission of taxes on internet purchases. In this Article, we focus on that dispute to highlight the significant constitutional barriers that limit, and in some instances preclude, North Carolina’s tax collection efforts.

1. Prior to the “Great Recession” in 2008, retail e-commerce sales volume generally increased over twenty percent every quarter (as compared to the same quarter from the previous year) from 2001 to 2008. See U.S. CENSUS BUREAU, ESTIMATED QUARTERLY U.S. RETAIL SALES (NOT ADJUSTED): TOTAL AND E-COMMERCE tbl. 4 (2010), available at <http://www.census.gov/retail/mrts/www/data/html/09Q4table4.html>. This growth far outstripped total retail sales. See *id.* The U.S. Census Bureau has reported that “[f]rom 2002 to 2007, retail e-sales increased at an average annual growth rate of 23.1%, compared with 5.0% for total retail sales.” U.S. CENSUS BUREAU, E-STATS 3 (2009), available at <http://www.census.gov/econ/estats/2007/2007reportfinal.pdf>. Following a dip in e-commerce sales during 2008 and early 2009, retail e-commerce sales started recovering in the fourth quarter of 2009 and have been up 14 to 15% each quarter since then as compared to the same quarter of the previous year. See U.S. CENSUS BUREAU, ESTIMATED QUARTERLY U.S. RETAIL SALES (NOT ADJUSTED): TOTAL AND E-COMMERCE, *supra*, at tbl.4; Press Release, U.S. Census Bureau, Quarterly Retail E-Commerce Sales 2nd Quarter 2010 (August 17, 2010), available at <http://www.census.gov/retail/mrts/www/data/html/10q2.html>.

2. For fiscal year 2011–12, North Carolina “is expected to face a \$3.7 billion budget” shortfall. FISCAL RESEARCH DIV., N.C. GEN. ASSEMBLY, NORTH CAROLINA’S FY 2011–12 BUDGET GAP (2010), available at http://www.chancellor.appstate.edu/sites/default/files/Dec_7_2010_Fiscal%20Brief_%20FY%202011-12%20Budget%20Gap.pdf.

3. See, e.g., DONALD BRUCE, WILLIAM F. FOX & LEANN LUNA, STATE AND LOCAL GOVERNMENT SALES TAX REVENUE LOSSES FROM ELECTRONIC COMMERCE 11, 26 (2009), available at <http://cber.utk.edu/ecomm/ecom0409.pdf>.

4. U.S. CENSUS BUREAU, E-STATS 1 (2010), available at <http://www.census.gov/econ/estats/2008/2008reportfinal.pdf>. E-commerce now accounts for roughly four percent of all retail sales in the United States. See *id.*

5. See, e.g., BRUCE ET AL., *supra* note 3, at 11, 26.

In particular, Part I of the Article provides an overview of the underlying legal issues that fostered the dispute between Amazon and North Carolina. After explaining the current law relating to the taxation of goods purchased over the internet, this part reviews the practical and constitutional constraints that have limited North Carolina's ability to increase tax compliance as well as the state's ongoing efforts to circumvent those constraints. Part II analyzes a recent decision of the Federal District Court for the Western District of Washington, *Amazon.com LLC v. Lay*.⁶ That decision held that the First Amendment prohibits North Carolina's attempt to improve tax compliance by forcing Amazon, as part of an audit of the company, to disclose to the DOR the identities and specific purchase information of North Carolina residents.⁷ The district court's decision raises novel First Amendment issues in the context of the state's exercise of its traditionally broad taxing authority. We contend that although the First Amendment limits North Carolina's ability to obtain the names and specific internet purchases of North Carolina consumers, it may not prohibit North Carolina from learning the names of and total amount purchased by North Carolinians who might owe taxes on their internet purchases.

In Part III, we examine the constitutionality of an alternative method that North Carolina should consider to increase tax compliance—enacting a statute requiring internet retailers to report the identity of and total amount purchased by their North Carolina customers. This type of reporting statute, which might be modeled after a similar Colorado statute, would (i) enable North Carolina to obtain use tax information from many, if not most, remote retailers without having to engage in the time and expense of individual company audits and (ii) provide the DOR with the information necessary to know whether North Carolinians are paying the taxes they owe on internet purchases. While a reporting statute of this sort is apt to confront serious dormant Commerce Clause⁸ and First Amendment challenges, we contend that North Carolina could draft its reporting statute to minimize these alleged constitutional

6. 758 F. Supp. 2d 1154 (W.D. Wash. 2010).

7. *Id.* at 1169.

8. The Commerce Clause of the U.S. Constitution states that Congress shall have the power “[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” U.S. CONST. art. I, § 8, cl. 3. The Supreme Court has interpreted this express provision of authority to Congress to limit the states’ authority to regulate interstate commerce by negative implication. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992). This implicit limitation on state authority to regulate interstate commerce is known as the “dormant Commerce Clause.”

infirmities. In particular, we argue that North Carolina's reporting statute should explain why in-state and out-of-state internet retailers are not similarly situated for dormant Commerce Clause purposes and should protect the anonymity of consumers by limiting the reporting requirements to internet retailers that do not specialize in the sale of expressive materials.

Ultimately, we conclude that if North Carolina wants to improve compliance with its tax laws relating to internet purchases, it must continue to seek new methods to encourage or compel such compliance. Moreover, given the potential First Amendment and Commerce Clause limits on North Carolina's collection efforts, the only solution certain to improve the problem of tax non-compliance with respect to internet transactions may be for Congress to enact federal legislation that allows the states to require remote retailers to collect and remit taxes owed on internet transactions.

I. BACKGROUND: THE USE TAX COLLECTION PROBLEM

To better understand the nature of the dispute between Amazon and North Carolina—and the constitutional issues raised by this dispute—consider the following common situation. Suppose you live in North Carolina and want to buy a new flat-screen LCD television. After researching the options, you find that you can buy the television from Amazon (with free shipping) for \$1,000. You can buy the identical television at your local electronics store for \$1,077.50, which includes all applicable North Carolina taxes.⁹ Which one would you buy? As North Carolina and forty-four other states have discovered,¹⁰ for many consumers the answer is easy—the television from Amazon because it *appears* to be cheaper. That is, the amount that you have to pay initially is less if you purchase from Amazon because, under existing United States Supreme Court precedent,¹¹ North Carolina

9. This hypothetical reflects the fact that consumers frequently look at products in local retail stores before ultimately purchasing goods online, especially major appliances, to reduce their overall costs by avoiding the amount of uncollected sales tax. In fact, according to statistical research by America's Research Group, 6.3% of consumers went to see products in stores but subsequently bought the products online on Black Friday in 2010. *Going to Brick-and-Mortar Stores, but Buying Online*, AMERICAN PUBLIC MEDIA (Dec. 2, 2010), <http://marketplace.publicradio.org/display/web/2010/12/02/pm-going-to-brickandmortar-stores-but-buying-online>.

10. Only Alaska, Delaware, Montana, New Hampshire, and Oregon do not collect sales taxes. U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS IN 2009, at 5 (2010), available at <http://www2.census.gov/govs/statetax/2009stcreport.pdf>.

11. See *Quill*, 504 U.S. at 301–02 (1992) (holding that states lack authority to require companies with no in-state physical presence to collect use tax).

cannot require many internet retailers (including Amazon) to collect state and local taxes on the goods they sell.

But what many consumers do not realize—or intentionally ignore—is that (i) North Carolina imposes a tax, called a “use tax,” on such internet purchases that is equal in amount to the state’s sales tax, and (ii) the consumer is responsible for paying that tax. The apparent savings in buying from Amazon, therefore, are illusory—at least for North Carolina consumers who pay the taxes they owe. If the consumer pays the use tax as required under North Carolina law, the total cost of the television to the consumer is the same whether buying from Amazon or from the local electronics store. And, although \$77.50 may not sound like a lot by itself, since 2003 North Carolina consumers have engaged in more than fifty million transactions with Amazon.¹² Consequently, it is easy to see why the total unpaid use taxes that North Carolinians owe on internet purchases is estimated at more than \$160 million per year.

The problem for North Carolina and other states is that most consumers do not comply with the existing use tax laws.¹³ In fact, estimates indicate that use tax compliance in North Carolina stands at less than four percent.¹⁴ As a result, North Carolina is confronted with the problem of trying to capture substantial amounts of “lost” use tax revenues. At the same time, the state is constrained in its ability to do so under Supreme Court precedent, which holds that states may not constitutionally require retailers to collect sales or use tax if the retailers have no in-state “physical presence.”¹⁵ North Carolina has made several attempts to work around this constitutional constraint and increase its use tax revenues, but so far with very limited success. Moreover, the state’s most recent attempt to increase use tax revenues—by exercising its audit power in an effort to obtain the identities of North Carolina customers who purchased from out-of-state retailers—resulted in Amazon’s suing the North Carolina Department of Revenue in the Western District of Washington.¹⁶ Given that the district court in that case recently held North Carolina’s detailed information request to Amazon violated the First

12. *Amazon*, 758 F. Supp. 2d at 1158.

13. See Eric A. Ess, *Internet Taxation Without Physical Representation?: States Seek Solution to Stop E-Commerce Sales Tax Shortfall*, 50 ST. LOUIS U. L.J. 893, 923 (2006) (“The Internet has changed the way the world transacts business and shares information. It has also unwittingly exacerbated consumer tax evasion.”).

14. See *infra* text accompanying footnotes 64–67 for an explanation of how we arrive at this estimated use tax compliance rate.

15. *Quill*, 504 U.S. at 298.

16. *Amazon*, 758 F. Supp. 2d at 1158–61.

Amendment,¹⁷ North Carolina is forced to come up with new options that conform to the requirements of the First Amendment and the Commerce Clause but still allow the state to significantly increase its use tax collections.

A. *An Overview of the Use Tax*

Although North Carolinians routinely pay taxes on their purchases of tangible personal property, many are unaware of the differences between—or the constitutional issues associated with—sales and use taxes. A sales tax is a consumption tax, i.e., a tax on the purchase of certain goods and services that is calculated as a percentage of the purchase price of the particular goods or services. In North Carolina, the state sales tax rate for most goods is set by statute at 5.75%.¹⁸ Most counties charge an additional 2% local sales tax, bringing the total sales tax rate in most North Carolina counties to 7.75%.¹⁹ Although imposed on and collected by the retailer, the sales tax “is intended to be passed on to the purchaser of a taxable item and borne by the purchaser instead of by the retailer.”²⁰ The retailer, therefore, simply serves as “a trustee on behalf of the State when it collects tax from the purchaser of a taxable item.”²¹ Retailers generally must remit the sales tax they collect, along with a sales tax return, to the DOR on a monthly basis.²²

North Carolina, like the forty-four other states with a sales tax, also has a use tax.²³ North Carolina’s use tax, which is called a “complementary use tax” in the General Statutes, is a tax on the use, storage, or consumption of non-exempt tangible personal property or services in North Carolina without regard to where the consumer purchased the property.²⁴ In general, the use tax applies when a consumer purchases a good or service without paying sales tax (or

17. *Id.* at 1169.

18. N.C. GEN. STAT. § 105-164.4(a) (2009). The 5.75% sales tax rate was reduced to 4.75% as of July 1, 2011. *Id.*

19. *Sales and Use Tax Rates Effective October 1, 2010*, N.C. DEP’T OF REVENUE (Sept. 30, 2010, 4:53 PM), http://www.dornc.com/taxes/sales/salesrates_10-10.html. A few North Carolina counties impose an additional 2.25% sales tax, such that the total tax rate in these counties is 8%. *Id.* Mecklenburg County has a 2% local sales tax rate and another 0.5% public transportation tax, bringing its combined state and local tax rate up to 8.25%. *Id.*

20. § 105-164.7.

21. *Id.*

22. § 105-164.16(b1).

23. § 105-164.4(a); JOHN F. DUE & JOHN L. MIKESSELL, *SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION* 245 (2d ed. 1994).

24. § 105-164.6(a).

paying a sales tax rate that is lower than the rate in her home state).²⁵ Moreover, the use tax rate in North Carolina is the same as the state's sales tax rate.²⁶ The use tax discourages residents of states with high sales tax rates from purchasing items in other states that either charge no sales tax or charge sales tax at a lower rate. In fact, as the Supreme Court of North Carolina has acknowledged, North Carolina adopted its use tax in 1937 because its sales tax, standing alone, "tended to encourage residents to make out-of-state purchases to escape payment of the tax."²⁷ The use tax, therefore, imposes the same total tax burden on purchases made out-of-state as those made in-state, thereby eliminating the incentive for consumers to cross state lines—or order online—to purchase goods at lower tax rates.²⁸ In this way, the use tax serves as a "corollary to the sales tax."²⁹ As one noted commentator has explained:

[U]se taxes are functionally equivalent to sales taxes. They are typically levied upon the use, storage, or other consumption in the state of tangible personal property that has not been subjected to a sales tax. The use tax imposes an exaction equal in amount to the sales tax that would have been imposed on the sale of the property in question if the sale had occurred within the state's taxing jurisdiction In principle, then, the in-state purchaser stands to gain nothing by making an out-of-state or interstate purchase free of sales tax because it will ultimately be saddled with an identical use tax when it brings the property into the taxing state.³⁰

So, for example, if a North Carolinian purchases a sweatshirt during a trip to Alaska, which does not have a sales tax (or through Amazon, which does not collect sales tax on purchases made by North Carolinians), the purchaser would owe use tax to North

25. *In re* Assessment of Add'l N.C. & Orange Cnty. Use Taxes, 312 N.C. 211, 214, 322 S.E.2d 155, 158 (1984).

26. § 105-164.6.

27. *Colonial Pipeline Co. v. Clayton*, 275 N.C. 215, 223, 166 S.E.2d 671, 677 (1969).

28. *See, e.g., Henneford v. Silas Mason Co.*, 300 U.S. 577, 581 (1937) ("One of [the Washington use tax's] effects must be that retail sellers in Washington will be helped to compete upon terms of equality with retail dealers in other states who are exempt from a sales tax or any corresponding burden. Another effect, or at least another tendency, must be to avoid the likelihood of a drain upon the revenues of the state, buyers being no longer tempted to place their orders in other states in the effort to escape payment of the tax on local sales.").

29. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 302 (1992).

30. 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION: SALES AND USE, PERSONAL INCOME, AND DEATH AND GIFT TAXES AND INTERGOVERNMENTAL IMMUNITIES* ¶ 16.01[2] (3d ed. 2000).

Carolina in the same amount as the North Carolina sales tax. The total cost, then, would be the same as if she had purchased the sweatshirt in North Carolina. If, on the other hand, the purchaser bought the sweatshirt in South Carolina, which does have a sales tax, the purchaser would receive a credit toward her North Carolina use tax in the amount of the sales tax paid to South Carolina.³¹ This prevents the North Carolina purchaser from being double taxed on the purchase. By imposing the same total tax burden on out-of-state purchases as that imposed on in-state purchases, states protect their tax revenues as well as the competitive position of their merchants in relation to retailers in states with lower sales tax rates.³²

Although North Carolina's sales and use taxes "taken and applied together, provide a uniform tax upon either the sale or use of all tangible personal property irrespective of where it may be purchased . . . and [are] functional parts of one system of taxation,"³³ they differ as to the object of the tax as well as to who is responsible for the collection and remission of the tax. A sales tax "is a tax on the freedom of purchase"³⁴ and is imposed on the retailer, even though the purchaser ultimately pays the amount due. But, while states have broad taxing authority, their power to charge a sales tax on a given purchase is not unlimited. The transaction to be taxed must fall within the scope of the state's taxing powers (i.e., must relate to an in-state purchase) because if the sales tax is "applied to interstate transactions, it is a tax on the privilege of doing interstate business,

31. See § 105-164.6(c) (allowing a full or partial credit for sales or use tax paid on an item to North Carolina or any other state); see also 2 HELLERSTEIN & HELLERSTEIN, *supra* note 30, ¶ 16.01[2] ("In order to avoid double taxation, every state imposing a use tax allows a credit against its use tax for sales or use tax paid to other states."). Thus, if the North Carolina purchaser bought the sweatshirt in a state imposing a 6.75% sales tax, she would owe North Carolina only 1% of the purchase price in use tax. If the state of purchase charged a 7.75% sales tax, then no use tax would be owed in most North Carolina counties.

32. See *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 343 (1954) ("The [sales tax], a fiscal measure of considerable importance, has the effect of increasing the cost to the consumer of acquiring supplies in the taxing state. The use tax, not in itself a relatively significant revenue producer, usually appears as a support to the sales tax in two respects. One is protection of the state's revenues by taking away from inhabitants the advantages of resort[ing] to untaxed out-of-state purchases. The other is protection of local merchants against out-of-state competition from those who may be enabled by lower tax burdens to offer lower prices. In this respect, the use tax has the same effect as a protective tariff becoming due not on purchase of the goods but at the moment of bringing them into the taxing states.").

33. *Johnston v. Gill*, 224 N.C. 638, 644, 32 S.E.2d 30, 33 (1944); see also *Miller Bros.*, 347 U.S. at 343 (explaining the complementary purposes of the sales and use taxes).

34. *Johnston*, 224 N.C. at 643, 32 S.E.2d at 33.

[which] creates a burden on interstate commerce and runs counter to the Commerce Clause of the Federal Constitution.”³⁵

Thus, as the United States Supreme Court has held, the Commerce Clause prohibits states from imposing their sales tax on every purchase that results in the shipment of goods into the taxing state. For example, in *McLeod v. J.E. Dilworth Co.*,³⁶ the Court held that Arkansas could not constitutionally impose its sales tax on goods that were purchased by Arkansas residents and shipped into Arkansas where (i) the retailer was not qualified to do business in Arkansas and maintained no offices in the state; (ii) the sale was finalized in Tennessee; and (iii) title to the goods passed from the retailer to the purchaser at the time they were delivered to a common carrier in Tennessee.³⁷ According to the Court, the transactions at issue in *McLeod* involved “sales made by Tennessee vendors that are consummated in Tennessee for the delivery of goods in Arkansas.”³⁸ As a result, given Arkansas’s extremely limited connection with the transactions, the Court held that “[f]or Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction” in violation of the dormant Commerce Clause.³⁹ In modern parlance, because these transactions lacked a sufficient “nexus” with Arkansas, Arkansas could not impose (or require the retailers to collect) its sales tax.⁴⁰

But given that the goods were shipped to purchasers in Arkansas for use, storage, or consumption in Arkansas, Arkansas could have imposed a use tax on the purchasers, who were subject to Arkansas’s taxing power. Because “a [use] tax is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end,”⁴¹ both the object of the tax (the use, storage, or consumption of the goods) and the individuals liable for the tax (the Arkansas purchasers) would have been subject to the taxing authority of Arkansas. Thus, even though Arkansas could not impose its sales

35. *Id.*

36. 322 U.S. 327 (1944).

37. *Id.* at 328–29.

38. *Id.* at 328.

39. *Id.* at 330.

40. Under modern Supreme Court jurisprudence, a state must have a “substantial nexus” with a transaction before the state may impose its sales tax on the transaction. See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274 (1977). See *infra* notes 45–55 and accompanying text regarding the Supreme Court’s holding that substantial nexus requires a physical presence.

41. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937) (upholding the Washington use tax against arguments that it unduly burdens interstate commerce).

tax on the transactions under consideration, it could have imposed a use tax to capture the same amount of tax revenue as if the sale had occurred in Arkansas (subject to a credit for any sales tax paid in Tennessee).

While imposing the use tax on the purchaser helps to bring the tax within the state's constitutional authority, it creates a different problem: enforcement. With the use tax, the purchaser, rather than the retailer, must report the purchase and remit to the state any use tax owed on the purchased items.⁴² But, as North Carolina has discovered, most consumers do not report and remit their use tax obligations. In fact, in 2008, only 2.5% of North Carolinians who filed state income tax returns reported owing any use tax.⁴³ As a result, given the threat of low compliance rates due to the self-reporting nature of the use tax, states originally sought to require retailers to collect and remit any use taxes owed, as they do with the sales tax. But the United States Supreme Court has held that the Commerce Clause restraint not only prohibits states from imposing a sales tax on certain out-of-state and internet purchases, but also precludes states from mandating that retailers collect and remit use taxes on such purchases.⁴⁴

In *Quill Corp. v. North Dakota*,⁴⁵ the Supreme Court held that the dormant Commerce Clause prohibits a state from requiring a retailer that has no "physical presence" in the state to collect and remit the state's use tax.⁴⁶ North Dakota had tried to require the Quill

42. N.C. GEN. STAT. § 105-164.16(d) (2009). The problem with self-reporting tax regimes, like use taxes, has been well recognized. See Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 *FORDHAM L. REV.* 1733, 1735 (2010) ("A core problem for enforcement of tax law is asymmetric information. . . . [T]he taxpayer knows the facts regarding the relevant transactions he or she engaged in during the tax year The government is forced to obtain that information after the fact, either from the taxpayer or from third parties.").

43. See *infra* Table 1 p. 2028.

44. *Quill Corp. v. North Dakota*, 504 U.S. 298, 311–13 (1992) (applying *Complete Auto's* four-part test to North Dakota's attempt to require out-of-state retailers to collect the state's use tax). In *Complete Auto*, the Supreme Court set forth a four-part test for determining the validity of state taxes under the Commerce Clause. 430 U.S. at 279. Under that test, a tax will survive a Commerce Clause challenge so long as the tax: "[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." *Id.*

45. 504 U.S. 298 (1992).

46. *Id.* at 301–02, 312. In *Quill*, the Court attempted to give states and retailers guidance as to what would constitute an in-state physical presence. *Id.* at 315. According to the Court, "a small sales force, plant, or office" provides the requisite physical presence whereas "vendors 'whose only connection with customers in the [taxing] State is by common carrier or the United States mail'" would not. *Id.* (quoting *Nat'l Bellas Hess, Inc.*

Corporation, an office supply company, to collect use tax on purchases made by North Dakota residents.⁴⁷ The state contended that Quill's contacts with North Dakota created a sufficient "nexus" to require it to collect the use tax.⁴⁸ The company advertised in the state and made annual sales of "almost \$1 million" to "about 3,000 customers in North Dakota."⁴⁹ Despite these contacts, the Court disagreed with North Dakota, finding that Quill's contacts with the state did not create the physical presence necessary under the dormant Commerce Clause to allow North Dakota to impose a use tax collection obligation on the company.⁵⁰

The *Quill* decision reaffirmed the physical presence standard previously introduced in *National Bellas Hess v. Department of Revenue of Illinois*,⁵¹ a case with similar facts but decided on both due process and Commerce Clause grounds.⁵² In reaffirming the "physical presence" standard, the *Quill* Court focused only on the Commerce Clause.⁵³ According to the Court, requiring out-of-state sellers to keep track of the tax rates and exemptions applicable in several thousand state and local taxing jurisdictions throughout the nation might "entangle" remote sellers "in a virtual welter of complicated obligations," which, in turn, would "unduly burden interstate commerce."⁵⁴ In light of this concern and the Court's belief that a "bright-line rule . . . encourages settled expectations and, in doing so, fosters investment by businesses and individuals,"⁵⁵ *Quill* upheld the requirement that before a state may impose a sales or use tax

v. Dep't of Revenue, 386 U.S. 753, 758 (1967)). North Carolina incorporated *Quill's* "physical presence" standard in its statutory definition of being "engaged in business" in the state. See § 105-164.3(9). Retailers who are "engaged in business" in North Carolina must collect sales and use tax owed to the state. N.C. GEN. STAT. § 105-164.8. Those not "engaged in business" in North Carolina have no such collection obligation under North Carolina's sales and use tax statutes. *Id.*

47. *Quill*, 504 U.S. at 302-03.

48. *Id.*

49. *Id.* at 302.

50. *Id.* at 318-19.

51. 386 U.S. 753 (1967).

52. *Id.* at 756. *Quill* differed from *Bellas Hess* in that *Quill* based the physical presence requirement solely on the dormant Commerce Clause. *Quill*, 504 U.S. at 312. By expressly rejecting the Due Process Clause as a basis for the physical presence requirement, the *Quill* Court opened the opportunity for Congress to eliminate the physical presence requirement. See *id.* at 318.

53. *Quill*, 504 U.S. at 312-19.

54. *Id.* at 313 n.6.

55. *Id.* at 316.

collection obligation on a retailer, the retailer must have a physical presence in the state.⁵⁶

After *Quill*, then, North Carolina could not constitutionally require retailers that lacked a physical presence in the state to collect and remit use taxes.⁵⁷ Out-of-state retailers may of course *voluntarily* collect and remit use taxes,⁵⁸ but most remote retailers understandably have declined the invitation to do so. Accordingly, given the Commerce Clause limits on North Carolina's taxing power, North Carolina must rely on individual purchasers to (i) self-report their out-of-state purchases, whether made physically out-of-state, via the internet, or through some other remote means (such as a mail-order catalog) and (ii) pay any use taxes owed on those purchases. In particular, North Carolinians are supposed to report on their annual income tax returns any items of tangible personal property that they store, use, or consume in the state if they did not pay sales or use taxes at the time of purchase.⁵⁹ Use tax payments are due at the same time as income taxes.⁶⁰ In the event that a purchaser is not required to file an income tax return (e.g., she does not have sufficient North Carolina taxable income to require the filing of an income tax return

56. *Id.* at 314, 317–18.

57. See N.C. DEPT. OF REVENUE, SALES AND USE TAX TECHNICAL BULLETINS § 1-1 (2008) [hereinafter SALES BULLETIN], available at <http://www.dornc.com/practitioner/sales/bulletins/section1.pdf#1-1> (stating that “[e]very person outside this State who is engaged in business in this State, as hereinafter defined, is required to register with the Department [of Revenue] and collect and remit the tax due on all taxable tangible personal property sold or delivered for storage, use or consumption in this State”). SALES BULLETIN defines “[e]ngaged in business” as

maintaining, occupying or using permanently or temporarily, directly or indirectly, or through a subsidiary or agent, by whatever name called, any office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business, for the selling or delivering of tangible personal property for storage, use or consumption in this State, or permanently or temporarily, directly or through a subsidiary, having any representative, agent, salesman, canvasser or solicitor operating in this State in such selling or delivering.

Id. § 1-2.

58. See, e.g., N.C. GEN. STAT. § 105-164.6A (2009) (“The Secretary may enter into agreements with sellers pursuant to which the seller agrees to collect and remit on behalf of its customers State and local use taxes due on items of tangible personal property, digital property, or services the seller sells. For the purpose of this section, a seller is a person who is engaged in the business of selling tangible personal property, digital property, or services for use in this State and who does not have sufficient nexus with this State to be required to collect use tax on the sales.”).

59. See 17 N.C. ADMIN. CODE 7B.0104(f) (2010).

60. See *id.*

with the state), the purchaser must file a separate consumer use tax return with the DOR.⁶¹

While the sales and use taxes are “complementary”⁶² and should result in the state receiving the same amount of tax revenue whether goods are purchased from in-state or out-of-state vendors, use tax compliance has been extremely low historically.⁶³ In fact, one federal legislator has called the use tax the “most ignored tax on the books.”⁶⁴ And this seems especially true in North Carolina. According to the North Carolina DOR, in 2008 only 109,003 individual income tax returns, out of 4,420,156 filed, reported any use taxes owed on purchases from out-of-state retailers.⁶⁵ Those returns reporting any use tax due resulted in the payment of approximately \$5.1 million in use taxes.⁶⁶ But economists estimate that North Carolina purchasers owed more than \$145 million in unpaid use taxes in 2008 on internet purchases alone.⁶⁷ North Carolina taxpayers’ use tax compliance rate, therefore, appears to be less than four percent.⁶⁸ Given this extremely low compliance rate, North Carolina has looked for other ways to increase self-reporting and, more importantly, to require out-of-state retailers like Amazon to collect use taxes without violating *Quill* or any other constitutional requirements.

B. North Carolina’s Prior Efforts to Increase Use Tax Compliance

North Carolina’s recent dispute with Amazon is only the latest in a series of attempts by the state to increase use tax compliance. To date, those attempts can be separated into two general categories: (i) efforts to inform North Carolina taxpayers about their use tax reporting and payment obligations and (ii) efforts to require retailers

61. *See id.*

62. *Johnston v. Gill*, 224 N.C. 638, 644, 32 S.E.2d 30, 33 (1944).

63. *See infra* Table 1 p. 2028 for data regarding North Carolina’s use tax reporting between 2000 and 2008.

64. H.R. REP. NO. 107-240, at 37 (2001) (statement of Rep. Jim Sensenbrenner, Chairman, H. Comm. on the Judiciary).

65. Email from Beth Stevenson, Dir. of Pub. Affairs/PIO, N.C. Dep’t of Revenue, to Andrew Haile, Assistant Professor of Law, Elon Univ. Sch. of Law (Jan. 31, 2011, 16:25 EST) (on file with authors).

66. *Id.*

67. *See BRUCE ET AL.*, *supra* note 3, at 11, 26. This figure does not include use taxes owed on other forms of remote purchases from out-of-state retailers, such as mail orders.

68. Some states have even lower estimated compliance rates. *See, e.g.*, STATE OF CALIFORNIA BOARD OF EQUALIZATION, REVENUE ESTIMATE: ELECTRONIC COMMERCE AND MAIL ORDER SALES 4 (2010), *available at* <http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-10.pdf> (estimating California consumers’ use tax compliance rate at approximately 1.5% for fiscal year 2008–09).

such as Amazon to collect and remit use taxes despite *Quill's* physical presence nexus requirement. While the former method is clearly constitutional,⁶⁹ the vast majority of North Carolinians still have not changed their reporting habits in response to any educational campaign. As a result, North Carolina has sought to force Amazon and other remote sellers to collect the more than \$160 million in use taxes that went unpaid in 2010.⁷⁰ With only limited success in those efforts, however, the state most recently turned its focus toward improving use tax compliance by increasing enforcement against individual consumers. This led to the audit request by the DOR to Amazon for information about customer purchases and, ultimately, to Amazon's lawsuit against the DOR.

1. North Carolina's Attempt to Inform Taxpayers of Their Use Tax Obligations

Although North Carolina has imposed a use tax since 1937, it did not make a concerted effort to inform taxpayers about the tax until 2000. Perhaps this should not be surprising, given that all the states bordering North Carolina have a sales tax and remote retail sales were a modest part of total retail sales until the growth of internet commerce during the 1990s.⁷¹ Consequently, North Carolina did not have a pressing problem with use tax compliance until the end of the 1990s.

Starting with tax year 2000, North Carolina began including a line on the state's individual income tax return for taxpayers to report and pay use tax on goods they purchased from out-of-state retailers if the retailers did not collect tax on the purchases.⁷² Presently, the instructions to North Carolina's individual income tax form explain that:

An individual in North Carolina owes use tax on an out-of-state purchase when the item purchased is subject to the North

69. The United States Supreme Court and the Supreme Court of North Carolina have both held that use taxes are constitutional. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937); *Johnston v. Gill*, 224 N.C. 638, 644, 32 S.E.2d 30, 33 (1944). Accordingly, there is no constitutional barrier to North Carolina informing its citizens of their obligation to pay such use taxes.

70. See, e.g., BRUCE ET AL., *supra* note 3, at 11.

71. The U.S. Census Bureau did not even start tracking e-sales data until 1999. See *E-Stats Historical Data*, U.S. CENSUS BUREAU, <http://www.census.gov/econ/estats/archives.html> (last visited Aug. 22, 2011).

72. See Act of July 22, 1999, ch. 341, 1999 N.C. Sess. Laws 1292, 1292-95 (codified at N.C. GEN. STAT. § 105-269.14 (2009)) (requiring inclusion of a line on the income tax return for reporting the amount of use tax owed).

Carolina sales tax and the retailer making the sale does not collect sales tax on the sale. . . . When an out-of-state retailer does not collect sales tax, the responsibility of paying the tax falls on the purchaser.⁷³

In addition, to assist taxpayers, the instructions include a “worksheet” to calculate the amount of use taxes owed on out-of-state purchases.⁷⁴ But, as the worksheet indicates, to make this calculation, taxpayers must have receipts showing the purchase price of all untaxed goods that the purchaser bought from out-of-state retailers during the previous year.⁷⁵ Recognizing that very few taxpayers actually keep individual purchase receipts, the instructions also contain a second “worksheet” for “taxpayers who do not have records of all out-of-state purchases.”⁷⁶ This second worksheet estimates the amount of use taxes that an individual taxpayer owes based on the taxpayer’s North Carolina taxable income.⁷⁷ Specifically, the worksheet presumes that taxpayers owe 0.0675% of their taxable income in use taxes.⁷⁸ For example, a taxpayer with \$50,000 of North Carolina taxable income is presumed to have a use tax liability of \$34. Given the current combined state and county sales tax rate of 7.75% applicable in the majority of North Carolina counties, the DOR estimates that a taxpayer with \$50,000 of taxable income spends \$439 annually on taxable purchases for which the retailer does not collect tax.⁷⁹

The inclusion of a use tax reporting line on the state’s income tax form has had, at best, only a modest effect on North Carolina’s ability to collect use taxes. In fact, based on information from the DOR illustrated in the table below, the number of taxpayers who report any use tax liability as compared to the number of total returns filed

73. N.C. DEP’T OF REVENUE, NORTH CAROLINA INDIVIDUAL INCOME TAX INSTRUCTIONS FOR FORM D-400, at 8 (2010), available at <http://www.dorn.com/downloads/D401.pdf>.

74. *Id.* at 9.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 8–9. According to the DOR, the 0.0675% estimate for use taxes was arrived at after “compar[ing] the information used in other states and [making] adjustments for the combined North Carolina state and local rates of tax.” *Frequently Asked Questions About Use Tax*, N.C. DEP’T OF REVENUE, <http://www.dorn.com/faq/use.html> (last visited Aug. 22, 2011).

79. This figure is calculated by dividing the estimated use tax (\$34) by the combined state and county sales tax rate (0.0775).

actually has decreased during the last decade even though the volume of internet transactions has continued to increase⁸⁰:

Table 1: NC Use Tax Reporting

Tax Year	Number of Individual Income Tax Forms Reporting any Use Tax Liability	Number of Individual Income Tax Forms Filed	Percentage of Taxpayers Reporting Use Tax Liability on Income Tax Form
2000	162,352	4,153,648	3.9%
2001	153,992	4,223,802	3.6%
2002	136,763	4,487,803	3.0%
2003	128,978	3,608,637	3.6%
2004	127,944	3,632,093	3.5%
2005	119,686	3,398,843	3.5%
2006	117,887	3,993,165	3.0%
2007	111,315	3,978,778	2.8%
2008	109,003	4,420,156	2.5%

Given the ubiquity of e-commerce and the fact that Amazon alone has engaged in over fifty million transactions with North Carolina customers since 2003,⁸¹ it strains belief that only 2 to 4% of North Carolinians annually engage in internet transactions for which the retailer collects no sales tax.⁸² Accordingly, because including a use tax reporting line on the income tax form has proven largely ineffective, North Carolina has attempted to work around *Quill* and shift the tax collection burden to out-of-state retailers.

2. The Streamlined Sales and Use Tax Agreement

North Carolina and most other states initially sought to work around *Quill's* physical presence standard by imposing use tax

80. Emails from Beth Stevenson, Dir. of Pub. Affairs/PIO, N.C. Dep't of Revenue, to Andrew Haile, Assistant Professor of Law, Elon Univ. Sch. of Law (Jan. 31, 2011, 16:25 EST and Feb. 4, 2011, 10:07 EST) (on file with authors).

81. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1158 (W.D. Wash. 2010).

82. A Nielsen study from 2008 found that 94% of Americans had made a purchase over the internet at one time or another. THE NIELSEN CO., TRENDS IN ONLINE SHOPPING: A GLOBAL NIELSEN CONSUMER REPORT 2 (2008), available at <http://id.nielsen.com/news/documents/GlobalOnlineShoppingReportFeb08.pdf>.

collection obligations directly on out-of-state retailers through the Streamlined Sales and Use Tax Project.⁸³ Between 2000 and 2002, representatives from North Carolina and forty-three other states,⁸⁴ the District of Columbia, local governments, and the business community, drafted the Streamlined Sales and Use Tax Agreement (“SSUTA”). The SSUTA was specifically intended to address the concerns the Court identified in *Quill* by simplifying the complex patchwork of state and local sales and use tax laws existing throughout the country.⁸⁵ In *Quill*, the Court emphasized the burdens imposed on interstate commerce by requiring out-of-state retailers to collect use tax on behalf of the thousands of state and local tax jurisdictions that exist in the United States.⁸⁶ Based in part on this potential “undu[e] burden” on interstate commerce, the Court prohibited states from forcing retailers without an in-state physical presence to collect use taxes.⁸⁷

To avoid this dormant Commerce Clause problem, the SSUTA sought to increase the uniformity of the sales and use tax laws around the country, thereby reducing the burden imposed on interstate commerce that might result from requiring remote retailers to collect and remit taxes. Specifically, under the SSUTA, each of the parties to the agreement—the “member states”⁸⁸—agreed to enact legislation with: uniform tax base definitions; “uniform and simpler exemption administration;” simplified rate structures; “state-level administration of all sales taxes;” uniform “sourcing” standards,⁸⁹ and “state funding of the administrative cost” of collecting sales and use taxes.⁹⁰ By implementing the SSUTA, member states hoped not only to mitigate the burden on interstate commerce identified by the Court in *Quill* but also to persuade Congress to exercise its Commerce Clause authority to pass federal legislation permitting member states to

83. See 2 HELLERSTEIN & HELLERSTEIN, *supra* note 30, at ¶ 19A.01[1].

84. The only state with sales and use taxes that did not participate in the drafting of the SSUTA was Colorado.

85. See 2 HELLERSTEIN & HELLERSTEIN, *supra* note 30, at ¶ 19A.01[1].

86. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.6 (1992).

87. *Id.*

88. STREAMLINED SALES & USE TAX AGREEMENT § 801 (2010), available at http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%2012_13_10.pdf (setting forth the procedures by which states may become member states).

89. “Sourcing” determines the location where a sale is taxable. *Id.* § 301.

90. See *Frequently Asked Questions*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=faqs> (last visited Aug. 22, 2011).

require out-of-state retailers to collect use tax.⁹¹ The Court acknowledged Congress's power to enact such legislation in *Quill*:

This aspect of our decision [affirming the physical presence standard] is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve [under the authority granted to it in the Commerce Clause]. . . . Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.⁹²

Thus, although member states lack the inherent authority to force retailers with no in-state physical presence to collect sales and use tax on the states' behalf, Congress has such authority pursuant to its Commerce Clause power.⁹³

Yet, despite member states' efforts to reduce the complexity and administrative burden of use tax collection, Congress has so far declined the invitation to act. On several occasions, Congress has considered proposed legislation that would permit SSUTA member states to require use tax collection by out-of-state retailers.⁹⁴ Each time, though, the legislation faced stiff opposition from internet and other remote retailers and failed to secure the necessary votes. Thus, the SSUTA has not yet achieved its goal of persuading Congress to enact federal legislation that would reverse *Quill* and allow SSUTA member states to require out-of-state retailers to collect use taxes.

91. *Id.* SSUTA member states also hoped that the increased uniformity of sales and use tax statutes among tax jurisdictions would persuade remote retailers voluntarily to collect use tax. It has succeeded to some extent, as over 1,400 retailers voluntarily collect sales and use tax in SSUTA member states. *See id.* These retailers have remitted more than \$700 million in taxes to those states. *Id.* Even so, the SSUTA Governing Board acknowledges that \$700 million "is a very small fraction of the amount of sales tax that remains uncollected." *Id.*

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

93. The *Quill* Court's decision that only the dormant Commerce Clause, and not the Due Process Clause, supported the physical presence requirement means that Congress can reverse the *Quill* decision by exercising its Commerce Clause power. If the Due Process Clause constituted the basis of the physical presence requirement, Congress would have no authority to eliminate the requirement. Given Congress' express constitutional authority to regulate interstate commerce, however, the dormant Commerce Clause does not prevent Congress from eliminating the physical presence requirement.

94. *See*, for example, the Main Street Fairness Act ("MSFA"), which would have permitted SSUTA member states to require remote retailers to collect sales and use tax. H.R. 5660, 111th Cong. § 4 (2010). A version of the MSFA was last introduced in 2007 as the "Sales Tax Fairness and Simplification Act." *See* H.R. 3396, 110th Cong. § 4 (2007); S.R. 34, 110th Cong. § 4 (2007). For a more comprehensive list of earlier versions of the MSFA, *see Quill*, 504 U.S. at 318 n.11.

3. North Carolina's "Amazon" Law

Seeing little effect on use tax compliance from the inclusion of the reporting line on the state income tax return and frustrated by congressional inaction in response to the SSUTA, North Carolina tried another approach to shifting the use tax collection obligation to the retailer—imputing physical presence nexus to out-of-state retailers based on their marketing relationships with in-state companies. In 2009, North Carolina became only the third state—following New York and Rhode Island—to enact a so-called “Amazon law.”⁹⁵ Under North Carolina’s Amazon law, a remote retailer is presumed to be doing business in the state, and is therefore obligated to collect North Carolina sales and use taxes, if the retailer has “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 retailer.”⁹⁶ That is, the Amazon law deems an out-of-state retailer to have an in-state physical presence if the retailer has a “click-through agreement” with an in-state company, i.e., pays commissions to an in-state company for every customer that “clicks through” a link on the in-state company’s website and makes a purchase from the out-of-state retailer. In effect, the Amazon law treats the in-state company linking customers to the out-of-state retailer’s website as an agent soliciting sales in the state on behalf of the retailer.⁹⁷

According to North Carolina, the Supreme Court in *Scripto, Inc. v. Carson*⁹⁸ established the basis for imputing a physical presence to the otherwise out-of-state retailer as a result of these “click-through” agreements with in-state companies. In *Scripto*, the taxpayer, a company “in the business of selling mechanical writing instruments,” employed ten independent contractors “conducting continuous local solicitation in Florida” on behalf of the company.⁹⁹ The independent contractors solicited orders and sent them back to the company’s

95. See N.C. GEN. STAT. § 105-164.8(b)(3) (2009); see also N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2010) (New York’s Amazon Law); R.I. GEN. LAWS § 44-18-15 (2010) (Rhode Island’s Amazon Law).

96. N.C. GEN. STAT. § 105-164.8(b)(3) (2009).

97. The imputed physical presence created by the Amazon law applies “only if the cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of ten thousand dollars (\$10,000) during the preceding four quarterly periods.” *Id.*

98. 362 U.S. 207 (1960).

99. *Id.* at 208, 211.

office in Georgia, where they were accepted and fulfilled.¹⁰⁰ Other than these independent contractors, *Scripto* had no presence in Florida. It did not “own, lease, or maintain any office, distributing house, warehouse or other place of business in Florida” or “have any regular employee or agent there.”¹⁰¹ Nevertheless, the Court found that the presence of independent contractors in Florida soliciting on behalf of *Scripto* amounted to a sufficient nexus with Florida to permit the state to require *Scripto* to collect use tax.¹⁰² Based on the holding in *Scripto*, North Carolina contends that out-of-state retailers that have click-through agreements with North Carolina companies are obligated to collect use tax.¹⁰³

Not surprisingly, out-of-state retailers, such as Amazon, have disagreed with this interpretation of *Scripto*. They contend that in-state companies with links on their websites to the websites of out-of-state retailers are just providing a modern form of “advertising,” which does not amount to “solicitation” and therefore fails to establish an in-state physical presence under *Quill*.¹⁰⁴ On this basis, Amazon has challenged New York’s Amazon law,¹⁰⁵ which served as the model for North Carolina’s law.¹⁰⁶ To date, the New York trial court and intermediate appellate court have upheld New York’s Amazon law against Amazon’s constitutional challenge.¹⁰⁷

100. *Id.* at 209.

101. *Id.*

102. *Id.* at 210–11 (“There must be . . . some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax. We believe that such a nexus is present here.”) (internal quotation marks omitted); *see also* Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62, 64–65 (1939) (upholding California’s use tax obligation based on the presence of two “general agents” soliciting on behalf of the taxpayer in the state).

103. *See* N.C. DEP’T OF REVENUE, FORM E-505 9-09, at 2–3, *available at* http://www.dornc.com/downloads/e505_8-09.pdf (noting that North Carolina’s Amazon law “codifies the principle announced by the United States Supreme Court in *Scripto* v. Carson that a state may require tax collection by a remote retailer that had contacts with 10 independent contractors in the state who solicited orders for products on its behalf”).

104. The taxpayer in *Quill* was held not to have a physical presence in North Dakota even though it “solicit[ed] business through catalogs and flyers, advertisements in national periodicals, and telephone calls.” *Quill Corp. v. North Dakota*, 504 U.S. 298, 302 (1992). Thus, the distinction between “solicitation” (creating nexus in *Scripto*) and “advertisement” (not establishing nexus in *Quill*) is seen as potentially dispositive with respect to the physical presence standard.

105. *See Amazon.com LLC v. N.Y. State Dep’t of Taxation & Fin.*, 877 N.Y.S.2d 842, 846 (N.Y. Cnty. Sup. Ct. 2009), *aff’d*, 913 N.Y.S.2d 129 (N.Y. App. Div. 1st Dept. 2010) (upholding New York’s Amazon law).

106. N.C. GEN. STAT. § 105-164.8(b)(3) (2009); *see* N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2010).

107. The Appellate Division rejected the facial challenges to New York’s Amazon law. It did, however, remand the case to the New York trial court to consider the as-applied

Despite New York's early success in defending its Amazon law and regardless of whether the law is ultimately upheld, North Carolina's Amazon law likely will have little impact on increasing use tax collections in North Carolina because Amazon and other out-of-state retailers have taken steps to limit the effect of North Carolina's law. Immediately after North Carolina enacted its Amazon law, Amazon and other internet retailers discontinued their click-through agreements with North Carolina companies, thereby avoiding any possible imputation of physical presence nexus based on those agreements.¹⁰⁸ As a result, in a striking example of unintended consequences, North Carolina's attempt to increase its use tax collections by enacting the Amazon law, in the end, may have cost the state tax dollars. When Amazon terminated its click-through agreements with in-state companies, it also eliminated the commission income those in-state companies received under the agreements, which would have been taxable in North Carolina. Consequently, North Carolina not only failed to increase use tax collections from remote retailers like Amazon but also lost the income tax revenues the in-state companies otherwise would have paid.¹⁰⁹

challenge by Amazon. *Amazon.com LLC v. N.Y. State Dep't of Taxation & Fin.*, 913 N.Y.S.2d 129, 132 (N.Y. App. Div. 1st Dept. 2010). While the New York and North Carolina Amazon laws are identical in statutory language, the New York Appellate Division (the state's intermediate appellate court) relied heavily on administrative issuances by the New York Department of Taxation and Finance in rejecting Amazon's constitutional challenge to the Amazon law. *Id.* at 133. North Carolina does not presently have comparable administrative guidance, which could make it easier for Amazon and other remote retailers to successfully challenge North Carolina's Amazon law. For an insightful analysis of the New York Appellate Division's decision, see Edward A. Zelinsky, *New York Appellate Division Upholds "Amazon" Law: Analysis*, 59 ST. TAX NOTES 93, 97-100 (2011).

108. See Mark Binker, *Amazon Cuts Relationships with N.C. Affiliates*, GREENSBORO NEWS & REC., June 26, 2009, http://www.news-record.com/content/2009/06/26/article/amazon_cuts_relationships_with_affiliates. In contrast, Amazon did not sever ties with its New York marketing associates after New York enacted its Amazon law. See Zelinsky, *supra* note 107, at 102-03.

109. North Carolina is not the only state to suffer from unintended consequences relating to efforts to collect additional sales and use taxes. In February 2011, Amazon announced that it intended to close a distribution facility operated by an Amazon subsidiary after the Texas Comptroller's Office assessed Amazon \$269 million for failing to collect sales tax on sales made to Texas residents between December 2005 and December 2009. See Nancy J. Moore, *Amazon.com to Close Texas Facility in Dispute Over State's Tax Demand*, DAILY TAX REPORT NO. 30, Feb. 14, 2011, at H-2. The Comptroller's Office apparently based the assessment on Amazon's alleged physical presence in Texas through its subsidiary. Maria Halkias, *Texas Bills Amazon for Millions in Sales Taxes*, DALLAS MORNING NEWS, Oct. 23, 2010, <http://www.dallasnews.com>

4. The Internet Transactions Resolution Program

Given the limited effectiveness of its Amazon law and its prior educational efforts, North Carolina was compelled to consider other ways to capture sales and use taxes from remote retailers. In 2010, the state created an amnesty program, the “Internet Transactions Resolution Program” (the “ITR Program”), that it hoped would induce out-of-state retailers (even those that discontinued their click-through agreements with in-state companies following enactment of the Amazon law) to collect use tax on a prospective basis.¹¹⁰

In effect, through the ITR Program, the DOR tried to leverage the potential liability of remote retailers that did not collect sales and use taxes during any periods they had click-through agreements with North Carolina companies to force those retailers to begin collecting use taxes prospectively. Under the ITR Program, the DOR agreed not to assess any taxes, penalties, or interest for an out-of-state retailer’s failure to collect sales or use taxes for periods prior to September, 2010, if the retailer agreed to collect sales and use taxes for at least a four year period commencing on that date.¹¹¹ How could an out-of-state retailer that terminated its click-through agreements upon enactment of the Amazon law have any liability for failing to collect sales or use tax for periods *before* North Carolina enacted its Amazon law? According to the DOR, the Amazon law simply “clarified” existing law, and out-of-state retailers with click-through agreements with North Carolina companies always had physical presence nexus with the state based on those agreements—even before the Amazon law went into effect.¹¹² Moreover, because there is

/business/headlines/20101023-Texas-bills-Amazon-for-millions-in-3631.ece. The closure of the distribution center will result in Amazon laying off 119 employees. Moore, *supra*.

110. Andrew M. Ballard, *North Carolina Launches Program Aimed at Collecting Internet Sales Taxes*, DAILY TAX REPORT NO. 78, Apr. 26, 2010, at H-3.

111. *See id.* One other state, Oklahoma, has offered a similar amnesty program for out-of-state retailers, even though it has not even passed an Amazon law like those in effect in New York and North Carolina. Under Oklahoma’s “Retailer Compliance Initiative,” the Oklahoma Tax Commission agrees not to “assess or seek payment of uncollected use taxes” from out-of-state retailers for the period from July 1, 2009 through June 30, 2010, if the retailers agree to register with the state and collect use taxes for at least a three year period starting on July 1, 2011. *See* OKLA. ADMIN. CODE §§ 710:1-11-1 to -5 (2010), available at <http://www.tax.ok.gov/rules/ER-11-29-10.pdf>.

112. *See Frequently Asked Questions about Internet Transactions Resolution Program*, N.C. DEP’T OF REVENUE, <http://staging.www.dor.state.nc.us/faq/itrp.html#ammendment> (archival copy on file with authors) (“[U]nder [the Amazon law], a retailer with representatives in the State who solicit or transact business on behalf of the retailer *has always been subject to sales tax*. The amendment simply modernized the terminology of the statute and added a bright line rebuttable presumption. The amendment did not change the nexus standard. *Retailers with affiliate programs in North Carolina therefore have*

no statute of limitations for sales and use tax liability if a retailer fails to file a sales or use tax return,¹¹³ out-of-state retailers could face substantial liabilities for not collecting sales and use taxes in transactions with North Carolina purchasers at any time (before or after effectiveness of the Amazon law) that the retailers had click-through agreements with in-state companies.

But the DOR may have over-reached in arguing that out-of-state companies should be held liable for failing to collect use tax for periods before North Carolina's Amazon law became effective. Prior to enactment of the Amazon law, there was no realistic way for remote retailers to know that they were obligated to collect use tax in North Carolina based solely on their click-through agreements with in-state companies. The Amazon law was an innovative and novel application of principles derived from *Scripto*, in which the Court attributed the out-of-state taxpayer with physical presence nexus based on sales agents engaging in face-to-face solicitation in-state on its behalf.¹¹⁴ The Amazon law attributes physical presence based on the existence of an agreement to compensate in-state companies for sending customers to out-of-state retailers via an internet link rather than face-to-face solicitation. While arguably legitimate, the DOR's interpretation is certainly an extension of *Scripto*. As such, the DOR's threat to hold out-of-state companies liable for failing to predict this extension and collect sales and use tax based on their click-through agreements with in-state companies violates the core tax principle that those potentially liable for a tax should have fair notice of their obligations.¹¹⁵

Not surprisingly, then, although the DOR sent information about the ITR program to 450 out-of-state retailers, only twenty-four signed on to participate in the program by the August 21, 2010 deadline.¹¹⁶ Amazon was not one of them.

always had nexus with the State and a duty to collect and remit sales tax." (emphasis added)).

113. See N.C. GEN. STAT. § 105-241.8(b)(2) (2009).

114. The *Scripto* Court did not actually use the term "physical presence," as it preceded both *Bellas Hess* and *Quill*. Nevertheless, the taxpayer's contacts with Florida through its sales agents constituted sufficient nexus for the Court to find it constitutional for Florida to require the company to collect use tax on its behalf. See *Scripto, Inc. v. Carson*, 362 U.S. 207, 211, 213 (1960).

115. RICHARD K. VEDDER & LOWELL E. GALLAWAY, JOINT ECON. COMM., SOME UNDERLYING PRINCIPLES OF TAX POLICY 4 (1998), available at <http://www.house.gov/jec/fiscal/tx-grwth/taxpol/taxpol.pdf> ("A good tax is one that is transparent; people are aware of its existence and know the burden that it imposes.").

116. See Emery P. Dalesio, *NC Sees Few Takers to Online Sales Tax Amnesty Bid*, GREENSBORO NEWS & REC., Aug. 26, 2010, <http://www.newsrecord.com/content/2010/08>

II. BALANCING USE TAX COLLECTION AGAINST TAXPAYERS'
FIRST AMENDMENT RIGHT TO RECEIVE EXPRESSIVE MATERIALS
ANONYMOUSLY

North Carolina and Amazon have been arguing about use tax collection since 2000, when North Carolina first contacted Amazon about the retailers' alleged tax obligations.¹¹⁷ While Amazon has steadfastly denied having any responsibility for collecting use taxes, North Carolina has continued to seek ways to capture these lost revenues. As part of the state's ongoing efforts, in 2009 the DOR contacted Amazon and directed it to remit all taxes that North Carolina alleged were due on the roughly fifty million transactions with North Carolina purchasers from August 2003 through February 2010.¹¹⁸ When Amazon objected, the DOR attempted a new strategy to recover its lost tax revenues—audit Amazon and use the information obtained through the audit to pursue North Carolina purchasers directly for their use tax liabilities. As explained by the DOR:

This audit [of Amazon] involves not only the potential sales tax liability of Amazon, but also the potential use tax liability of Amazon's North Carolina customers. . . . Because Amazon has failed to collect sales tax on its sales to North Carolina customers, [the DOR] also requires the identity of those customers and minimal product descriptions in order to determine whether they have complied with the North Carolina use tax laws.¹¹⁹

Yet, despite the DOR's repeated claim that it sought only "minimal product descriptions," in December 2009 the DOR sent an information request to Amazon seeking "all information for all sales to customers with a North Carolina shipping address by month in an electronic format for all dates between August 1, 2003, and February 28, 2010."¹²⁰

/26/article/nc_sees_few_takers_to_online_sales_tax_amnesty_bid; Penelope Lemov, *The 'Amazon Tax' Battle Escalates*, GOVERNING.COM (Oct. 20, 2010), <http://www.governing.com/topics/finance/amazon-sales-tax-battle-escalates.html#continued>.

117. North Carolina Motion to Dismiss at 4, *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154 (W.D. Wash. 2010) (No. 10-cv-00664-MJP), available at <http://docs.justia.com/cases/federal/districtcourts/washington/wawdce/2:2010cv00664/167064/43/0.pdf>.

118. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1158 (W.D. Wash. 2010).

119. North Carolina Motion to Dismiss, *supra* note 117, at 5.

120. Complaint for Declaratory Relief at ¶ 26, *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154 (W.D. Wash. 2010) (No. 2:10-cv-00664-BAT) (internal quotation marks omitted).

Although Amazon had repeatedly refused to collect use taxes on the state's behalf, the company did respond to the DOR's audit request, providing the DOR with extensive information regarding the millions of purchases that North Carolinians made during the specified time period.¹²¹ In particular, Amazon gave the DOR "the order ID number, seller, ship-to city, county, postal code, the non-taxable amount of the purchase, and the tax audit record identification" as well as the "Amazon Specific Identification Number" ("ASIN") for every purchase made by North Carolina customers from 2003 through 2010.¹²² The ASIN enabled the DOR to access detailed information about every product purchased, including the specific titles of books and videos.¹²³ Amazon, however, did not provide the DOR with the "name, address, phone number, e-mail address or other personally identifiable information of any customer."¹²⁴

Dissatisfied with this response, North Carolina wrote Amazon in March 2010 and reiterated its request for "all information for all sales to customers with a North Carolina shipping address," including the name and address of the payer and of the person to whom the product was shipped.¹²⁵ In addition, the DOR threatened that if Amazon did not provide the requested information, the DOR would file a summons against the company in North Carolina, subjecting Amazon to potential contempt penalties if it did not produce the requested information.¹²⁶ Instead of waiting to be haled into court in North Carolina, Amazon filed suit against the DOR on April 19, 2010, in federal court in the Western District of Washington. In the suit, Amazon sought a declaration that the DOR's request for Amazon to provide "all information" regarding customer

121. *Amazon*, 758 F. Supp. 2d at 1159.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* According to the DOR, the names of specific purchasers were needed "to determine if any exceptions to the sales or use tax apply." *Id.* at 1160. Yet, as the Court noted, the DOR admitted that, absent such information, it would tax Amazon at the highest rates and leave it to Amazon to prove that an exemption or lower tax rate applied. *Id.* Thus, the requested information was not actually necessary for the purposes of auditing Amazon's tax liability, as opposed to determining which North Carolinians owed use taxes.

126. *Id.* at 1159; see N.C. GEN. STAT. § 105-258 (2009) (authorizing the Secretary of Revenue to examine any "books, papers, records, or other data" relevant to "ascertaining the correctness of any return," as well as summoning individuals to produce and testify about the relevant information). Section 105-258 is the state analogue to 26 U.S.C. § 7602 (2006).

purchases—including the identities of consumers and the titles of the expressive materials they purchased—violated (i) the First Amendment speech rights of Amazon and its customers¹²⁷ as well as (ii) the Video Privacy Protection Act.¹²⁸ According to Amazon, if the DOR received the requested information, it would “possess all information necessary to know the expressive content of all purchases from Amazon by individual North Carolina residents,” which would impermissibly chill the speech activity of Amazon’s customers.¹²⁹ Seven individuals represented by the American Civil Liberties Union moved to intervene in the action, raising similar claims under the First Amendment and the Video Privacy Protection Act and explaining that they would stop purchasing expressive material online if the DOR was allowed to track their purchases.¹³⁰

Following cross-motions for summary judgment, the court in *Amazon.com LLC v. Lay* entered an order granting summary judgment to Amazon on its First Amendment claim.¹³¹ The court held that the DOR’s request for “all information for all sales” by Amazon to customers in North Carolina impermissibly chilled speech and

127. The Supreme Court has recognized that organizations can assert the First Amendment rights of others. For example, in *NAACP v. Alabama*, the Court permitted the NAACP to assert the First Amendment rights of its members because the identity of the members, which was the subject of Alabama’s information request and the basis of the First Amendment challenge to that request, would be compromised if the members were forced to appear and personally invoke their First Amendment rights. 357 U.S. 449, 459 (1958); *see also* *Virginia v. Am. Booksellers Ass’n, Inc.*, 484 U.S. 383, 392–93 (1988) (holding that booksellers had standing to assert the First Amendment rights of book buyers).

128. *Amazon*, 758 F. Supp. 2d at 1160. The Video Privacy Protection Act (the “VPPA”), Pub. L. No. 100-618, 102 Stat. 3195 (codified as amended at 18 U.S.C. § 2710 (2006)), was passed in 1988 in response to the press disclosing the video rental records of United States Supreme Court nominee Robert Bork. *See Video Privacy Protection Act*, EPIC.ORG, <http://epic.org/privacy/vppa/> (last visited Aug. 22, 2011). The VPPA “makes it illegal for a video tape service provider,” like Amazon, “to disclose ‘personally identifiable information concerning any consumer.’” *Amazon*, 758 F. Supp. 2d at 1166 (quoting 18 U.S.C. § 2710(b)(1) (2006)). The Washington federal district court found that the DOR’s information request violated the VPPA because it required Amazon to “disclose the personally identifiable information about its customers to the government.” *Id.* at 1167.

129. *Amazon*, 758 F. Supp. 2d at 1159. After Amazon filed its complaint, the DOR informed Amazon that it was “not seeking information regarding the titles of books and CDs purchased by North Carolina customers” and that such specific information was not necessary “to calculate the amount of sales or use tax properly due the State.” *Id.* (internal quotation marks omitted). The DOR, however, refused to amend its initial broad request and, in fact, continued to request the name and bill to and ship to addresses for all sales to North Carolina customers so that it could “determine Amazon’s and its customers’ North Carolina sales and use tax liability.” *Id.* at 1160 (internal quotation marks omitted).

130. *Id.*

131. *Id.* at 1169.

therefore violated the First Amendment.¹³² The court, however, did not grant Amazon the specific relief it requested; rather, the court held that if the DOR destroyed the detailed purchase information it previously received, it could issue a new information request for “information as to only the names and addresses of Amazon’s customers and general product information.”¹³³ Accordingly, we analyze both the court’s conclusion that the DOR’s initial broad request violated the First Amendment and its implicit finding that its proposed, more limited information request does not violate the First Amendment.

A. *Anonymity in Purchasing Expressive Materials: The First Amendment Right of Amazon’s North Carolina Purchasers*

The district court properly held that the DOR’s request to Amazon for “all information” relating to the purchases by North Carolina customers violated the customers’ First Amendment rights.¹³⁴ Although the DOR’s request neither prohibited nor

132. *Id.* at 1170.

133. *Id.* at 1171.

134. In its Complaint, Amazon also invoked its First Amendment rights: “Amazon asserts the privacy and First Amendment rights of itself and of its customers . . . [to be] protected from unnecessary government scrutiny.” See Complaint for Declaratory Relief, *supra* note 120, at ¶ 7. Although the district court did not analyze whether Amazon’s First Amendment rights were implicated, Amazon’s complaint raises an important and previously unresolved question: whether the First Amendment imposes any limits on the government’s ability to compel disclosures pursuant to its taxing power. There is no doubt that the government has broad authority to pursue its tax collection efforts. See *generally* *United States v. Arthur Young & Co.*, 465 U.S. 805, 815–16 (1984) (holding that there is no accountant-client privilege that protects a client’s papers from being disclosed during an IRS audit). But the government’s authority to tax is not unlimited, and when its taxing power implicates the First Amendment, strict scrutiny applies: “A tax that burdens rights protected by the First Amendment cannot stand unless the burden is necessary to achieve an overriding governmental interest.” *Minneapolis Star & Tribune Co. v. Minn. Comm’r of Revenue*, 460 U.S. 575, 582 (1983). Thus, Amazon might argue that the DOR’s information request also implicates its First Amendment rights such that strict scrutiny also should apply to the DOR’s request. *Riley v. Nat’l Fed’n of the Blind of N.C.*, 487 U.S. 781, 798 (1988); *Pac. Gas & Elec. Co. v. Public Utils. Comm’n*, 475 U.S. 1, 19 (1986). After all, the First Amendment protects the right not to speak as well as the right to speak. *Riley*, 487 U.S. at 796–97. And, as the Court has acknowledged, the right to be free from compelled speech applies to companies, such as Amazon, as well as to individuals. *Pac. Gas & Elec.*, 475 U.S. at 1; *First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 776, 777 (1978). Moreover, this right is not limited to compelled political or ideological statements because even “compelled statements of ‘fact’ . . . burden[] protected speech.” See *Riley*, 487 U.S. at 797–98.

Although courts and taxpayers apparently assume that the government can require taxpayers to disclose such information, the Court has not explained whether strict scrutiny applies or whether tax information falls within an exception to the general rules against compelled speech. If strict scrutiny applies, then the request might be

compelled North Carolina consumers to speak, it threatened a particular aspect of consumers' First Amendment rights—the right to receive expressive materials anonymously. But while the district court reached the proper conclusion with respect to the DOR's information request, its reasoning failed to convey the novelty and complexity of the First Amendment issues involved in the case. This failure is evident from the fact that the district court did not even consider whether its proposed alternative—allowing the DOR to destroy the detailed product information and issue a new request for customer identities matched with more generalized information about the products purchased—violates the First Amendment. Accordingly, to provide a more fully developed First Amendment analysis, we consider two separate questions for each proposed request: (i) whether the information request implicates the First Amendment rights of Amazon's customers and, if so, (ii) whether the information request violates those rights under the applicable standard of review.

1. The DOR's Initial Information Request Implicates the First Amendment Rights of Amazon's North Carolina Purchasers

While the text of the First Amendment states only that “Congress shall make no law . . . abridging the freedom of speech, or of the press,”¹³⁵ the Supreme Court has interpreted the protection afforded under the First Amendment broadly. According to the Court, freedom of speech and press include more than the freedom to speak or to publish: “The right of freedom of speech and press includes not only the right to utter or to print, but the right to distribute, the right to receive, the right to read.”¹³⁶ Just as the

unconstitutional because it does not seek “relevant information” regarding Amazon's tax liability. North Carolina is seeking information from Amazon about third parties even though, as the district court acknowledges, that information is not necessary for the DOR to carry out its audit. Is all information relevant provided it has some connection to tax collection or should the Court impose a higher standard to protect the First Amendment rights of individuals and companies? If Amazon has a First Amendment right that shields it from having to provide the identities of its customers when that information is not necessary for (or possibly relevant to) the DOR's calculation of Amazon's tax liability, then Amazon can refuse to provide customer names for all purchases whether or not those purchases involve expressive materials. Thus, *Amazon* raises a unique First Amendment issue regarding the scope of the First Amendment rights of consumers and companies that are required to reveal tax information regarding third parties when that information may not be directly relevant to the calculation of their own tax liability.

135. U.S. CONST. amend. I.

136. *Griswold v. Connecticut*, 381 U.S. 479, 482 (1965); see also *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58, 64–65 n.6 (1963) (“The constitutional guarantee of freedom of the press embraces the circulation of books as well as their publication.”); *Smith v. California*, 361 U.S. 147, 150 (1943) (noting that “the free publication and dissemination of books and

freedom not to speak is a “complementary component” of the right to speak,¹³⁷ the “right [to receive information] is an inherent corollary of the rights of free speech and press. . . . [T]he right to receive ideas is a necessary predicate to the *recipient’s* meaningful exercise of his own rights of speech, press, and political freedom.”¹³⁸

Of course, neither the DOR’s request nor Amazon’s responding to that request directly prohibits consumers from receiving expressive materials from Amazon or other internet retailers. If the DOR’s request sought to limit access to certain books or videos based on the content of those materials, then the First Amendment would be implicated directly.¹³⁹ For example, in *Stanley v. Georgia*,¹⁴⁰ the Court noted that, while obscene materials are unprotected speech under the First Amendment, the First Amendment prohibits a state’s criminalizing the mere possession of obscene materials in one’s home:

If the First Amendment means anything, it means that a State has no business telling a man, sitting alone in his own house, what books he may read or what films he may watch. Our whole constitutional heritage rebels at the thought of giving government the power to control men’s minds.¹⁴¹

According to the Court, the First Amendment secures both “the right to receive information and ideas, regardless of their social worth” and the “right to be free, except in very limited circumstances, from unwarranted governmental intrusions into one’s privacy.”¹⁴²

The DOR, however, expressed no interest in regulating or restricting the ability of retailers or consumers to buy or sell expressive materials. Rather, according to the DOR, it wanted the identities and product purchase information for North Carolina

other forms of the printed word furnish very familiar applications” of the First Amendment); *Martin v. City of Struthers*, 319 U.S. 141, 143 (1943) (“The right of freedom of speech and press has broad scope. . . . This freedom embraces the right to distribute literature . . . and necessarily protects the right to receive it.” (citations omitted)).

137. *Wooley v. Maynard*, 430 U.S. 705, 714 (1977) (“The right to speak and the right to refrain from speaking are complementary components of the broader concept of ‘individual freedom of mind.’” (quoting *W.Va. Bd. of Educ. v. Barnette*, 319 U.S. 624, 637 (1943))).

138. *Bd. of Educ. v. Pico*, 457 U.S. 853, 867 (1982).

139. *Id.* at 867 (holding that the First Amendment precluded the government’s removing books from the shelves of a school library based on the content of those books).

140. 394 U.S. 557 (1969).

141. *Id.* at 565. In *Stanley*, the appellant alleged that the First Amendment provided broad protection for expressive activity, including “the right to be free from state inquiry into the contents of his library.” *Id.*

142. *Id.* at 564.

customers only to properly determine the amount of tax that Amazon and those purchasers owed:

NC Revenue does in fact need information about Amazon's customers in order to properly assess Amazon for sales tax liability. . . . More fundamentally, however, this information is absolutely critical to NC Revenue's ability to assess Amazon's customers for use tax liability. . . . Because Amazon has refused to collect sales taxes on the sales of products it shipped to North Carolina, its customers are liable for the use tax under North Carolina law. Amazon's refusal to provide customer information therefore directly impedes NC Revenue's ability to assess taxes properly due the State.¹⁴³

Even assuming the sincerity of the DOR's claims, though, the district court held that the government's alleged good faith—i.e., that it would use the requested information only for its limited tax purposes and not to deter expressive activity—was insufficient: “While the DOR states that it could not possibly match the names to the purchases, its promise of forbearance is insufficient to moot the First Amendment issue.”¹⁴⁴

Moreover, given the broad protection afforded speech under the First Amendment,¹⁴⁵ the fact that the government is not directly prohibiting the sale or receipt of expressive materials does not end the inquiry. Because the First Amendment also protects freedom from “unwanted governmental intrusion into one's privacy,”¹⁴⁶ First Amendment values are also violated when the government acts in a way that deters or chills First Amendment activity, such as the purchase of expressive materials. As Justice Douglas stated in his oft-quoted concurrence in *United States v. Rumely*¹⁴⁷:

A requirement that a publisher disclose the identity of those who buy his books, pamphlets, or papers is indeed the beginning of surveillance of the press. True, no legal sanction is involved here. Congress has imposed no tax, established no board of censors, instituted no licensing system. But the

143. North Carolina Motion to Dismiss, *supra* note 117, at 11–12.

144. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1169 (W.D. Wash. 2010); *see also* *United States v. Stevens*, 130 S. Ct. 1577, 1591 (2010) (stating that the Court “would not uphold an unconstitutional statute merely because the Government promised to use it responsibly”).

145. *See, e.g.*, *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 891 (2010) (“First Amendment standards, however, ‘must give the benefit of any doubt to protecting rather than stifling speech.’” (citation omitted)).

146. *Stanley*, 394 U.S. at 564.

147. 345 U.S. 41 (1953).

potential restraint is equally severe. . . . Once the government can demand of a publisher the names of the purchasers of his publications, the free press as we know it disappears. Then the spectre of a government agent will look over the shoulder of everyone who reads. The purchase of a book or pamphlet today may result in a subpoena tomorrow. Fear of criticism goes with every person into the bookstall. . . . When the light of publicity may reach any student, any teacher, inquiry will be discouraged. . . . If [a remote retailer] can be required to disclose what [purchasers] read yesterday and what [they] will read tomorrow, fear will take the place of freedom in the libraries, bookstores, and homes of the land. . . . Congress could not do this by law. The power of investigation is also limited. Inquiry into personal and private affairs is precluded.¹⁴⁸

In *Rumely*, the Court considered whether the House Select Committee on Lobbying Activities could compel an organization to disclose the names of people who purchased books “of a particular political tendentiousness.”¹⁴⁹ The majority in *Rumely* did not reach the underlying First Amendment issue, dismissing the case because Congress had not given the legislative committee the power to investigate attempts to influence public opinion.¹⁵⁰ But the Court subsequently has applied Justice Douglas’s First Amendment analysis to protect the constitutional right to anonymity when individuals are engaged in expressive activity.

For example, in *NAACP v. Alabama*,¹⁵¹ the State of Alabama sought the names and addresses of all NAACP members in Alabama. In holding that the constitution provided “immunity from state scrutiny of . . . membership lists,” the Court cited to Justice Douglas’s concurrence in *Rumely* for the proposition that “[i]nviolability of privacy in group association may in many circumstances be indispensable to preservation of freedom of association, particularly where a group espouses dissident beliefs.”¹⁵² Moreover, in *Lamont v. Postmaster General of the United States*,¹⁵³ the Court directly considered a postal regulation that prohibited an addressee from receiving “communist political propoganda” unless he previously filed a written request with the post office.¹⁵⁴ In striking down the

148. *Id.* at 57–58 (Douglas, J., concurring) (citations omitted).

149. *Id.* at 42 (majority opinion).

150. *Id.* at 44, 48.

151. 357 U.S. 449 (1958).

152. *Id.* at 450, 462.

153. 381 U.S. 301 (1965).

154. *Id.* at 302.

regulation, the Court emphasized the deterrent effect of the regulation and noted that such an identification requirement was “at war with the ‘uninhibited, robust, and wide-open’ debate and discussion that are contemplated by the First Amendment.”¹⁵⁵ Similarly, in *Denver Area Educational Telecommunications Consortium, Inc. v. FCC* (“*Denver Area*”),¹⁵⁶ the Court invalidated part of a federal statute that required cable television subscribers to submit a request to view “patently offensive” sexually themed material on leased channels.¹⁵⁷ Pursuant to the statute, cable operators were required to block access to such material and could provide unblocked access only after receiving a written request from a cable subscriber. Focusing once again on the deterrent effect of the restriction, the Court struck down the requirement because it would “further restrict viewing by subscribers who fear for their reputations should the operator, advertently or inadvertently, disclose the list of those who wish to watch the ‘patently offensive’ channel.”¹⁵⁸

Although the district court in *Amazon* did not expressly rely on *NAACP v. Alabama*, *Stanley*, *Lamont*, or *Denver Area*,¹⁵⁹ it acknowledged that the First Amendment “protects a buyer from having the expressive content of her purchase of books, music, and audiovisual materials disclosed to the government.”¹⁶⁰ According to the court, anonymity is important because it “‘exemplifies the purpose behind the Bill of Rights, and of the First Amendment in particular.’”¹⁶¹ Absent the freedom to receive expressive materials anonymously, the government would be able to monitor the reading and viewing habits of its citizens, which, as Justice Douglas emphasized in his *Rumely* concurrence, would limit the *free* exercise

155. *Id.* at 307 (quoting *N.Y. Times Co. v. Sullivan*, 376 U.S. 254, 270 (1964)).

156. 518 U.S. 727 (1996).

157. *Id.* at 733–34.

158. *Id.* at 754.

159. Moreover, the Court has sought to protect anonymity in the context of campaign speech as well. In *Buckley v. Valeo*, the Court recognized that the “invasion of privacy of belief may be as great when the information sought concerns the giving and spending of money as when it concerns the joining of organizations, for ‘[f]inancial transactions can reveal much about a person’s activities, associations, and beliefs.’” 424 U.S. 1, 66 (1976) (Powell, J., concurring) (quoting *California Bankers Ass’n v. Shultz*, 416 U.S. 21, 78–79 (1974) (Powell, J., concurring)). Consistent with these First Amendment cases, the district court properly held that “the First Amendment protects the disclosure of individual’s reading, listening, and viewing habits.” *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1168 (W.D. Wash. 2010).

160. *Amazon*, 758 F. Supp. 2d at 1167.

161. *Id.* (quoting *McIntyre v. Ohio Elections Comm’n*, 514 U.S. 334, 357 (1995)); see also *Talley v. California*, 362 U.S. 60, 64 (1960) (extending anonymity under the First Amendment to the distribution of campaign literature).

of one's First Amendment rights: "Some will fear to read what is unpopular what the powers-that-be dislike. When the light of publicity may reach any student, any teacher, inquiry will be discouraged."'¹⁶² The *Amazon* court's opinion also reflects *Lamon's* concern about the deterrent effect of the government seeking to know who is reading certain types of expressive materials: "The fear of government tracking and censoring one's reading, listening, and viewing choices chills the exercise of First Amendment rights."¹⁶³ Accordingly, the district court properly held that the DOR's request for "all information for all sales to customers with a North Carolina shipping address," implicated the First Amendment rights of Amazon's customers because the request would chill the exercise of the constitutionally-protected right to receive information.¹⁶⁴

2. The DOR's Information Request Fails Heightened Scrutiny and, Therefore, Violates the First Amendment Rights of North Carolinians to Receive Expressive Materials from Remote Retailers Anonymously

Having determined that the First Amendment applied to the DOR's information request, the district court next addressed whether that request actually violated the First Amendment. Although the Supreme Court has recognized the importance of anonymity under the First Amendment, it has not determined the standard of review that applies to information requests that (i) implicate the First Amendment and (ii) arise within the context of the state's exercising its tax collecting authority. As a result, the Washington district court looked to two of the three lower federal court decisions that have addressed the standard for reviewing governmental requests for information that threaten constitutionally-protected anonymity.¹⁶⁵ In both cases, the government issued subpoenas seeking the identities of individuals who purchased expressive materials, and the lower federal courts had to determine whether heightened scrutiny applied.¹⁶⁶

162. *Amazon*, 758 F. Supp. 2d at 1168 (quoting *United States v. Rumely*, 345 U.S. 41, 57–58 (1953) (Douglas, J., concurring)).

163. *Id.*

164. *Id.* In reaching its conclusion that the First Amendment applies, the district court also relied on the "uncontroverted statements" of the intervenors that "they fear the disclosure of their identities and purchases from Amazon to the DOR and that they will not continue to make such purchases if Amazon reveals the contents of the purchases and their identities." *Id.*

165. *Id.*

166. *Id.*

In *In re Grand Jury Subpoena to Amazon.com Dated August 7, 2006* (“*WI Grand Jury*”),¹⁶⁷ the government was investigating an independent book seller suspected of tax evasion. The book seller used Amazon as a platform for making sales.¹⁶⁸ Accordingly, as part of its investigation, the government issued a subpoena duces tecum to Amazon requesting the identities of the book seller’s customers.¹⁶⁹ Although Amazon provided a variety of responsive information, it refused to disclose the identities of its customers, invoking their First Amendment right to privacy in their reading choices.¹⁷⁰ In upholding the book purchasers’ right to anonymity, the court applied a heightened standard of review to the grand jury subpoena, requiring the government “to pass a test of substantial relation or compelling need.”¹⁷¹

Applying this standard, the court found that, even though the government had “a bona fide investigative need” to interview at least some of the book buyers, “the government is not entitled to unfettered access to the identities of even a small sample of this group of book buyers without each book buyer’s permission.”¹⁷² The court denied the government access to the requested information because of its concern over the potentially chilling effect that revealing the identities of book purchasers would have on the exercise of First Amendment rights: “[I]f word were to spread over the Net—and it would—that the FBI and the IRS had demanded and received Amazon’s list of customers and their personal purchases, the chilling effect on expressive e-commerce would frost keyboards across America.”¹⁷³ As a result, the court held that the First Amendment prohibited the government from “peek[ing] into the reading habits

167. 246 F.R.D. 570 (W.D. Wis. 2007).

168. *Id.* at 571.

169. *Id.*

170. *Id.* at 572.

171. *Id.* at 573.

172. *Id.* Ultimately, the court attempted to reach a “compromise” solution by allowing Amazon and the U.S. Attorney’s Office to send letters to a small sample of book buyers explaining to them the government’s need for information about the book seller and requesting for volunteers to provide information. *Id.* at 573, 576. The court specified, however, that the letters would have to explain that “[a]nyone who wishes *not* to participate in this exercise [i.e., the investigation], by virtue of his or her silence, will be left alone, and the government will never learn that person’s identity or the titles of materials he/she purchased from [the book seller under investigation] through Amazon.” *Id.* at 574.

173. *Id.* at 573.

of specific individuals without their prior knowledge or permission.’”¹⁷⁴

Several years earlier, the District Court for the District of Columbia reached the same conclusion regarding the government’s authority to obtain the book purchase records of specific individuals. In *In re Grand Jury Subpoena to Kramerbooks & Afterwords, Inc.*,¹⁷⁵ the court held that the First Amendment prevented the Independent Counsel investigating President Clinton from obtaining the titles of books that Monica Lewinsky purchased from a bookstore.¹⁷⁶ Drawing on Justice Douglas’s opinion in *Rumely*, the court held that the bookstore and Ms. Lewinsky “persuasively alleged a chilling effect on their First Amendment rights.”¹⁷⁷ Given that the First Amendment was implicated, the court required the Independent Counsel to demonstrate that the government had a compelling interest in knowing the specific titles of her purchases and that there was a sufficient nexus between that interest and the ongoing investigation.¹⁷⁸ Because the governing standard had not been clarified previously, the court ordered that the Independent Counsel have an opportunity to make the requisite showing.¹⁷⁹ But the court affirmed the general principle upon which the Washington district court in *Amazon* ultimately relied—that, when the First Amendment rights of consumers are implicated, the government must not simply have a compelling need for information related to its investigation; it must show a compelling need for the specific titles that a particular person purchased.¹⁸⁰

The District Court for the District of Columbia also applied a heightened standard when governmental investigations touch on First

174. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1168 (W.D. Wash. 2010) (quoting *In re Grand Jury Subpoena to Amazon.com*, 246 F.R.D. at 572).

175. 26 Media L. Rep. (BNA) 1599 (D.D.C. 1998).

176. *Id.* at 1600–01.

177. *Id.* at 1600.

178. *Id.* at 1601; *see also* *Bursey v. United States*, 466 F.2d 1059, 1083 (9th Cir. 1972) (setting forth the standard for a grand jury subpoena that triggers the First Amendment: “When governmental activity collides with First Amendment rights, the Government has the burden of establishing that its interests are legitimate and compelling and that the incidental infringement upon First Amendment rights is no greater than is essential to vindicate its subordinate interests.”).

179. *Kramerbooks*, 26 Media L. Rep. (BNA) at 1601.

180. *Id.*; *see also* *Tattered Cover, Inc. v. City of Thornton*, 44 P.3d 1044, 1058 (Colo. 2002) (en banc) (“[T]he law enforcement officials’ need to investigate crime will almost invariably be a compelling one. Thus, the court must engage in a more specific inquiry as to whether law enforcement officials have a compelling need *for the precise and specific information sought*. Yet this more particularized showing captures the nexus requirement, normally considered separately from the government’s interest.”).

Amendment rights in *In re Grand Jury Investigation of Possible Violation of 18 U.S.C. § 1461*,¹⁸¹ which the Washington district court did not cite. In that case, the government sought the names of customers who purchased videos from a company that was being investigated for distributing obscene materials. The federal district court for the District of Columbia followed *Kramerbooks* and *In re Grand Jury Subpoena to Amazon.com* in holding that the First Amendment protects the anonymity of customers.¹⁸² Because the government's request would have a chilling effect on First Amendment activity, the government had to satisfy a heightened standard of scrutiny to obtain the requested information. In particular, the government had to show a compelling need for the records sought "and a sufficient nexus between the records and the grand jury's investigation."¹⁸³ The district court held that the government had failed to meet this standard because, given the other information that the government already had obtained, it lacked a compelling need for the disclosure of the customers' names.¹⁸⁴

181. 706 F. Supp. 2d 11, 17 (D.D.C. 2009).

182. *Id.* ("[T]he expressive materials being investigated are presumptively protected by the First Amendment and Company X's customers have a correlative right to receive that information anonymously.")

183. *Id.* at 18.

184. *Id.* at 21; see *Lubin v. Agora, Inc.*, 882 A.2d 833, 847 (Md. 2005). In *Lubin*, the Maryland court held that the First Amendment precluded the Maryland Securities Commissioner from enforcing a subpoena on a publisher that required the publisher to disclose its subscriber list for certain investment newsletters and the names of those who purchased a certain investment report. Consistent with the federal district court in *Kramerbooks*, the Maryland Supreme Court held that the subpoenas implicated the First Amendment:

Enforcement of the subpoenas would intrude upon the First Amendment rights of Agora's subscribers and customers because disclosure of their subscriber status and purchase of the Report would destroy the anonymity that the Supreme Court has recognized as important to the unfettered exercise of First Amendment freedoms Agora's subscribers may be discouraged from reading its materials if they are interviewed by government personnel investigating potential securities violations, even if the readers are told that, individually, they are not under investigation.

Id. at 846. Based on the application of the First Amendment, the court in *Lubin* applied a heightened "substantial relation" and "compelling interest" standard to the Commissioner's subpoena. *Id.* at 849. The Commissioner failed to meet this standard. *Id.* Although the requested information "might be useful to the . . . [Commissioner's] investigation," the First Amendment precluded the Commissioner from engaging in a " 'fishing expedition,' " i.e., from seeking the identities of individual subscribers and then contacting those individuals in the hope of uncovering additional instances of securities fraud. *Id.* at 847. Because the government lacked any compelling need for this additional information and the effect would be to deter people from buying Agora's products, "[e]nforcement of this demand would 'sacrifice First Amendment protections' for too

The district court in *Amazon*, focusing on the chilling effect caused by the government's monitoring the reading materials of its citizens, also held that the DOR had to satisfy a heightened standard of review before it could obtain the identities and specific titles of expressive materials that Amazon's North Carolina customers bought.¹⁸⁵ In particular, the DOR had to demonstrate "a compelling governmental interest warrants the burden, and that less restrictive means to achieve the government's ends are not available."¹⁸⁶ Drawing on *Kramerbooks* and *In re Grand Jury Subpoena to Amazon.com*, the court also required the DOR to show "a 'substantial relation between the information sought and a subject of overriding and compelling state interest'" in receiving the specific information requested.¹⁸⁷ The requirement that the government establish a "substantial relation" between the State's interest and the specific information requested served to protect First Amendment rights even when the government was fulfilling one of its central functions—tax collection. As *United States v. Arthur Young & Co.*¹⁸⁸ demonstrates, the government always has a compelling interest in collecting taxes and, therefore, gathering information pertinent to that end:

Our complex and comprehensive system of federal taxation, relying as it does upon self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities. Without such disclosure, and the concomitant power of the Government to compel disclosure, our national tax burden would not be fairly and equitably distributed. In order to encourage effective tax

'speculative a gain.'" *Id.* (quoting *CBS v. Democratic Nat'l Comm.*, 412 U.S. 94, 127 (1973)).

185. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1169 (W.D. Wash. 2010) (quoting *United States v. C.E. Hobbs Found.*, 7 F.3d 169, 173 (9th Cir. 1993)).

186. *Id.* (quoting *C.E. Hobbs Found.*, 7 F.3d at 173); *see also* *Beverly v. United States*, 468 F.2d 732, 748 (5th Cir. 1972) ("It is simply a statement of long recognized horn-book principles of constitutional law to say that no government, either state or federal, may encroach upon First Amendment rights without the demonstration of a compelling interest.").

187. *Amazon*, 758 F. Supp. 2d at 1169 (quoting *Gibson v. Fla. Legislative Investigation Comm'n*, 372 U.S. 539, 546 (1963)); *see also* *Buckley v. Valeo*, 424 U.S. 1, 65 (1976) ("This type of scrutiny is necessary even if any deterrent effect on the exercise of First Amendment rights arises, not through direct government action, but indirectly as an unintended but inevitable result of the government's conduct in requiring disclosure."); *St. German of Alaska E. Orthodox Catholic Church v. United States*, 840 F.2d 1087, 1094 (2d Cir. 1988) (stating that disclosure of information pursuant to an IRS summons "should not be ordered unless it is substantially related to a compelling governmental interest").

188. 465 U.S. 805 (1984).

investigations, Congress has endowed the IRS with expansive information-gathering authority¹⁸⁹

When the government's interest in tax collection threatens First Amendment principles, though, the courts impose the additional requirement that the government demonstrate a substantial connection between that compelling interest and the particular information sought—here, the identities of North Carolina residents matched with the titles of their expressive purchases—to ensure that the First Amendment rights of individuals are adequately protected.¹⁹⁰ That is, as the district court noted, “[t]he DOR must ‘actually need[] the disputed information.’”¹⁹¹

Under the court's substantial relation test, though, the resolution of Amazon's First Amendment defense to the DOR's broad request for “all information” about North Carolina purchasers appears relatively straightforward. Because “the DOR's requests for information were made solely in the context of calculating Amazon's potential tax liability,” the DOR had to show a substantial relation between the information sought (“all information” about purchases by North Carolina customers) and the state's interest (calculating Amazon's tax liability).¹⁹² But given that “Amazon has provided all of the data necessary to determine its tax liability, except any potential tax exemptions,” the DOR could not make the requisite showing.¹⁹³ Having received all the information it needed to calculate Amazon's taxes, the DOR had no need for additional information regarding the identities of the individuals who made specific purchases.¹⁹⁴

Although the DOR might want that information to determine whether Amazon qualified for any tax exemptions, the DOR lacked a compelling need to calculate those exemptions. The DOR simply could assess Amazon for the maximum amount of taxes it contended Amazon owed, and then Amazon could present evidence regarding

189. *Id.* at 815–16; *see also In re Grand Jury Proceeding*, 842 F.2d 1229, 1236 (11th Cir. 1988) (finding that a criminal investigation into tax evasion constitutes a compelling need because “[n]o power is more basic to the ultimate purpose and function of government than is the power to tax” (quoting *Bates v. City of Little Rock*, 361 U.S. 516, 524 (1960) (internal quotation marks omitted)); *St. German*, 840 F.2d at 1094 (“[A] compelling governmental interest exists here—that of enforcement of the tax laws.”).

190. The fact that the DOR has a compelling interest in tax enforcement helps explain why the district court adopted the standard used in subpoena cases.

191. *Amazon*, 758 F. Supp. 2d at 1169 (quoting *In re Grand Jury Subpoena to Amazon.com*, 246 F.R.D. 570, 572 (W.D. Wis. 2007)).

192. *Id.*

193. *Id.*

194. *Id.*

whether any of its sales were in fact tax exempt.¹⁹⁵ To the extent that the DOR sought the identities of North Carolinians and the titles of their specific purchases to gather general incriminating evidence about their use tax obligations, such information was not substantially related to “calculating Amazon’s potential tax liability.”¹⁹⁶ Thus, the DOR had no compelling interest in or need for “all information” about North Carolina taxpayers, and its request failed heightened scrutiny review.

B. The District Court’s Modified Relief, Allowing the DOR to Obtain the Identities of North Carolina Consumers and General Information About Their Purchases, May Also Threaten First Amendment Principles

Although the district court held that the DOR’s initial information request violated the First Amendment, it did not grant Amazon’s requested relief to protect the anonymity of North Carolina purchasers completely. Rather, the court stated that the DOR’s “demand[] that Amazon disclose its customers’ names, addresses or any other personal information . . . violates the First Amendment . . . only as long as the DOR continues to have access to or possession of detailed purchase records obtained from Amazon (including ASIN numbers).”¹⁹⁷ Therefore, while the DOR could not obtain customer identities while it continued to possess the detailed purchase information that Amazon previously provided, the court allowed the DOR to “issu[e] a new request for information as to only the names and addresses of Amazon’s customers and general product information, assuming that DOR destroys any detailed information that it currently possesses.”¹⁹⁸

The court’s ultimate holding, then, provides the DOR with a way to obtain the names and addresses of North Carolina purchasers as well as generic information about purchases of expressive materials, e.g., that they bought a book or video.¹⁹⁹ Under the district court’s

195. *Id.* (“[The DOR] admitted that it can and will assess Amazon at the highest rate and it would permit Amazon to challenge the assessment and . . . establish that exemptions or lower tax rates applied to some products.” (internal quotation marks omitted)).

196. *Id.*

197. *Id.* at 1171.

198. *Id.*

199. The court mentions in its Order that starting in 2008 Amazon maintained records with generalized categories of goods sold to customers, e.g., “general books,” “digital books,” “candy,” and “general food.” *Id.* at 1159. Therefore, it would not seem to be an undue administrative burden for Amazon to provide this more generic information to the DOR, at least for periods after 2008.

opinion, neither Amazon's initial disclosure (giving detailed product information but not the identities of purchasers) nor the court's alternative approach (allowing the DOR to receive the identities of purchasers and generic product information) violates the First Amendment rights of consumers.²⁰⁰ That is, the First Amendment protects anonymity, but its protection extends only to the DOR's possessing "both sets of information," i.e., both the identity of each North Carolina purchaser and the detailed product information. If the DOR returned or destroyed the detailed information about each purchase (such that the DOR could not determine the specific titles of books or videos that a specific person bought), the DOR could issue a new request seeking the identity of each purchaser matched with a generic description of the products purchased.

Having spent much of its opinion evaluating whether the First Amendment applied to the DOR's request and what the appropriate standard was, though, the district court simply proposed the modified relief without analyzing whether this new request violates the First Amendment. That is, the court failed to explain why the DOR would have a compelling need for customers' identities and more generalized information about their purchases with respect to determining Amazon's potential tax liability when the court already found that "Amazon ha[d] provided all of the data necessary to determine its tax liability, except any potential tax exemptions."²⁰¹ Instead, the court appears to assume that the First Amendment is not implicated by its proposed information request.

But the district court's order raises a novel and important First Amendment question: whether the First Amendment prohibits the disclosure of the names of individual consumers when the government seeks "generic" information about the expressive materials that the individual purchased. Accordingly, this Article does what the *Amazon* court did not—subject the court's proposed information request to the same First Amendment analysis as the DOR's initial request. In other words, it considers whether the proposed government request to Amazon for customer identities and "generic" purchase information (i) implicates the First Amendment rights of Amazon's customers and, if so, (ii) whether it violates those rights under the applicable standard of review.

200. *Id.* at 1171.

201. *Id.*

1. Does the *Amazon* Court's Codified Information Request Implicate the First Amendment?

As previously explained, government action implicates the First Amendment not only when it prohibits speech but also when it chills the right to receive information.²⁰² Whether the *Amazon* court's proposed information request implicates the First Amendment rights of Amazon customers, then, depends on the chilling effect that the DOR's knowing a specific individual purchased a particular type of expressive material (such as "books" and "DVDs") would have on the individual's willingness to make those purchases. In the most basic terms, whether the court's proposed information request triggers First Amendment protection turns on whether purchasers would hesitate to buy from Amazon if they knew that the company would be required to disclose to the government their identities and the fact that they bought, for example, \$100 worth of "books."

Given that it did not even consider the First Amendment implications of its modified relief, the district court apparently assumed that this type of disclosure would not deter purchasers' willingness to buy books, videos, or other forms of expressive materials from Amazon. If the request did chill speech, then, as the court notes in its discussion of the DOR's initial information request, heightened scrutiny would apply.²⁰³ The DOR would have to show a substantial relation between its compelling interest and the specific information sought. But the district court does not mention, let alone apply, strict scrutiny (or any other standard) after modifying the requested injunctive relief; it simply states that the DOR can request the names and addresses of the individuals who purchased expressive materials as well as generic product information about those materials.²⁰⁴

Although the court fails to explain why the First Amendment does not apply to this modified request, one can imagine the court's reasoning as follows. Amazon, a general retailer, sells an expansive variety of expressive materials on most every subject. Thus, under the court's proposed information request, the government would know only that a particular person bought a "book" or "video;" it would not know the specific titles—or even the general subject matter (e.g., religion, politics, physical or psychological health, gender or sexual topics)—of the expressive materials purchased. Given the lack of

202. *See supra* Part II.A.1.

203. *Amazon*, 758 F. Supp. 2d at 1169.

204. *Id.* at 1172.

specific information about the individual's reading or viewing habits, the government could not determine a specific individual's particular reading habits, and therefore, speech activity would not be chilled. Anonymity, the "shield from the tyranny of the majority,"²⁰⁵ is preserved—at least at the level of *what* information an individual receives, though, admittedly not as to the fact that the individual received any expressive materials at all. But given that the government would not know what consumers were reading or viewing (only that they were purchasing things that could be read or viewed), there would be no corresponding "chill" on speech. And with no chilling effect on speech, the First Amendment simply is not implicated.

This reasoning, though, seems at odds with one of the cases upon which the *Amazon* court relies. In *WI Grand Jury*,²⁰⁶ the Wisconsin district court suggests that the government's asking for the identities of consumers and generic product information triggers First Amendment protection when the product is an "expressive medium."²⁰⁷ In that case, the government sought the identities of book buyers who were "potential witnesses to . . . alleged fraud and tax evasion schemes [of a book seller under investigation] by virtue of having completed financial transactions with him."²⁰⁸ According to the Wisconsin court, "neither the government nor the grand jury [was] directly interested in the actual titles or content of the books that people bought."²⁰⁹ That is, the government was interested in the identities of consumers only because they had bought "books" from the book-seller. Nevertheless, the *WI Grand Jury* court expressed concern over the potential chilling effect that disclosure of the book buyers' identities might have and, therefore, prohibited the government from obtaining "unfettered access to the identities of even a small sample of . . . book buyers without each book buyer's permission."²¹⁰ Explaining its reason for apprehension, the *WI Grand Jury* court stated:

In this era of public apprehension about the scope of the USAPATRIOT Act, the FBI's (now-retired) "Carnivore"

205. *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 357 (1995) (holding that an Ohio prohibition against distributing anonymous campaign literature violated the First Amendment).

206. 246 F.R.D. 570 (W.D. Wis. 2007).

207. *Id.* at 572.

208. *Id.*

209. *Id.*

210. *Id.* at 573.

Internet search program, and more recent highly-publicized admissions about political litmus tests at the Department of Justice, rational book buyers would have a non-speculative basis to fear that federal prosecutors and law enforcement agents have a secondary political agenda that could come into play when an opportunity presented itself. Undoubtedly a measurable percentage of people who draw such conclusions would abandon online book purchases in order to avoid the possibility of ending up on some sort of perceived “enemies list.”²¹¹

Given that the government is requesting the identity of purchasers of expressive materials, even if it did not seek the titles or specific information relating to those expressive materials, deterred First Amendment activity, the court held that heightened scrutiny should apply.²¹² But the *WI Grand Jury* court did not articulate a clear standard for determining when government action has a chilling effect on First Amendment activities. The court mentioned a “rational book buyer[]” and speculated that a “measurable percentage” of such rational book buyers would stop online purchases if they believed the government would discover their reading habits.²¹³ These references suggest a “reasonable person” standard for deciding whether government’s information seeking chills the First Amendment activity of online book buyers. Yet at the same time, the *WI Grand Jury* court expressly stated that it “should concern itself with blogger outrage disproportionate to the government’s actual demand of Amazon” because “*well-founded or not*, rumors of an Orwellian federal criminal investigation into the reading habits of Amazon’s customers could frighten countless potential customers into canceling planned online book purchases, now and perhaps forever.”²¹⁴ That is, despite its previous mention of a “rational book buyer,” the court seems to apply a “subjective concern” standard in assessing whether government inquiries impermissibly deter speech activity. And, of course, the more subjective the standard is for determining whether government action chills First Amendment activity, the broader the protection is for anonymity—and, consequently, the more difficult it is for the DOR to obtain information regarding individual consumers’ use tax liability.

211. *Id.* In this way, the court’s reasoning is similar to Justice Douglas’s position in *Rumely*. See *supra* note 148 and accompanying text.

212. *WI Grand Jury*, 246 F.R.D. at 573.

213. *Id.*

214. *Id.* (emphasis added).

Moreover, even though the court acknowledged that the government had no interest in the titles of any books that the potential witnesses had purchased, the court noted that “it is an unsettling and un-American scenario to envision federal agents nosing through the reading lists of law-abiding citizens while hunting for evidence against somebody else.”²¹⁵ Under this view of the First Amendment, then, the *Amazon* court’s modified relief—allowing the DOR to obtain the identities of North Carolina purchasers and generic product information about each purchase—threatens anonymity in its own way. Although the DOR would not be able to connect a specific title to a specific purchaser, it would know, at a minimum, how many books, movies, magazines, or other expressive materials each North Carolinian bought, the name of the remote retailer or publisher who sold the materials, and the cost of each purchase. If, as the *WI Grand Jury* court suggests, citizens’ subjective concern (whether “well-founded or not”) over the threat of government intrusion into their reading habits is sufficient to implicate First Amendment protection, then the *Amazon* court’s proposed information request could be found to chill the receipt of expressive materials, thereby infringing on the First Amendment rights of Amazon’s North Carolina customers.

Furthermore, under this “subjective concern” standard, the uncontroverted testimony of the intervenors in the *Amazon* case might be used to support the Wisconsin district court’s view that the disclosure of even generic product information with respect to expressive materials may chill the reading and viewing habits of consumers. In her complaint in the *Amazon* case, intervenor Jane Doe 1 stated that her former spouse developed substance abuse and domestic violence problems and that she purchased self-help books from Amazon to help her understand the problems and to pursue a divorce.²¹⁶ As set out in her complaint, Jane Doe 1 wanted her purchases to remain anonymous.²¹⁷ And, given her situation, she would want that anonymity to extend to the fact that she was purchasing expressive materials at all.²¹⁸ That is, she would not want her abusive spouse to know that she secretly was purchasing any

215. *Id.* In *WI Grand Jury*, the government had not asked for any reading lists; it had requested only witness identities, so there was no possibility of government agents “nosing through” reading lists. *Id.*

216. Complaint in Intervention for Declaratory and Injunctive Relief at 16, *Amazon.com, LLC v. Lay*, 758 F. Supp. 2d 1154 (W.D. Wash. 2010) (No. 2:10-cv-00664-MJP).

217. *Id.*

218. *Id.*

books, even if he did not know the specific titles of those books. Yet the forced disclosure of her purchases by Amazon to the DOR, and a subsequent audit of Jane Doe 1 and her husband based on that disclosure, could lead to his discovering those purchases.²¹⁹ As a result, consumers like Jane Doe 1 might elect to stop purchasing expressive materials online so as to avoid the possible disclosure of their book purchases to the government (and perhaps others).

Similarly, other consumers might worry about the government's learning that they purchased expressive materials (such as books or videos), regardless of whether this information is ever disclosed to a third party and, under the *WI Grand Jury* subjective concern standard, whether their worries are well-founded. The fact that the government knows that they are purchasing expressive materials might be enough for some consumers to alter their purchasing habits even if the government has no intention of using that information for a nefarious purpose.²²⁰

Thus, whether the *Amazon* court's modified information request implicates the First Amendment depends on the standard used to determine whether government actions chill First Amendment activity. If a "reasonable person" standard is used, as courts have done in the campaign speech context,²²¹ then the court would have to make a threshold determination as to whether a hypothetical reasonable person would be deterred by the government's request. Under such a standard, the testimony of one person (or a few people)

219. Moreover, each of the intervenors in the North Carolina Amazon case stated that they intended to continue buying expressive materials through the internet but that their "behavior will be changed as each time [they] purchase[] certain items in the future, [they] will seriously have to consider whether to purchase them on a website if the State is able to obtain that information." *Id.* at 20. Other intervenors expressed similar intentions. *Id.* at 18, 21–25. If some North Carolinians will be deterred from engaging in First Amendment activity because the government is inquiring into their purchasing habits, the chilling effect—and, therefore, the burden on the First Amendment—might be the same even if the government does not know the specific title of the book or video.

220. See *United States v. Stevens*, 130 S. Ct. 1577, 1591 (2010) (holding that the Court "would not uphold an unconstitutional statute merely because the Government promised to use it responsibly").

221. *In re Grand Jury Proceeding*, 842 F.2d 1229, 1235–36 (11th Cir. 1988) (holding in the context of campaign speech "that a merely subjective fear of future reprisal is insufficient to establish a restraint on freedom of association. The Supreme Court recognized the difficulties of formally proving the evils of chill and harassment, however, and accordingly required only that minor parties show 'a reasonable probability that the compelled disclosure . . . will subject them to threats, harassment, or reprisals from either Government officials or private parties.'" (quoting *Buckley v. Valeo*, 424 U.S. 1, 74 (1976))); see also *Brown v. Socialist Workers '74 Campaign Comm'n*, 459 U.S. 87, 101–02 (1982) (invalidating a campaign disclosure provision as applied to the Socialist Workers Party).

would not be sufficient by itself to establish a chilling effect. Rather, the court would have to make its own assessment, determining whether the disclosure of the identities of online purchasers and generic information about their purchases would chill the First Amendment activity of a reasonable person. Under this standard, a court may find that the *Amazon* court's modified request does not implicate the First Amendment because the government obtains no information about the political, religious, or other personal preferences, beliefs, or views of the consumer; rather, the government learns only that a consumer purchased a certain amount of expressive materials.

On the other hand, if a "subjective concern" standard is used, the court could determine, based on affidavits or the court's own analysis, that the government's seeking of information about the amount of expressive materials purchased by specific individuals would deter some consumers from purchasing expressive materials online—whether the basis for their decision to stop buying expressive materials is well-founded or not. Under this analysis, the chilling effect caused by the government's attempt to obtain even generic purchase information, as authorized by the *Amazon* court's modified information request, might "frost keyboards across America" and, therefore, implicate the First Amendment rights of Amazon's North Carolina customers.²²²

2. Does the *Amazon* Court's Modified Information Request Violate the First Amendment?

If the modified information request for generic purchase information does not implicate the First Amendment, as assumed by the *Amazon* court, then, of course, it does not violate the First Amendment. But if the government's request for the names of purchasers and generic product information chills First Amendment activity (as could be the case under the *WI Grand Jury* "subjective concern" standard), then the DOR must demonstrate that it "needs" the information—i.e., that the DOR has a compelling interest and that there is a "substantial relation" between its compelling interest and the specific information sought.²²³

Given the narrow scope of the DOR's audit ("the DOR's document request to Amazon is not part of an investigation of North

222. *WI Grand Jury*, 246 F.R.D. 570, 573 (W.D. Wis. 2007).

223. *Id.*

Carolina residents' tax liability"),²²⁴ though, the DOR would have a difficult time showing a compelling need for *any* information matching consumers with their purchases, whether detailed or generic. As explained by the court, Amazon already had provided the DOR all the information it needed to assess Amazon's maximum potential sales tax liability.²²⁵ For this reason, the *Amazon* court rejected the DOR's explanation for wanting detailed customer purchase information. Because the DOR's desire for detailed customer purchase information was not "substantially related" to "calculating Amazon's potential tax liability," the *Amazon* court held that the DOR's request violated the First Amendment.²²⁶ But the analysis is the same if the DOR requests generic purchase information.²²⁷ Given that the DOR already has enough information to determine Amazon's tax liability, it does not need the identities of North Carolina purchasers. The court's modified request, therefore, lacks a substantial nexus between the government's alleged interest (verifying Amazon's tax liability) and the information sought (the identities of consumers and generic information about their purchases).²²⁸

Moreover, even if the *Amazon* court considered the information request in connection with the potential use tax liability of Amazon's North Carolina consumers, it is not clear that the request would pass the heightened scrutiny standard that the court adopted. Because "the DOR [had] not made a showing that its investigation of Amazon is the only way to acquire such information,"²²⁹ the court's modified request would not be the "least restrictive means" of obtaining the desired information.²³⁰ The DOR could pursue a variety of actions to improve use tax compliance without infringing on the First Amendment rights of North Carolina consumers—e.g., conducting an enhanced educational campaign to inform taxpayers about their

224. *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1164 (W.D. Wash. 2010).

225. *Id.* at 1169.

226. *Id.*

227. As the Maryland Supreme Court held in *Lubin v. Agora, Inc.*, "[a]lthough access to this information might be useful to the Division's investigation, the State has not shown that it has any compelling need for its disclosure." 882 A.2d 833, 847 (Md. 2005).

228. *Amazon*, 758 F. Supp. 2d at 1169 ("There must also be a 'substantial relation between the information sought and a subject of overriding and compelling state interest.'" (quoting *Gibson v. Fla. Legislative Investigation Comm'n*, 372 U.S. 539, 546 (1963))).

229. *Id.* at 1164.

230. *Id.* at 1169.

obligations,²³¹ enforcing its Amazon law, pursuing other types of legislation that might avoid *Quill*, and auditing individual taxpayers. Thus, whether the *Amazon* court's modified relief violates the First Amendment rights of North Carolina consumers depends in large measure on the standard that a court uses to determine whether such an information request chills speech. Therefore, if the DOR decides to issue a new request for information consistent with the *Amazon* court's order, it should be prepared to argue that a reasonable person standard should govern the court's analysis of whether the request chills First Amendment activity.

III. A POSSIBLE NEXT STEP IN NORTH CAROLINA'S USE TAX COLLECTION EFFORTS: A USE TAX REPORTING STATUTE

With over \$18 billion in North American sales last year, Amazon is a major player in the e-commerce world, but it is, of course, only one of the thousands of internet retailers. Moreover, pursuing Amazon alone does little to capture the majority of the estimated \$160 to \$180 million in use taxes that currently go unpaid in North Carolina.²³² As a result, the DOR may look to expand its efforts to obtain customer purchase information by seeking the same information from other retailers. This would enable the DOR to pursue additional delinquent North Carolina taxpayers directly.

Given the Washington district court's decision, North Carolina seems to have two primary ways to expand its use tax information collection efforts. First, the DOR could audit more companies that do not collect sales or use tax ("non-collecting retailers") and issue information requests modeled after the district court's modified relief. If the courts adopted a reasonable purchaser standard, then, as we discuss above, such requests might survive First Amendment challenges. But audits are costly, time-consuming, and often lead to litigation, as demonstrated by the *Amazon* case. For these reasons, North Carolina might instead consider a second option—enacting a statute pursuant to which all non-collecting retailers would have to report purchases by North Carolina customers to the DOR. In effect, North Carolina would seek customer purchase information from all remote retailers, removing the need to audit individual companies to get information about North Carolina purchasers. To date, one other

231. Govind S. Iyer et al., *Successfully Increasing Compliance in Washington State*, TAX ANALYSTS: SPECIAL REPORT, July 6, 2010, at 9 (analyzing the effect on use tax compliance of Washington's efforts to educate its taxpayers about their use tax obligations).

232. BRUCE ET AL., *supra* note 3, at 11.

state, Colorado, has taken this approach by passing the first use tax reporting statute in 2010.²³³ Based on the interest of other states in enacting similar statutes, the Multistate Tax Commission (“MTC”)²³⁴ is currently drafting a model use tax reporting statute using the Colorado law as a template.²³⁵

Although an attractive solution to North Carolina’s use tax collection problems, a use tax reporting statute presents its own potential constitutional concerns around which North Carolina would have to navigate. For example, in January 2011, a federal district court in Colorado entered an order enjoining the state’s use tax reporting statute²³⁶ while the Direct Marketing Association²³⁷ (the “DMA”) and the Colorado Department of Revenue litigate the statute’s constitutionality. Although the DMA contends that requiring non-collecting retailers to report information about their sales violates both the dormant Commerce Clause and the First Amendment, the Colorado federal district court’s preliminary injunction order focused only on the dormant Commerce Clause claim, finding that there was a substantial likelihood that the reporting statute violates this constitutional doctrine.²³⁸ As we discuss below, contrary to the Colorado court’s analysis, there is reason to believe that a Colorado-style reporting statute could survive dormant Commerce Clause review.

But the dormant Commerce Clause is not the only hurdle facing such a reporting statute. After examining how the statute operates

233. COLO. REV. STAT. § 39-21-112(3.5) (2010).

234. The Multistate Tax Commission “is an intergovernmental state tax agency working on behalf of states and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises.” *About the Multistate Tax Commission*, MULTISTATE TAX COMM’N, <http://www.mtc.gov/About.aspx?id=40> (last visited Aug. 22, 2011).

235. For a copy of the draft model statute, see SALES & USE TAX UNIFORMITY SUBCOMM., MULTISTATE TAX COMM’N, DRAFT MODEL SALES & USE TAX NOTICE AND REPORT ACT (2011), *available at* [http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Minutes/Model%20Use%20Tax%20Notice%20and%20Reporting%20Act%201-28-11%20Showing%20Markup%20from%20December%207\(3\).pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Minutes/Model%20Use%20Tax%20Notice%20and%20Reporting%20Act%201-28-11%20Showing%20Markup%20from%20December%207(3).pdf).

236. Order Granting Motion for Preliminary Injunction, *Direct Mktg. Ass’n v. Huber*, No. 10-cv-1546-REB-CBS, 2011 WL 250556 (D. Colo. Jan. 26, 2011) [hereinafter *DMA Injunction*], *available at* <http://www.the-dma.org/segment/segmentfiles/catalogers/20110126OrderGrantingPI.pdf>.

237. The Complaint in the action describes the DMA as “the nation’s largest trade association of organizations marketing products directly to consumers via mail order, telephone orders, and the Internet.” Complaint at ¶ 2, *Direct Mktg. Ass’n v. Huber*, No. 10-cv-1546-REB-CBS (D. Colo. June 30, 2010), *available at* <http://www.digestiblelaw.com/files/Uploads/Documents/DMA%20Complaint.pdf>.

238. *DMA Injunction*, *supra* note 236, at 5. The challengers did not argue the First Amendment claim in their preliminary injunction motion.

and the Commerce Clause issues it raises, we consider an issue that no court has yet addressed—whether the reporting statute violates the First Amendment. Unlike the court’s modified relief entered in the *Amazon* case, both the Colorado reporting statute and the draft MTC reporting statute do not call for any information about the goods purchased. Instead, these statutes ask only for the total amount of purchases by the individual consumer from the retailer. But even this most “generic” of information reporting requirements could implicate the First Amendment when applied to some retailers. Therefore, North Carolina legislators would have to draft the reporting statute to exempt certain retailers or categories of expressive materials. This would present a difficult line-drawing exercise that ultimately may reduce the statute’s effectiveness. Therefore, we conclude that while North Carolina should consider enacting a Colorado-style reporting statute, such a statute, standing alone, will not solve the state’s serious use tax compliance problem.

A. *A Model for North Carolina?—The Colorado Use Tax Reporting Statute*

In 2010, when the Colorado General Assembly first considered enacting legislation to address the problem of use tax non-compliance, it considered an Amazon law similar to those enacted in New York, North Carolina, and Rhode Island.²³⁹ Given concerns that Amazon and other major out-of-state internet retailers would terminate their commission agreements with Colorado marketing companies (as they had in North Carolina and Rhode Island), the Colorado legislature decided against an Amazon law. Instead, the General Assembly passed House Bill 10-1193 (“HB 1193”),²⁴⁰ Colorado’s use tax reporting statute.

Unlike an “Amazon” law, HB 1193 neither seeks to avoid *Quill* by imputing physical presence nexus based on click-through agreements, nor requires remote retailers to collect use taxes.²⁴¹ Rather, the statute imposes reporting requirements on non-collecting

239. Chuck Berry, Guest Commentary, *Ignoring the Impact of Tax Increases on Businesses*, DENVER POST, Feb. 22, 2010, http://www.denverpost.com/search/ci_14445194.

240. Act of Feb. 24, 2010, ch. 9, 2010 Colo. Sess. Laws 54 (codified at COLO. REV. STAT. § 39-21-112(3.5) (2010)). Ironically, despite the fact that HB 1193 does not impose physical presence nexus based on marketing relationships, Amazon still elected to terminate its commission agreements with Colorado marketing companies after enactment of the statute. See Geoffrey A. Fowler, *Amazon Hits Back at Colorado Web Sales Tax*, WALL ST. J., Mar. 9, 2010, at B4, available at <http://online.wsj.com/article/SB10001424052748704869304575110040812179072.html>.

241. Ch. 9, 2010 Colo. Sess. Laws 54.

retailers that serve two purposes: (i) an educational function, notifying Colorado purchasers of their obligation to pay use tax on goods purchased from non-collecting retailers, and (ii) a verification function, allowing the Colorado Department of Revenue to determine whether Colorado purchasers are in fact paying the use tax they owe.²⁴² To accomplish these goals, HB 1193 requires non-collecting retailers to:

- i. provide notice with each sale to a Colorado purchaser²⁴³ that the purchase is not exempt from Colorado sales or use tax merely because it is made over the internet and that the purchaser may be required to pay tax to the Department of Revenue (the “Transactional Notice”),²⁴⁴
- ii. provide an annual summary to Colorado purchasers of purchases made during the previous calendar year if the purchaser bought more than \$500 in goods from the retailer over that period (the “Annual Customer Report”);²⁴⁵ and

242. *Id.*

243. For the regulatory definition of a “Colorado purchaser,” see COLO. CODE REGS. § 39-21-112(3.5)(1)(b) (2010).

244. See COLO. DEP’T OF REVENUE, FYI SALES 79, SALES OF TAXABLE ITEMS OVER THE INTERNET 2 (2010), available at <http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application/pdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251668367920&ssbinary=true>. The Transaction Notice must:

- State that the retailer does not collect Colorado sales or use tax.
- State that the purchase is not exempt from Colorado sales or use tax merely because it is made over the Internet or by other remote means.
- State that the State of Colorado requires Colorado purchasers to file a sales or use tax return at the end of the year for all taxable Colorado purchases that were not taxed, and pay tax on those purchases.
- The notice must be easily seen and located near the total price.

Id.

245. Under Department of Revenue guidance, the Annual Customer Report must:

- Be sent by first class mail to the last known address by January 31 of the following year in an envelope prominently marked with the words “Important Tax Document Enclosed.
- Summarize the date(s) of purchase(s), a general description of the item(s) (e.g., “books,” “consumer electronics,” “household appliances”) and the dollar amount(s) of the purchase(s).
- State that the State of Colorado requires that the consumer file a sales or use

iii. file an annual report with the Department of Revenue identifying each Colorado purchaser and setting forth the total amount of purchases by the purchaser from the retailer during the prior calendar year, without separating purchases into categories or providing any information about the products purchased other than the aggregate purchase amount (the “Annual Retailer Report”).²⁴⁶

The Transactional Notice and Annual Customer Report inform Colorado purchasers that they are required to pay use taxes, while the Annual Retailer Report assists the Colorado Department of Revenue in determining whether Colorado purchasers have complied with that obligation.

Colorado’s reporting statute provides an exemption for any non-collecting retailer with gross sales of less than \$100,000 in Colorado.²⁴⁷ But a retailer that exceeds this *de minimis* exemption and fails to comply with the reporting requirements is subject to substantial penalties. In particular, each separate failure to provide a Transactional Notice subjects the non-collecting retailer to a \$5 penalty.²⁴⁸ Each failure to provide either an Annual Customer Report or an Annual Retailer Report carries a \$10 penalty.²⁴⁹ Although the Colorado Department of Revenue’s regulatory guidance limits these penalties in the first year, a non-collecting retailer is required to meet the reporting requirements of HB 1193,²⁵⁰ and such retailers still confront the possibility of hefty fines for failing to comply with the reporting requirements.

tax return at the end of every year and pay the tax on Colorado purchases that did not include tax.

- Indicate that the retailer is required by law to provide the Colorado Department of Revenue the total dollar amount of purchases made by Colorado consumers, however no information about the purchases other than the dollar amount will be provided.

Id.

246. The annual retailer report must include: “The name(s) of all the Colorado purchasers; [t]he billing address of all the Colorado purchasers; [t]he shipping addresses of all the Colorado purchasers; [t]he total dollar amount of purchases made by each customer in Colorado for the previous year.” *Id.*

247. COLO. CODE REGS. § 39-21-112(3.5)(1)(a)(iii) (2010). The exemption considers the amount of sales in the previous year and the expected sales in the current year.

248. COLO. REV. STAT. § 39-21-112(3.5)(c)(II) (2010).

249. § 39-21-112(3.5)(d)(III).

250. COLO. CODE REGS. § 39-21-112(3.5)(2)(f), (3)(d), (4)(f).

1. North Carolina and the Dormant Commerce Clause Challenge to a Colorado-Style Reporting Statute

In granting the DMA's preliminary injunction motion against HB 1193, the Colorado federal district court relied on two dormant Commerce Clause arguments. First, the court found that the DMA had shown a substantial likelihood that the reporting requirements do what the dormant Commerce Clause forbids—discriminate against interstate commerce.²⁵¹ Specifically, the court held that HB 1193 discriminates “because, in practical effect, [it] impose[s] a burden on interstate commerce that is not imposed on in-state commerce.”²⁵² Second, the court found that the reporting requirements most likely violate *Quill's* physical presence requirement because out-of-state retailers are required to comply with a statute that has as its “sole purpose” the goal of “enhanc[ing] the collection of use taxes by the State of Colorado.”²⁵³ Given that (i) *Quill* prohibits the state from requiring out-of-state retailers to collect use tax and (ii) HB 1193's reporting requirements relate solely to the collection of use tax, the district court concluded that *Quill* also prohibits the state from requiring out-of-state retailers to comply with these reporting requirements.²⁵⁴

In concluding that HB 1193 discriminates against interstate commerce though, the court failed to consider whether the disparate treatment of out-of-state retailers was based on legitimate, non-protectionist reasons. The Supreme Court has indicated in its recent decisions that these are relevant considerations, signaling a somewhat more permissive approach to its dormant Commerce Clause analysis.²⁵⁵ Moreover, this Article contends that the Colorado court inappropriately extended *Quill's* physical presence requirement to Colorado's reporting statute. Given that reporting statutes do not impose the same administrative burdens as tax collection statutes, the Court's analysis in *Quill* should not be extended to reporting requirements. *Quill's* physical presence requirement was predicated, in part, on the substantial burden created by a company's having to track numerous tax rates for jurisdictions across the country.²⁵⁶ This

251. DMA Injunction, *supra* note 236, at 4.

252. *Id.* at 7.

253. *Id.* at 10.

254. *Id.*

255. See *infra* Part III.A.3.

256. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992). *Quill* also relied on *stare decisis* grounds in reaching its holding, as the Court re-affirmed the physical presence

concern, though, does not apply to the disclosure of information that companies already keep and maintain. In addition, rather than erecting a barrier to disadvantage out-of-state commerce, a use tax reporting statute actually seeks to promote the principles underlying the dormant Commerce Clause by reducing the artificial competitive advantage enjoyed by out-of-state retailers resulting from consumers' almost complete disregard for their use tax obligation. Therefore, this Article contends that use tax reporting statutes, whether enacted in Colorado or North Carolina, should survive dormant Commerce Clause review, the Colorado federal court's decision to grant a preliminary injunction notwithstanding.

2. The Dormant Commerce Clause and Discrimination Against Interstate Commerce

The Commerce Clause authorizes Congress "to regulate Commerce with foreign Nations, and among the several States."²⁵⁷ It says nothing about the protection of interstate commerce in the absence of congressional action. Nevertheless, the Supreme Court has interpreted the Commerce Clause to have a "negative sweep as well, . . . prohibit[ing] certain state actions that interfere with interstate commerce."²⁵⁸

The historical context of the Commerce Clause helps to explain why use tax reporting statutes comport with, rather than violate, the principles underlying the dormant Commerce Clause doctrine. The Framers gave Congress broad power over interstate commerce to prevent "the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation."²⁵⁹ Left to pursue their own economic interests, states enacted protective tariffs against goods

standard introduced twenty-five years earlier in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967). *Quill*, 504 U.S. at 317.

257. U.S. CONST. art. I, § 8, cl. 3.

258. *Quill*, 504 U.S. at 309.

259. *Hughes v. Oklahoma*, 441 U.S. 322, 325–26 (1979); see also *W. Lynn Creamery v. Healy*, 512 U.S. 186, 193 n.9 (1994) ("The 'negative' aspect of the Commerce Clause was considered the more important by the 'father of the Constitution,' James Madison. In one of his letters, Madison wrote that the Commerce Clause 'grew out of the abuse of the power by the importing States in taxing the non-importing, and was intended as a negative and preventive provision against injustice among the States themselves, rather than as a power to be used for the positive purposes of the General Government.'" (quoting MAX FARRAND, *THE RECORDS OF THE FEDERAL CONVENTION OF 1787*, at 478 (1911))).

brought into a state by out-of-state merchants.²⁶⁰ These tariffs prevented outsiders from competing on equal footing with local businesses.²⁶¹ As Justice Jackson explained, the Commerce Clause provided the national government with the means to protect nationwide commerce:

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.²⁶²

Thus, the dormant Commerce Clause doctrine developed as a means of preventing the states from creating artificial barriers to the free flow of commercial goods to protect local merchants from fair and robust competition by “outsiders.” This concern over protectionist legislation explains why the modern test for assessing whether a state statute violates the dormant Commerce Clause involves a determination of whether the statute “discriminates” against interstate commerce.²⁶³ This determination is critical because if a statute discriminates, it is subjected to strict scrutiny, which is almost always fatal to the state legislation. On the other hand, a “nondiscriminatory” statute challenged under the dormant Commerce Clause is subjected to the less rigorous (though highly unpredictable) *Pike* balancing test, which requires the court to weigh the statute’s benefits and burdens.²⁶⁴ As explained by one scholar:

260. See *Quill*, 504 U.S. at 312 (“Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills.”).

261. *W. Lynn Creamery*, 512 U.S. at 193 (“The paradigmatic example of a 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.”).

262. *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 539 (1949).

263. The only cases in which a “discriminatory” law survives under the dormant Commerce Clause relate to issues of health and safety or the integrity of natural resources. See, e.g., *Maine v. Taylor*, 477 U.S. 131, 142–43, 151–52 (1986) (upholding a statute prohibiting the importation of out-of-state baitfish to prevent the introduction of parasites or non-native species); *Clason v. Indiana*, 306 U.S. 439, 443–44 (1939) (upholding a quarantine law because of the safety issues involved).

264. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

For those state or local laws that “discriminate,” on their face or in their purposes or effects, against interstate commerce or interstate commercial actors, strict scrutiny applies, requiring the government to demonstrate a legitimate (i.e., non-protectionist) purpose for the law, and that there are no less discriminatory means to effectuate that interest. It is a test that is nearly always fatal in fact. For nondiscriminatory measures that nevertheless burden interstate commerce, a deferential balancing test is employed: to prevail, the challenger must demonstrate that the burdens on interstate commerce are “clearly excessive in relation to the putative local benefits.”²⁶⁵

The initial inquiry, then, in assessing a use tax reporting requirement under the dormant Commerce Clause is to determine whether the statute discriminates in purpose or effect against interstate commerce or interstate commercial actors. To make this determination, courts typically consider whether the statute under review treats in-state economic interests more favorably than out-of-state economic interests. As explained by the Supreme Court in *Oregon Waste Systems v. Department of Environmental Quality*,²⁶⁶ a law discriminates if it imposes “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”²⁶⁷ The discrimination in *Oregon Waste Systems* was apparent on the face of the statute—Oregon placed a higher surcharge on the transfer and handling of out-of-state waste brought into Oregon than on the transfer and handling of in-state waste.²⁶⁸ Moreover, the different surcharges were based solely on the waste’s geographic place of origin rather than on any characteristic of out-of-state waste that would make it more costly to handle than in-state waste.²⁶⁹ Because Oregon offered no reason for charging a higher fee on out-of-state waste based on the nature of the waste rather than its place of origin,²⁷⁰ the Court found Oregon’s statute discriminated against interstate commerce.

265. Brannon P. Denning, *Reconstructing the Dormant Commerce Clause Doctrine*, 50 WM. & MARY L. REV. 417, 421–22 (2008).

266. 511 U.S. 93 (1994).

267. *Id.* at 99.

268. *Id.* at 96.

269. *Id.* at 101.

270. *Id.* at 106. The justification that Oregon offered for the surcharge was that in-state companies bore other tax burdens that out-of-state companies did not have to bear, including state income taxes. As a result, higher surcharge on companies disposing of out-of-state waste helped to level the competitive market between in-state and out-of-state companies. In effect, Oregon argued that the surcharge on out-of-state waste served as a compensatory tax. The Court, however, found that the additional tax burden borne by in-

The Colorado federal district court in *DMA* applied this “differential treatment” standard to conclude that HB 1193 discriminates against interstate commerce.²⁷¹ Although on its face HB 1193 applies even-handedly to all non-collecting retailers, whether in-state or out-of-state, in practice the statute’s reporting requirements apply only to out-of-state retailers because in-state retailers are required, subject to civil and criminal penalties, to collect Colorado sales tax.²⁷² Therefore, in-state retailers are not “non-collecting retailers” under HB 1193, and the reporting requirements never apply to them. Because the reporting requirements apply only to out-of-state retailers, the Colorado court concluded that HB 1193 discriminates against interstate commerce under *Oregon Waste Systems*.²⁷³

After finding HB 1193 to be discriminatory, the *DMA* court applied the dormant Commerce Clause’s strict scrutiny standard of review to the statute.²⁷⁴ Under this heightened standard, the court considered whether the state would be able to “justify [the reporting requirements] both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake.”²⁷⁵ But despite acknowledging that Colorado’s “need to collect tax revenue” constitutes a “legitimate local interest,”²⁷⁶ the court found at least one non-discriminatory alternative for achieving this interest: the state could provide a line on the Colorado income tax return where taxpayers could report the use taxes they owe.²⁷⁷ Because allowing taxpayers the opportunity to report their use tax liability on their income tax return could improve use tax compliance without

state companies related to an activity (generation of income) qualitatively different than the activity to which the surcharge on out-of-state waste applied (hauling waste). It therefore rejected Oregon’s compensatory tax argument. *Id.* at 102.

271. *DMA Injunction*, *supra* note 236, at 4.

272. COLO. REV. STAT. §§ 39-26-103(4), 26-104(1)(a), 21-118(2) (2010).

273. *DMA Injunction*, *supra* note 236, at 4.

274. *See Oregon Waste Sys.*, 511 U.S. at 99 (stating that discriminatory statutes are “virtually per se invalid”).

275. *DMA Injunction*, *supra* note 236, at 7–8 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)).

276. *Id.* at 8.

277. *Id.* at 8. Unlike North Carolina (and approximately two dozen other states), Colorado provides no line on its income tax return to report use taxes owed and instead requires taxpayers to file a separate use tax return. *See NINA MANZI, MINN. HOUSE OF REPRESENTATIVES, USE TAX COLLECTION ON INCOME TAX RETURNS IN OTHER STATES 5* (2010), available at <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf> (stating that twenty-three states with sales and use taxes allow for reporting of the use tax liability on the state’s income tax form).

discriminating against out-of-state retailers,²⁷⁸ the court found that the more onerous reporting statute would likely fail strict scrutiny.²⁷⁹ The court, therefore, granted the DMA's preliminary injunction motion.

3. An Alternate Approach: Disparate, But Not Discriminatory, Treatment

In concluding that HB 1193 discriminates against out-of-state retailers, the DMA court relied on the Supreme Court's seemingly unequivocal statement in *Oregon Waste Systems* that discrimination means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."²⁸⁰ But recent Supreme Court decisions suggest that the application of this definition is not as straightforward as the DMA court assumed. In *Wyoming v. Oklahoma*,²⁸¹ the Court acknowledged that there may be no "clear line" for determining when a statute discriminates (and is subject to strict scrutiny) and when it does not (and falls under the more lenient *Pike* balancing test reserved for non-discriminatory statutes).²⁸² In fact, the Court has indicated elsewhere that discrimination, "in the constitutionally prohibited sense," requires more than just differential treatment; it also requires courts to consider whether the state statute is a "protectionist enactment."²⁸³

278. North Carolina's experience has been that providing a use tax line on the income tax return may constitute an alternative, but not an effective one. For the nine year period from 2000 to 2008, an average of only 3% of taxpayers filing North Carolina individual income tax returns included on their returns any amount of use taxes owed. Email from Beth Stevenson to Andrew Haile, *supra* note 65.

279. If North Carolina adopts a use tax reporting statute similar to HB 1193, the North Carolina statute would arguably have a better chance of surviving a challenge (even under a strict scrutiny standard) because the state already allows taxpayers to report use tax liability on their state income tax returns. Of course, other alternatives for improving use tax compliance still exist, such as a well-funded public education campaign or an increase in audits. The Supreme Court stated in *Maine v. Taylor*, however, that the "abstract possibility" of alternatives, "particularly when there is no assurance as to their effectiveness" does not render invalid a state statute even if that statute discriminates against interstate commerce. 477 U.S. 131, 147 (1986) (quoting *United States v. Taylor*, 585 F. Supp. 393, 398 (1984)). *Maine v. Taylor* appears to support the position that any non-discriminatory alternative must be (1) realistic and (2) at least marginally effective, to invalidate a statute. *See id.*

280. *Oregon Waste Sys. v. Dep't of Env'tl. Quality*, 511 U.S. 93, 99 (1994).

281. 502 U.S. 437 (1992).

282. *Id.* at 455 n.12 (quoting *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 579 (1986)). The Court in *Brown-Forman* went on to state that in determining what standard of review to apply to a statute under the dormant Commerce Clause, the "critical consideration is the overall effect of the statute on both local and interstate activity." 476 U.S. at 579.

283. *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988).

Under the Supreme Court's more recent precedent, some cases of *disparate* treatment may not constitute *discriminatory* treatment if the parties subject to the disparate treatment are not similarly situated. In other words, the Court has recognized that disparate treatment may not always amount to the "protectionism" the dormant Commerce Clause was intended to prevent.

a. *No Discrimination if Not "Similarly Situated"*

In *General Motors Corp. v. Tracy*,²⁸⁴ the Supreme Court upheld an Ohio statute that in its effect treated out-of-state companies differently than in-state companies.²⁸⁵ Under the Ohio law, "natural gas companies" were exempted from the state's general sales tax even though only in-state companies satisfied the statutory definition of the term.²⁸⁶ While out-of-state producers and independent marketers of natural gas had to collect Ohio sales and use tax for any gas they sold into Ohio, "natural gas companies" (called "local distribution companies" or "LDCs" throughout the Court's opinion) did not.²⁸⁷ General Motors, a major consumer of natural gas from out-of-state companies, filed suit alleging that the application of Ohio's general sales and use tax to out-of-state gas suppliers, but not to LDCs, violated the dormant Commerce Clause.²⁸⁸

Even though the Ohio statute effectively imposed sales and use taxes only on out-of-state companies, the Court held that the statute did not discriminate against interstate commerce.²⁸⁹ According to the Court, the in-state and out-of-state companies were not similarly situated and, consequently, did not have to be treated the same:

Conceptually, of course, any notion of discrimination assumes a comparison of substantially similar entities. Although this central assumption has more often than not itself remained dormant in this Court's opinions on state discrimination subject to review under the dormant Commerce Clause, when the allegedly competing entities provide different products, as here, there is a threshold question whether the companies are indeed similarly situated for constitutional purposes.²⁹⁰

284. 519 U.S. 278 (1997).

285. *Id.* at 310.

286. *Id.* at 282.

287. *Id.*

288. *Id.* at 285.

289. *Id.* at 310.

290. *Id.* at 298–99.

Although the LDCs and out-of-state natural gas producers provided the same fungible good to Ohio customers—natural gas—the Court found that these gas suppliers actually provided different “products,” and therefore were not similarly situated.²⁹¹ Under Ohio law, LDCs had to submit annual supply and demand forecasts to the Utilities Commission, “comply with a range of accounting, reporting, and disclosure rules, and get permission from the . . . Utilities Commission to issue securities or even enter into certain contracts.”²⁹² LDCs also had “to serve all members of the public” throughout their areas of operation, “were required to provide a firm backup supply of gas,” and had “to assure a degree of continued service to low-income customers despite unpaid bills.”²⁹³ None of these regulations and requirements applied to out-of-state natural gas suppliers. Accordingly, the Court found that the LDCs “provide[d] a product consisting of gas bundled with the services and protections” required under Ohio’s regulatory regime, while the out-of-state natural gas producers provided natural gas “unbundled” from the services and protections imposed by state regulation.²⁹⁴ As a result, because in-state and out-of-state natural gas suppliers were not similarly situated for dormant Commerce Clause purposes, giving the Ohio sales and use tax exclusion only to LDCs did not discriminate against interstate commerce.²⁹⁵

Under *General Motors*, then, differential treatment by itself does not amount to discrimination triggering strict scrutiny. Rather, the state statute must differentiate between *similarly situated* in-state and out-of-state entities. But in-state and out-of-state retailers are not similarly situated with respect to their sales and use tax obligations. Like the LDCs in *General Motors*, in-state retailers must comply with an extensive regulatory regime involving sales and use tax collection and remission that states cannot apply to out-of-state retailers in the wake of *Quill*.²⁹⁶ Using the Court’s terminology in *General Motors*, in-state retailers effectively sell different “products” (goods bundled with sales and use tax collected at the time of purchase) than out-of-state retailers sell (goods that require consumers to determine and remit use taxes on their own). That is, because the state can impose

291. *Id.* at 299.

292. *Id.* at 295–96 (internal citations omitted).

293. *Id.* at 297.

294. *Id.*

295. *Id.* at 310.

296. *See, e.g.*, N.C. GEN. STAT. §§ 105-164 to -187 (2009) (setting forth over fifty statutes comprising North Carolina’s sales and use tax laws).

tax collection requirements on in-state retailers but not on out-of-state retailers, in-state and out-of-state retailers are not in the same position with respect to the need for reporting requirements. As a result, the state can provide for disparate treatment under use tax reporting statutes without impermissibly discriminating against interstate commerce.²⁹⁷

b. North Carolina Has a Legitimate, Non-Protectionist Basis for Adopting a Reporting Statute

If North Carolina adopts a reporting statute along the lines of HB 1193, it could avoid strict scrutiny by advancing a legitimate, non-protectionist basis for applying the reporting requirements to out-of-state retailers. Given that in-state retailers are required, under threat of civil and criminal penalty, to collect sales tax, consumers do not owe use tax on in-state purchases.²⁹⁸ As a result, use tax non-compliance simply does not exist with respect to in-state retailers. The problem arises only in relation to sales by out-of-state retailers. That is, because in-state retailers already collect sales taxes, and therefore are subject to a burden that does not apply to out-of-state retailers, a state has no reason to require them to report information regarding use tax collection.

In fact, the Supreme Court has indicated that disparate treatment may not be discriminatory if a legitimate reason underlies the disparate treatment. In *Philadelphia v. New Jersey*,²⁹⁹ the Court considered the constitutionality of a statute prohibiting the importation of “solid or liquid waste which originated . . . outside [New Jersey’s] territorial limits” into the state.³⁰⁰ The Court determined that the New Jersey statute discriminated against interstate commerce, but in reaching this conclusion it stated that “whatever New Jersey’s ultimate purpose [for prohibiting the importation of waste], it may not be accomplished by discriminating against articles of commerce coming from outside the State *unless there is some reason, apart from their origin, to treat them*

297. Of course, this does not mean that states with sales and use taxes are free to enact any legislation, no matter how onerous, that falls on out-of-state retailers but not on in-state retailers. First, protectionist legislation is still subject to strict scrutiny. Moreover, any form of legislation, which, while not discriminatory, still affects interstate commerce, would be subject to the balancing test applicable to non-discriminatory statutes. See *infra* text accompanying notes 306–25 for a description of this balancing test.

298. See, e.g., § 105-164.6(c) (allowing consumers a credit against their use tax for any sales tax paid).

299. 437 U.S. 617 (1978).

300. *Id.* at 618.

*differently.*³⁰¹ That is, the Court suggested that states may differentiate if there is a reason for disparate treatment other than the extraterritorial origin of the regulated good or entity.

In the use tax context, there is an appropriate reason for treating sales by retailers with no in-state physical presence differently than sales by retailers that have an in-state presence. Out-of-state retailers are not required to collect sales taxes and, as a result, can offer their products at a cheaper price. The state must rely on consumers to report and pay use taxes on those sales, which, if paid, make the total cost of the good the same as if it was purchased in-state. But as empirical evidence indicates, consumers (in North Carolina, at least) comply with their use tax obligations at exceptionally low rates—under 4%.³⁰² On the other hand, statistical data from the North Carolina DOR indicates that sales tax compliance is substantially higher, as assessments compared to collections indicate a compliance rate of well over 90%.³⁰³ Therefore, transactions by in-state and out-of-state retailers differ substantially with respect to the obligations imposed on the retailers and, consequently, the state's ability to collect the taxes on internet purchases. As a result, the different regulatory schemes, coupled with the vastly different tax compliance rates, constitute a reason apart from the origin of the goods sold for states to impose the reporting requirements exclusively on out-of-state retailers.

In addition, removing the artificial price advantage created by use tax delinquency preserves “the unitary national market” that the Founders intended the Commerce Clause to protect.³⁰⁴ A use tax reporting statute is not the type of protectionist measure that the Commerce Clause was meant to prohibit. Unlike import tariffs, which

301. *Id.* at 626–27 (emphasis added).

302. See *supra* text accompanying notes 65–68 for an explanation of this figure.

303. For the fiscal year ending June 30, 2010, the DOR reported combined sales and use tax revenue of over \$5.56 billion. N.C. DEP'T OF REVENUE, STATE GENERAL FUND: TAX REVENUES BY SOURCE 1, available at <http://www.dornc.com/publications/abstract/2010/table2.pdf>. For that same fiscal year, the DOR assessed North Carolina taxpayers approximately \$61.6 million in sales and use tax liability. Email from Beth Stevenson, Dir. of Pub. Affairs/PIO, N.C. Dep't of Revenue, to Andrew Haile, Associate Professor, Elon Univ. Sch. of Law (Feb. 10, 2011 14:48 EST) (on file with authors). So, overall sales and use tax assessments amount to only 1.1% of sales and use tax revenues.

304. *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994). In explaining why tariffs on out-of-state goods are prohibited by the dormant Commerce Clause, the Court held that such tariffs undermine “the principle of the unitary national market by handicapping out-of-state competitors, thus artificially encouraging in-state production even when the same goods could be produced at lower cost in other States.” *Id.* (emphasis added).

gave in-state merchants an artificial competitive advantage over out-of-state competition, reporting requirements seek only to level the playing field by removing the competitive disadvantage that has arisen post-*Quill*. Because out-of-state retailers do not have to collect sales and use taxes and less than four percent of North Carolinians pay any use taxes, out-of-state retailers enjoy a *de facto* price advantage over in-state sellers. By increasing use tax compliance, reporting statutes actually encourage, rather than discourage, robust and fair competition between in-state and out-of-state retailers, exactly as the Framers intended.

Moreover, reporting requirements do this without eliminating competitive advantages that out-of-state retailers enjoy independent of the sales and use tax scheme. While out-of-state retailers who produce goods at the highest quality and lowest cost normally should prevail in commercial competition regardless of the place of origin of those goods,³⁰⁵ the Commerce Clause does not protect their right to prevail based on the tax delinquency of in-state consumers. Thus, reporting statutes are constitutionally distinguishable from the state regulation struck down in *Hunt v. Washington State Apple Advertising Commission*.³⁰⁶ In *Hunt*, North Carolina enacted a statute prohibiting Washington apple growers from using Washington's more stringent grading system for apples shipped into North Carolina. The ostensible purpose for the North Carolina statute was to protect North Carolina citizens from "fraud and deception in the marketing of apples."³⁰⁷ The Washington apple growers, however, argued that North Carolina sought to prevent them from marketing their higher grade apples and expanding their share of the North Carolina apple market.³⁰⁸ The Supreme Court struck down the statute because, among other reasons, it had "the effect of stripping away from the Washington apple industry the competitive and economic advantages *it has earned for itself* through its expensive inspection and grading system."³⁰⁹

305. See Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1118 (1986) ("[P]rotectionism is inefficient because it diverts business away from presumptively low-cost producers without any colorable justification in terms of a benefit that deserves approval from the point of view of the nation as a whole.").

306. 432 U.S. 333 (1977).

307. *Id.* at 349.

308. See *id.* at 348 (noting that North Carolina challenged the district court's determination in favor of the Washington apple growers that the statute burdened the industry by "increasing its costs of doing business in the North Carolina market").

309. *Id.* at 351 (emphasis added).

But out-of-state retailers have not “earned for themselves” the price advantage resulting from *Quill*. As a result, reporting requirements are not “protectionist.” Instead of trying to give in-state retailers an unfair price advantage, reporting requirements seek to put in-state retailers on the same level with out-of-state retailers with respect to the amount of tax ultimately collected on goods sold in or into North Carolina. They ensure that all retailers—those located in-state and those with no in-state physical presence—have the same opportunity to compete for the business of in-state residents.³¹⁰ By increasing the likelihood that consumers who buy from out-of-state retailers will ultimately pay the taxes owed on their purchases, use tax reporting statutes help to eliminate the artificial price advantage out-of-state retailers now have.

4. *Pike* Balancing—Weighing the Benefits and Burdens of a Colorado-Style Reporting Statute

Even if a court determines that a reporting statute does not discriminate, the dormant Commerce Clause analysis is not finished. State action that affects but does not discriminate against interstate commerce is still subject to the balancing test set forth by the Supreme Court in *Pike v. Bruce Church, Inc.*³¹¹ Under this test, one challenging a statute must demonstrate that the burdens imposed by the statute on interstate commerce are “clearly excessive in relation to the putative local benefits.”³¹²

The Supreme Court has acknowledged the inherent difficulty and potential institutional incompetence of the judiciary in weighing the benefits and burdens of a statute under the dormant Commerce Clause. In *Department of Revenue of Kentucky v. Davis*, the Court analyzed whether a state income tax exemption that traditionally had been given for state-issued bonds violated the dormant Commerce

310. In upholding the constitutionality of the use tax, Justice Cardozo, writing on behalf of the Court, stated:

When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed.

Henneford v. Silas Mason Co., 300 U.S. 577, 584 (1937). Likewise, the reporting requirements ensure that the “stranger from afar” and the “dweller within the gates” both face the same tax burden in selling their goods, with neither unfairly advantaged over the other.

311. 397 U.S. 137 (1970).

312. *Id.* at 142.

Clause.³¹³ Although the exemption gave state-issued bonds special treatment, the Court declined to apply the *Pike* balancing test, stating that “the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the [plaintiffs] to satisfy a *Pike* burden in this particular case.”³¹⁴ The Court explained that identifying the benefits and burdens and then “weighing or quantifying them for a cost-benefit analysis would be a very subtle exercise,”³¹⁵ one for which the Court was not qualified. Moreover, the Court’s concerns about institutional competence were heightened in relation to the tax statutes at issue in *Davis*: “Courts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. The complexities of factual economic proof always present a certain potential for error, and courts have little familiarity with the process of evaluating the relative economic burden of taxes.”³¹⁶

Concurring in part in *Davis*, Justice Scalia expressed skepticism over the Court’s ability to weigh benefits and burdens under the *Pike* balancing test. According to Justice Scalia, attempting to balance benefits and burdens in dormant Commerce Clause cases was like trying to determine “whether three apples are better than six tangerines.”³¹⁷ Under the balancing test, the Court must compare incommensurate things—alleged burdens on interstate commercial activity and the perceived benefits to local, intrastate activities. As Justice Scalia stated in *Bendix Autolite Corp. v. Midwesco Enterprises*,³¹⁸ “[t]his process is ordinarily called ‘balancing,’ but the scale analogy is not really appropriate, since the interests on both sides are incommensurate. It is more like judging whether a particular

313. 553 U.S. 328 (2008).

314. *Id.* at 353.

315. *Id.* at 354.

316. *Id.* at 355 (quoting *Fulton Corp. v. Faulkner*, 516 U.S. 325, 342 (1996)). While use tax reporting statutes are not tax statutes, the benefit-burden analysis under *Pike* would require an assessment of economic factors similar to those involved in weighing the costs and benefits of tax statutes. For example, in *Davis* the Court doubted its ability to assess the challenger’s arguments that the state tax exemption for state-issued bonds harmed (i) out-of-state sellers; (ii) in-state buyers; (iii) the national securities market; and (iv) other states that felt compelled to enact similar laws but thereby reduced their bond yield revenue. *See id.* Many of these same arguments could be made by opponents of reporting statutes, specifically, that they harm (i) out-of-state sellers; (ii) in-state consumers; (iii) the efficiency of the national retail market; and (iv) states that enact similar use tax reporting statutes and thereby drive away out-of-state retailers who prefer not to deal with the burden imposed.

317. *Id.* at 360 (Scalia, J., concurring).

318. 486 U.S. 888 (1988).

line is longer than a particular rock is heavy.”³¹⁹ Whereas *General Motors* held that the in-state and out-of-state gas producers must be similarly situated, critics of *Pike* balancing contend that the test seeks to compare dissimilar national and local interests.³²⁰

Despite acknowledging the difficulties inherent in the test, the Court continues to apply it.³²¹ As a result, a court may have to weigh the benefits and burdens created by any reporting statute that North Carolina might adopt. The local benefits, of course, include the expected increase in tax revenues due to improved use tax enforcement. One study has estimated Colorado’s lost revenues from use tax non-compliance on internet purchases (not including other forms of remote commerce, like mail order purchases) at \$130 million for 2010.³²² North Carolina’s use tax deficiency for 2010 has been estimated to be \$160 to \$180 million.³²³ Although use tax reporting requirements may not enable states to collect the full amount of these delinquencies, they will assist states in identifying and pursuing the worst use tax scofflaws.

In addition, confronted with increased enforcement of use tax laws, taxpayers who are not themselves assessed by the taxing authority will likely increase their use tax compliance instead of waiting to be audited, taxed, and penalized as a result of information reported under the statute. That is, the DOR’s obtaining information about each person’s use tax liability will help to eliminate the perception that taxpayers can ignore their use tax obligations with impunity.³²⁴ As explained by one scholar, “[t]he taxpayer’s perception

319. *Id.* at 897 (Scalia, J., concurring). One respected commentator has argued that while courts purport to engage in a balancing analysis under the Commerce Clause, all that they actually do (and all they should do) is to determine whether the challenged statute has a protectionist purpose. *See* Regan, *supra* note 305, at 1092 (“In the central area of dormant commerce clause jurisprudence . . . the Court has been concerned exclusively with preventing states from engaging in purposeful economic protectionism.”).

320. *See* *United Haulers Ass’n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 348 (2007) (Scalia, J., concurring); Denning, *supra* note 265, at 453.

321. *But see* David S. Day, *The “Mature” Rehnquist Court and the Dormant Commerce Clause Doctrine: The Expanded Discrimination Tier*, 52 S.D. L. REV. 1, 47–50 (2007) (contending that although the Supreme Court still purports to use a two-tiered test in dormant Commerce Clause cases, in the twelve dormant Commerce Clause cases decided between 1992 and 2005 the Court found reasons not to apply the *Pike* balancing test to any of the cases). A plurality of the Court did apply the *Pike* balancing test in the 2007 *United Haulers* case, so the test appears to have continued vitality. *See United Haulers*, 550 U.S. at 346–47.

322. BRUCE ET AL., *supra* note 3, at 11.

323. *Id.*

324. The IRS has studied and tried to quantify the indirect deterrent effect that enforcing tax laws against some taxpayers has on the compliance rate of others. *See, e.g.*,

of the probability that cheating will be detected influences the compliance decision. Accordingly, any information that the taxpayer knows the government has about the taxpayer's activities will foster honesty."³²⁵ In addition, because the reporting statute's Transaction Notice and Annual Customer Report components serve an educational function, some taxpayers who were unaware of their use tax obligations will learn about these requirements, thereby increasing the opportunities for compliance.

Finally, with respect to the benefit side of the *Pike* balancing scale, reducing widespread use tax evasion may be regarded as a benefit in and of itself (i.e., regardless of the additional revenue recovered). The government has an important interest in ensuring that its laws are followed, and broad-based disregard for the tax laws—whether out of ignorance or intent—undermines both the stability of a tax system based on self-assessment and the general respect for and adherence to the law. Thus, given the importance of the taxing scheme and the historically low compliance rate, a court might consider improved use tax compliance resulting from the reporting requirements to be a significant benefit to the overall tax system.

On the other side of the *Pike* balancing ledger, out-of-state retailers have argued in the Colorado litigation that the reporting requirements are costly, time-consuming, and unduly burden interstate commerce.³²⁶ Whereas the Colorado Department of Revenue's expert estimated that "the smallest retailers affected by [HB 1193, those with over \$100,000 of in-state gross sales,] will incur first year compliance costs ranging from about 3,100 dollars to 7,000 dollars,"³²⁷ the DMA estimated compliance costs at "upwards of \$26,500" in the first-year, and "perhaps \$9,000 annually thereafter, plus mailing/postage expense."³²⁸ Given that these costs fall only on out-of-state retailers that are not themselves liable for use tax

JEFFREY A. DUBIN, CAL. INST. OF TECH., CRIMINAL INVESTIGATION ENFORCEMENT ACTIVITIES AND TAXPAYER NONCOMPLIANCE 21 (2004), available at <http://www.irs.gov/pub/irs-soi/04dubin.pdf> (stating that "an additional dollar allocated to audit would return \$58 in general deterrence" based on IRS data from 1988 through 2001); see also Joseph Bankman, *Eight Truths About Collecting Taxes from the Cash Economy*, 117 TAX NOTES 506, 511 (2007) ("By now almost everyone knows the tremendous bang for the buck we get with third-party reporting.").

325. Lederman, *supra* note 42, at 1735.

326. DMA Injunction, *supra* note 236, at 4–5.

327. *Id.* at 6.

328. Plaintiff's Reply to Defendant's Response in Opposition to Plaintiff's Motion for a Preliminary Injunction at 6, *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546, 2011 WL 250556-REB-CBS (D. Colo. 2011).

collection under *Quill*, the Colorado court in its preliminary injunction order was understandably troubled by the financial burden.³²⁹

Thus, a court analyzing the impact of a reporting statute on interstate commerce must identify the relative benefits and burdens and then balance them against each other. When conducting the balancing, though, courts must remember that it is “not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business.”³³⁰ Although the reporting statute is not a tax, it assists the state in enforcing a tax. And even though North Carolina cannot require remote retailers to collect and remit use taxes, the state could argue that access to its retail market comes at the cost of having to provide information that enables the state to enforce its tax laws.

Having determined that the statute likely discriminated against interstate commerce, the Colorado court applied a strict standard of review instead of the *Pike* balancing test.³³¹ If a court agrees with the analysis set forth above and finds that a use tax reporting statute does not discriminate “in the constitutionally prohibited sense,”³³² the court would apply *Pike* balancing review, which, unlike strict scrutiny, is not necessarily fatal in fact. But the outcome of the balancing test depends largely on the “weights” a court gives to the perceived benefits and burdens of the challenged statute. Not surprisingly, given the difficulty in applying the test, whether a reporting statute would survive *Pike* balancing is hard to predict. In light of the ever-expanding role of internet commerce in the national economy and the fact that a tax reporting statute does not require retailers to keep track of constantly changing tax rates and exemptions (like a tax collection statute does), these authors believe that a court examining a Colorado-style use tax reporting statute should uphold the statute under a balancing test analysis. Moreover, considering the substantial amount of unpaid use tax at stake, a use tax reporting statute is one of the few options that states like North Carolina and Colorado have available to increase their use tax collections. But, in this view, such a

329. DMA Injunction, *supra* note 236, at 11 (discussing potential irreparable harm to out-of-state retailers if preliminary injunction not granted).

330. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 623–24 (1981) (quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975)).

331. DMA Injunction, *supra* note 236, at 4.

332. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988).

statute can survive judicial review only if its constitutionality is determined under the *Pike* balancing test.³³³

5. The Second Basis for the *DMA* Court's Preliminary Injunction Decision: The Improper Extension of *Quill* to Use Tax Reporting Statutes

In addition to determining that the Colorado reporting statute discriminated against interstate commerce, the Colorado federal court enjoined HB 1193 for another reason: it held that the reporting statute violated *Quill's* physical presence standard and, therefore, most likely placed an undue burden on interstate commerce.³³⁴ Under *Quill*, a state may not require a retailer to collect and remit sales or use tax if the retailer has no physical presence in the state.³³⁵ Although the Colorado court acknowledged that HB 1193's reporting requirements do not themselves constitute a tax collection obligation, it stated:

[The reporting requirements] do require out-of-state retailers to gather, maintain, and report information, and to provide notices to their Colorado customers and to the [Department of Revenue] about their Colorado customers. The sole purpose of

333. Other arguments, not presented by Colorado in the preliminary injunction hearing, also may cause a court to subject HB 1193—or a use tax reporting statute enacted in North Carolina—to a less rigorous standard of review than the strict scrutiny applied by the Colorado court. In particular, *Department of Revenue of Kentucky v. Davis* offers support for the proposition that in seeking to collect unpaid taxes (through the imposition of reporting requirements like those in HB 1193) the state is performing a “traditional government function,” and “a government function is not susceptible to standard dormant Commerce Clause scrutiny owing to its likely motivation by legitimate objectives distinct from the simple economic protectionism the Clause abhors.” 533 U.S. 328, 341 (2008). In addition, the reporting requirement imposed on out-of-state retailers may be viewed as “compensatory” or “complementary” charges to the sales taxes imposed on in-state retailers. If so, the reporting requirements may come within the protection of the “compensatory tax doctrine.” The compensatory tax doctrine, as explained in *Oregon Waste Systems v. Department of Environmental Quality*, allows for even a facially discriminatory tax to survive dormant Commerce Clause review if the tax imposes on interstate commerce “the rough equivalent of an identifiable and ‘substantially similar’ tax on intrastate commerce.” 511 U.S. 93, 102–03 (1994) (quoting *Maryland v. Louisiana*, 451 U.S. 725, 758–59 (1981)). The reporting requirements impose an obligation on out-of-state retailers that corresponds closely to the sales tax collection obligation imposed on in-state retailers. Nevertheless, the reporting requirements are not themselves a tax, and therefore do not fall cleanly within the existing test for determining whether the complementary tax doctrine applies. *See id.* at 103 (providing the details of that test). Moreover, the Court has been very reluctant to extend the complementary tax doctrine beyond the narrow confines of justifying the constitutionality of the use tax itself. *See id.* at 105 n.8 (expressing the Court’s reluctance to extend its “carefully confined compensatory tax jurisprudence”).

334. *DMA Injunction*, *supra* note 236, at 4–5.

335. *Quill Corp. v. North Dakota*, 504 U.S. 298, 311, 314 (1992).

these requirements is to enhance the collection of use taxes by the State of Colorado. I conclude that these requirements likely impose on out-of-state retailers use tax-related responsibilities that trigger the safe-harbor provisions of *Quill*. Although the burden of the notice and reporting obligations imposed by the Act and the Regulations [i.e., HB 1193 and the regulations issued thereunder] may be somewhat different than the burden of collecting and remitting sales and use taxes, the sole purpose of the burdens imposed by the Act and the Regulations is the ultimate collection of use taxes when sales taxes cannot be collected. Looking to the practical effect of the Act and the Regulations, I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in *Quill*.³³⁶

Although the reporting requirements unquestionably relate to the state's efforts to collect use tax, the Colorado court improperly assumed that they impose burdens "inextricably related in kind and purpose to the burdens condemned in *Quill*."³³⁷ Contrary to the Colorado court's claim, however, the burden condemned in *Quill*—imposition of a tax collection obligation in a jurisdiction where the retailer had no physical presence—is substantively different than the burden Colorado's use tax reporting requirements impose. In *Quill*, the Court focused on the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements."³³⁸ Requiring an out-of-state retailer to collect tax could unduly burden interstate commerce because meeting the potential tax collection obligations in all of the "[n]ation's 6,000-plus taxing jurisdictions" could "entangle [an out-of-state retailer] in a virtual welter of complicated obligations."³³⁹

To date, Colorado is the only taxing jurisdiction in the country to enact a use tax reporting statute.³⁴⁰ Although North Carolina and other states may follow Colorado's lead, tax reporting requirements are substantially less burdensome than the tax collection requirements considered in *Quill* for at least two reasons. First, states

336. DMA Injunction, *supra* note 236, at 10.

337. *Id.* at 5.

338. *Quill*, 504 U.S. at 313 n.6.

339. *Id.*

340. Oklahoma has enacted a use tax notice statute, requiring out-of-state retailers only to notify Oklahoma customers of their obligation to pay use taxes. See 2010 Okla. Sess. Laws 412, available at <http://www.oscn.net/applications/oscn/deliverdocument.asp?id=459019&hits=>. The Oklahoma statute does not contain the Annual Customer Report or the Annual Retailer Report requirements contained in HB 1193. *Id.*

would impose reporting requirements for the same purposes—to inform consumers of their obligation to pay use taxes and to enable the taxing authority to determine whether consumers are making those payments. As a result, while there may be minor variations between and among states, reporting requirements in other jurisdictions invariably would seek the same information as the Colorado statute—the names of purchasers and the total amount of taxable purchases. Unlike the patchwork of tax collection and remission requirements that the Court considered in *Quill*,³⁴¹ the reporting requirements would impose a generally uniform reporting obligation on out-of-state retailers. Second, Colorado’s reporting statute permits retailers to use a generalized Annual Customer Report if the retailer is required to provide a similar notice in other states:

If the retailer is required by another state to provide a similar notice [to the Annual Customer Report required by HB 1193], and the retailer provides a single such notice to all purchasers with respect to items purchased for delivery in all states, the notice required [by Colorado] shall be sufficient if it contains substantially the information required in a form that is generalized to any state.³⁴²

To the extent that other jurisdictions allow retailers to use a single form to satisfy the reporting requirements, states will guarantee uniformity in the information requested from retailers, thereby distinguishing the reporting requirements from the far more complex and jurisdiction-specific tax collection and remission requirements considered in *Quill*.

Because reporting statutes do not impose the same degree of burden on interstate commerce as a tax collection requirement, courts should reconsider the *DMA* court’s extension of *Quill* to information reporting statutes. Limiting *Quill* to tax collection is faithful to that opinion and recognizes, as Justice Stevens put it, that the physical presence standard was “artificial at its edges” when first imposed.³⁴³ With the rapid expansion of e-commerce, that “artificiality” has been amplified, creating a substantial tax disparity between internet

341. The lack of uniformity in sales and use tax collection requirements has been reduced significantly since *Quill* with the creation of the SSUTA. See *supra* Part I.B.2 for a description of the SSUTA.

342. COLO. CODE REGS. § 39-21-112(2)(e) (2010). The current draft of the MTC’s model use tax notice and reporting statute does not contain a comparable provision. See SALES & USE TAX UNIFORMITY SUBCOMM., *supra* note 235.

343. *Quill*, 504 U.S. at 315.

retailers and traditional brick-and-mortar retailers. The *DMA* court's application of the physical presence standard to a reporting requirement that does not itself impose a tax collection obligation perpetuates that disparity and, therefore, should be rejected.

B. Possible First Amendment Problems with a North Carolina Reporting Statute

If North Carolina adopts a Colorado-style reporting statute, then non-collecting retailers (i.e., remote retailers that are not required to collect sales or use taxes) would have to file an annual report with the DOR identifying each North Carolina purchaser and specifying the total amount of purchases that each purchaser made from that retailer during the year. Although similar to the *Amazon* district court's modified relief, the reporting statute would differ from the court's order in two important ways. First, the reporting statute would not require a remote retailer to provide even generic product information, only the total amount of purchases made from the retailer.³⁴⁴ Second, with a possible exception for retailers with *de minimis* sales in North Carolina, the reporting statute would apply to all retailers, not just retailers that the DOR is auditing.

Despite these differences, the general First Amendment questions remain the same: (i) whether the reporting statute implicates the First Amendment and, if so, (ii) whether it survives heightened scrutiny. As discussed above, the *Amazon* court assumed that its modified relief did not trigger the First Amendment rights of North Carolina consumers.³⁴⁵ This might cause one to think that the reporting statute, which does not even require non-collecting retailers to disclose generic product information, is even less likely to implicate the First Amendment rights of consumers.

But given that the reporting statute applies to *all* retailers, it raises a different First Amendment problem: overbreadth. The First Amendment overbreadth doctrine "allows a party to whom the law may constitutionally be applied to challenge the statute on the ground that it violates the First Amendment rights of others."³⁴⁶ Therefore,

344. The Annual Retailer Report required by the Colorado reporting statute calls only for the non-collecting retailer to report to the Colorado Department of Revenue the name, address, and "total dollar amount of purchases made by each customer in Colorado for the previous year." See COLO. DEP'T OF REVENUE, *supra* note 244, at 2.

345. See *supra* Part II.B.1.

346. See *United States v. Stevens*, 130 S. Ct. 1577, 1593 (2010) ("A party seeking to challenge the constitutionality of a statute generally must show that the statute violates the party's own rights. The First Amendment overbreadth doctrine carves out a narrow

even assuming that a government knows that a North Carolina taxpayer buying \$400 of goods from Amazon does not chill First Amendment activity, Amazon still could claim that the reporting statute violates the First Amendment if the government's knowledge that a taxpayer buying \$400 of goods from another retailer does chill First Amendment activity. Moreover, this Article contends that the government's knowledge that a person bought \$400 of items from a publisher specializing in political, religious, sexual, or any controversial, embarrassing, or unpopular topics does implicate the First Amendment under Supreme Court precedent. Given the broad protection afforded anonymity in receiving expressive materials, a reporting statute that required specialty publishers or retailers to divulge the identities of their customers would violate the customers' speech rights even though the government might never know the titles of the expressive materials or even the medium of expressive materials purchased (e.g., books or videos).

As the Supreme Court has stated, anonymity "exemplifies the purpose behind the Bill of Rights, and of the First Amendment in particular: to protect unpopular individuals from retaliation—and their ideas from suppression—at the hand of an intolerant society."³⁴⁷ Anonymity ensures that individuals can pursue their reading and viewing interests without having to worry about the government's monitoring their expressive choices, which, in turn, might chill First Amendment activity.³⁴⁸ Without anonymity, people would be afraid of, or at least discouraged from, reading, writing, viewing, or

exception to that general rule." (internal citations omitted)); *see also* Bd. of Trs. of State Univ. of N.Y. v. Fox, 492 U.S. 469, 483 (1989) ("Ordinarily, the principal advantage of the overbreadth doctrine for a litigant is that it enables him to benefit from the statute's unlawful application *to someone else.*"); *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 462 n.20 (1978) (describing the overbreadth doctrine as one "under which a person may challenge a statute that infringes protected speech even if the statute constitutionally might be applied to him").

347. *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 357 (1995); *see also* *United States v. Playboy Entm't Grp.*, 529 U.S. 803, 817 (2000) ("The citizen is entitled to seek out or reject certain ideas or influences without Government interference or control."); *Tattered Cover, Inc. v. City of Thornton*, 44 P.3d 1044, 1052 (Colo. 2002) ("Anonymity is often essential to the successful and uninhibited exercise of First Amendment rights, precisely because of the chilling effects that can result from disclosure of identity.").

348. As the Amazon court noted, "[c]itizens are entitled to receive information and ideas through books, films, and other expressive materials anonymously" because without this protection "[t]he fear of government tracking and censoring one's reading, listening, and viewing choices chills the exercise of First Amendment rights." *Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154, 1168 (W.D. Wash. 2010). *See supra* Part II.A.1 for discussion of the First Amendment's protection for receiving expressive materials anonymously and Justice Douglas's concurrence in *Rumely*.

distributing expressive materials of which the government or others might disapprove.³⁴⁹ Thus, as the *Amazon* court acknowledged with respect to the DOR's initial request, the "chilling effect" of the government's actions is a touchstone for First Amendment violation.³⁵⁰

But First Amendment speech activity is chilled not only from the government's being able to identify the particular titles that specific individuals are reading or viewing; it is also chilled when the government knows that particular individuals are reading or viewing specific *types* of expressive materials. If a non-collecting publisher is identified as specializing in a specific genre of expressive materials that the government might disapprove of or the community at large might find distasteful—e.g., militant or jihadist literature; sexually explicit magazines, books, or movies; new age readings; or counter-cultural literature—then permitting the government to know that a citizen bought anything from the publisher would have the same chilling effect on that person's speech activity as the government's learning that the person bought a book or video of the same disfavored genre from Amazon. If, as the *Amazon* court suggests, a person may be dissuaded from buying *The Communist Manifesto* if the person knows that purchase will be reported to the government, the person might likewise hesitate to buy a book from a publisher specializing in communist political writings if the government will discover that he made a purchase from that publisher.

Moreover, *Lamont v. Postmaster General of the United States* and *Denver Area Educational Telecommunications Consortium, Inc. v. FCC* directly support this conclusion.³⁵¹ In *Lamont*, plaintiffs challenged a postal regulation pursuant to which the postal service would screen mail for certain "communist political propaganda." If a piece of mail was determined to be communist political propaganda, the Post Office would detain the mail and send a notice to the addressee, identifying the mail being detained and informing the addressee that the mail would be destroyed unless she requested

349. See, e.g., *McIntyre*, 514 U.S. at 357; *Griswold v. Connecticut*, 381 U.S. 479, 482 (1965) ("The right of freedom of speech and press includes not only the right to utter or to print, but the right to distribute, the right to receive, the right to read and freedom of inquiry." (internal citations omitted)); *Talley v. California*, 362 U.S. 60, 64 (1960) (holding that the First Amendment protects anonymity in the distribution of campaign literature); *Martin v. City of Struthers*, 319 U.S. 141, 143 (1943) ("The right of freedom of speech and press has broad scope. . . . This freedom embraces the right to distribute literature and necessarily protects the right to receive it.").

350. *Amazon*, 758 F. Supp. 2d at 1169.

351. See *supra* Part II.A.1 for a prior discussion of these cases.

delivery by returning an attached reply card.³⁵² The Court struck down the requirement on First Amendment grounds because the identification requirement was an “unconstitutional . . . limitation on the unfettered exercise of the addressees [sic] First Amendment rights.”³⁵³ In particular, the Court emphasized the chilling effect that the requirement would have on speech activity, noting that it was “almost certain to have a deterrent effect, especially as respects those who have sensitive positions.”³⁵⁴ Given the political nature of the literature and the government’s singling out that type of political literature for special treatment, “any addressee is likely to feel some inhibition in sending for literature which federal officials have condemned as ‘communist political propaganda.’”³⁵⁵

In *Lamont*, then, the deterrent effect resulted from the government’s requiring that a person identify herself before receiving certain *types* of expressive materials—communist political propaganda. Regardless of the specific titles of pamphlets or other materials contained in the detained mail, individuals had to give notice to the government that they wanted to receive this kind of literature.³⁵⁶ And knowing just the *type* of literature—communist propaganda—was sufficient to infringe on First Amendment values: “Public officials like schoolteachers who have no tenure, might think they would invite disaster if they read what the Federal Government says contains the seeds of treason.”³⁵⁷

The principle applied in *Lamont* would seem to apply with equal force to the government’s learning that an individual received expressive materials from publishers that specialize in certain types of books, magazines, or videos. If a publisher or remote retailer is in the business of selling and distributing expressive materials that are

352. *Lamont v. Postmaster Gen. of U.S.*, 381 U.S. 301, 303 (1965).

353. *Id.* at 305.

354. *Id.* at 307.

355. *Id.*

356. Initially, individuals receiving a notice that the government was holding communist political propaganda could indicate that they wanted to receive “any similar publication” going forward. *Id.* at 303. The Post Office, therefore, maintained a list of such people. *Id.* In *Lamont*, the Post Office inspected the contents of the mail to determine whether the particular literature constituted communist political propaganda. *Id.* at 306. As a result, the government had access to the publications themselves and, hence, the titles of those publications. *Id.* at 304. But the purpose of the program was to identify and restrict a specific category of literature, and the government’s knowing who received that type of expressive material impermissibly chilled the exercise of First Amendment rights. *Id.* at 307. The Post Office subsequently stopped keeping the list but continued detaining this type of political literature and requiring people to return a reply card to receive it. *Id.* at 303.

357. *Id.* at 307.

outside the mainstream or at odds with what the majority views as acceptable, requiring those publishers to identify their customers' names to the government would deter the First Amendment activities of those customers. Nor should it make a constitutional difference that, under a reporting statute, the remote retailer would provide the purchaser's name and address instead of the individual providing that information through a reply card as in *Lamont*. In either case, an individual's receiving expressive materials from a remote publisher or retailer would result in the government's learning that the purchaser is reading or viewing certain kinds of expressive materials, which, in turn, would deter First Amendment activity. As a result, under *Lamont*, if North Carolina adopted a Colorado-style reporting statute, that statute still would be "at war with the 'uninhibited, robust, and wide-open' debate and discussion that are contemplated by the First Amendment."³⁵⁸

Similarly, in *Denver Area*, the Court struck down on First Amendment grounds a statute that required individuals to identify themselves before receiving certain broadcast programming because of, among other things, the deterrent effect of the requirement.³⁵⁹ Under a section of the Cable Television Consumer Protection and Competition Act, cable system operators were required to segregate and block "patently offensive" sex-related programming that appeared on leased channels.³⁶⁰ Subscribers who wanted to view the sexually themed programming had to submit a written request to have the cable operator unblock the leased channel and, once finished viewing, another written request to have the station reblocked.³⁶¹ The Court noted that this "'written notice' requirement [would] further restrict viewing by subscribers who fear for their reputations should the operator, advertently or inadvertently, disclose the list of those who wish to watch the 'patently offensive' channel."³⁶²

358. *Id.* (quoting *N.Y. Times Co. v. Sullivan*, 376 U.S. 254, 270 (1964)). As the concurrence in *Lamont* notes, the fact that a government regulation or restriction does not expressly prohibit expressive activity does not insulate the regulation from a First Amendment challenge. Government action can neither prohibit nor inhibit the exercise of core First Amendment rights, such as freedom of speech, "[b]ut inhibition as well as prohibition against the exercise of precious First Amendment rights is a power denied to government." *Id.* at 309.

359. *Denver Area Educ. Telecomms. Consortium, Inc. v. F.C.C.*, 518 U.S. 727, 733 (1996).

360. 47 U.S.C. § 532(J) (1996), *declared unconstitutional by Denver Area*, 518 U.S. at 727.

361. *Denver Area*, 518 U.S. at 735 (citing 47 C.F.R. § 76.701(c) (1995)).

362. *Id.* at 754 (citing *Lamont*, 381 U.S. at 307). In the context of a use tax reporting statute, consumers also may worry about the disclosure of information about their

Stated differently, the statute threatened First Amendment values because the cable operators did (and third-parties might) learn that the subscriber was watching a certain *type* of programming, namely “patently offensive” sex-related programming, even though neither the cable operators nor third-parties would know the specific titles of the programs that the subscriber viewed. Thus, although the Court did not explicitly state that viewers (or readers) of expressive materials have a First Amendment right to anonymity with regard to the fact that they are reading certain kinds of materials, the Court’s focus on the deterrent effect of the government action, coupled with the broad protection afforded First Amendment activity, suggests just such a rule.

Accordingly, under *Lamont* and *Denver Area*, a reporting statute cannot give the DOR or the State of North Carolina unfettered discretion to require all remote retailers to disclose the identities of North Carolina purchasers and the amount of their purchases. Rather, because a Colorado-style reporting statute implicates the First Amendment rights of consumers, the DOR must satisfy the heightened scrutiny standard set out in the *Amazon* court’s opinion. That is, to obtain the names of purchasers and the amount purchased from all non-collecting retailers, North Carolina must show a compelling interest in that information and a substantial relation between that interest and the particular information sought. But given the protection afforded anonymity under *Lamont* and *Denver Area*, the DOR cannot make the required showing. Because the reporting statute would deter the speech activity of consumers who purchase from specialized retailers, “[e]nforcement of this demand would ‘sacrifice First Amendment protections’ for too ‘speculative a gain.’”³⁶³

North Carolina, however, might try to avoid the overbreadth problem by distinguishing in the reporting statute between different

purchases, whether advertently or inadvertently. At least one state, Oklahoma, has been criticized for selling its citizens’ personal information and several incidents of unintentional disclosures have also occurred. See *Laptop Stolen from Connecticut State Tax Office; Information of 106,000 at Risk*, SC MAGAZINE BLOG (Aug. 29, 2007), <http://www.scmagazineus.com/laptop-stolen-from-connecticut-state-tax-office-information-of-106000-at-risk/article/154986/> (noting that a laptop containing the tax information of over 100,000 Connecticut citizens was stolen); Paul Monies, *Oklahoma Brings in Millions by Selling Personal Data*, NEWSOK (Apr. 5, 2010, 1:51 PM), <http://blog.newsok.com/politics/2010/04/05/oklahoma-brings-in-millions-by-selling-personal-data/> (discussing Oklahoma’s sale of driver’s license information).

363. *Lubin v. Agora, Inc.*, 882 A.2d 833, 847 (Md. 2005) (quoting *CBS v. Democratic Nat’l Comm.*, 412 U.S. 94, 127 (1973)).

types of retailers—“general” retailers and “specialized” retailers.³⁶⁴ The state would have to argue that the chilling effect on speech is not present when a “general” retailer such as Amazon discloses the identity of a particular person and the fact that that person spent a certain amount on purchases from Amazon. Given that Amazon sells books, videos, tools, cameras, toys, and a variety of other products, the government’s knowing that a person bought a certain amount of items from Amazon is constitutionally different from knowing that the person bought a specific book. With a retailer like Amazon, the government lacks the ability to connect the individual to any expressive materials, let alone to a particular title. Accordingly, the government’s requirement of general retailers to provide such information would not chill the First Amendment activity of Amazon’s consumers. On the other hand, if a retailer like Penthouse, Quakerbooks.org, or Jihadiliterature.com has to report even the amount of purchases a particular individual made, the government obtains important information about the purchaser’s reading or viewing habits. Under *Lamont* and *Denver Area*, the government’s knowledge or disclosure of even the fact of purchasing from these or other specialized retailers might deter individuals from exercising their “unfettered” First Amendment right to receive expressive materials.³⁶⁵

Of course, the difficulty comes in trying to define the distinction between “general” and “specialized” non-collecting retailers in a way that is not unconstitutionally vague. Amazon provides a relatively clear example of a general retailer—it sells all varieties of expressive and non-expressive materials. Quakerbooks.com exemplifies a “specialized” retailer—it sells books focused on Quaker beliefs. But how should the state classify Barnes & Noble, which sells an extensive variety of almost exclusively expressive materials? Are bookstores “general” retailers because they carry all sorts of books or would they be exempt from reporting requirements under the “subjective concern” standard that the Wisconsin district court adopted in *In re Grand Jury Subpoena to Amazon*?³⁶⁶ Alternatively, how many non-

364. These authors use the term “general” retailers to mean those that sell all types of goods, perhaps including expressive materials on a variety of topics. With respect to “specialized” retailers, these authors mean those that focus their sales on certain types of expressive materials, e.g., political, sexually-themed, countercultural, or religious literature.

365. *In re Grand Jury Subpoena to Amazon.com*, 246 F.R.D. 570, 573 (W.D. Wis. 2007)).

366. See *supra* text accompanying notes 214–19 for an explanation of the “subjective concern” standard adopted in *WI Grand Jury*.

expressive products must a retailer specializing in sexually-themed products sell to qualify as a general retailer? Numerous other questions arise when one considers how to distinguish “general” retailers from “specialized” retailers.³⁶⁷

Given that Colorado is the first state to enact a reporting statute, the courts have not, as yet, had to address these issues. In light of its current budget problems, North Carolina should continue pursuing additional ways to improve use tax compliance, including the possible enactment of a Colorado-style reporting statute. North Carolina’s version, though, should distinguish expressly between general and specialized non-collecting retailers to avoid the First Amendment problems discussed above because, if nothing else, Amazon has shown that it is willing to assert and defend the First Amendment rights of its customers.

CONCLUSION

North Carolina has been proactive in trying to address the problem of use tax delinquency. Even so, North Carolina’s efforts to date have seen only limited success and, in the case of the click-through Amazon law, actually may have cost the state revenue. But with e-commerce continuing to expand and use tax compliance at less than four percent (which amounts to more than \$160 million in unpaid use taxes each year), North Carolina should continue seeking new ways to recapture these lost revenues.

The Washington district court’s opinion in *Amazon* provides North Carolina with one avenue—audit a remote retailer and request the names and general product information of consumers as part of that audit. This strategy raises a unique First Amendment question: whether the First Amendment limits the state’s ability to gather information about use tax compliance when the consumer purchases expressive materials. As we have explained, the constitutionality of this strategy likely depends upon whether the government’s request chills the First Amendment speech activity of North Carolina consumers. But, to date, no court has articulated a clear test for making this determination. Thus, North Carolina must be ready to explain why such a request does not deter expressive activity and,

367. For example, if a publisher of political propaganda sells clothing or home decorations, would this be sufficient to remove the chilling effect of the government’s learning about a taxpayer’s purchases from that publisher? Or would purchasers still worry—and therefore change their online purchasing habits—if the government knows that they are purchasing anything from retailers specializing in identifiable political, religious, or sexual themes?

consequently, avoids the First Amendment problems that plagued its general request for “all information” about North Carolina purchasers.

Given the time and expense of audits, coupled with the DOR’s desire to recover more of the unpaid use taxes, we believe that North Carolina should pursue two other courses of action to improve use tax compliance. First, North Carolina should consider adopting a Colorado-style reporting statute. Although this option is not without risk, it gives the DOR the means to learn both the identities of North Carolinians who make online purchases and the total amounts of those purchases, thereby enabling the DOR to determine each consumer’s use tax liability. Such a statute undoubtedly would confront dormant Commerce Clause and First Amendment challenges, but North Carolina has ways to respond to these constitutional claims.

With respect to the dormant Commerce Clause, the Supreme Court’s recent decisions suggest a more lenient approach toward statutes that provide disparate treatment to in-state and out-of-state economic interests where those economic interests are not “similarly situated.” Given that in-state retailers are required to collect sales tax at the time of sale and out-of-state retailers are not, the retailers are not similarly situated. Moreover, *Quill’s* antiquated physical presence standard, adopted at a time when internet commerce was in its infancy, should not be expanded to preclude uniform reporting requirements that require remote retailers to disclose information that they already maintain.

Furthermore, a carefully drafted reporting statute might avoid the First Amendment problems that threaten the Colorado statute. Although the First Amendment protects a citizen’s right to receive expressive materials anonymously, North Carolina should draft its reporting statute to avoid chilling a purchaser’s willingness to make purchases from retailers specializing in expressive materials that relate to private, controversial, embarrassing, or unpopular issues or topics. In particular, North Carolina should distinguish between specialized retailers and general retailers, such as Amazon, that sell a variety of expressive and non-expressive items. While such a distinction would be subject to a vagueness challenge, it would give the DOR a way to obtain tax-related information from most remote retailers and not only from Amazon.

Second, given that a reporting statute will not close the use tax gap completely, North Carolina and other states should continue trying to convince Congress to exercise its Commerce Clause

authority and to reverse *Quill's* antiquated physical presence standard. This would level the playing field between in-state and out-of-state retailers by allowing the states to require Amazon and other remote internet retailers to collect the use tax without implicating First Amendment or dormant Commerce Clause problems.

