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Locality v. Online Travel Company: Does the Bell Finally Toll for *Quill Corporation v. North Dakota*?

I. INTRODUCTION

IN RECENT YEARS, numerous lawsuits have arisen between localities and Online Travel Companies (“OTCs”) with regard to the payment of local “occupancy taxes.” Many localities impose occupancy tax on all hotel rooms rented within their borders, taxes that owner or operator of the hotel is responsible for collecting and remitting to the locality.¹ The tax is usually calculated as a percentage of the retail price a customer pays for a room.² Hotels thus charge their customers this retail rate plus the amount of the tax.³

This system of occupancy tax collection becomes more complex with the insertion of a third party into the booking process.⁴ Travel agencies, whether online or “brick-and-mortar” establishments, most commonly accept payment for the room directly from the consumer at a marked-up rate, then remit payment to the hotel consisting of the hotel’s wholesale rate plus an additional amount for taxes.⁵ This raises a question regarding the calculation of the tax – should it be calculated based on the wholesale rate the hotel charges for the room, or the marked-up rate that the consumer actually pays?

This question has given rise to much litigation between localities and OTCs.⁶ At issue initially were two main questions: (1) are OTCs responsible for this tax, and (2) if so, how is the tax calculated?⁷ The answers to these issues generally boiled down to statutory interpretation of the relevant ordinances, with an examination of the relevant enabling statute being the focus of each dispute.⁸ Naturally, different

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1. See *infra* Part II.a.

2. See *infra* Part II.a.

3. See *infra* Part II.a.

4. See *infra* Part II.b.

5. See *infra* Part II.b.

6. See *infra* Part II.c.

7. See *infra* Part II.d.

8. See *infra* Part II.d.

cases were decided differently based on the variations in local statutory language and judicial interpretation thereof.⁹

As a result, many localities amended their enabling statutes to explicitly hold OTCs responsible for collecting and remitting occupancy taxes based on the retail rate of the rooms rented.¹⁰ This set the stage for the next round of OTC litigation, in which the constitutionality of the imposition of the tax upon OTCs became the primary issue.¹¹ Perhaps the most in-depth discussion of this issue comes from *Baltimore v. Priceline*,¹² in which the City of Baltimore brought suit against numerous OTCs to recover underpaid occupancy taxes based on the City's amended enabling statute.¹³ The OTCs, now clearly identified in the statutes as being responsible for the tax, responded by arguing that the imposition of such a tax upon them is unconstitutional.¹⁴ Specifically, the OTCs argued that the statute violates the dormant commerce clause based on the physical presence requirement of *Quill Corp. v. North Dakota*,¹⁵ and fails the Supreme Court's test for the constitutionality of a state tax on an out-of-state entity set forth in *Complete Auto Transit v. Brady*.¹⁶

Underlying this dispute is an apparent trend toward the imposition of state sales and use taxes on internet sales by out-of-state entities.¹⁷ As Amazon seems to be accepting, or even supporting, the imposition of such taxes upon its sales, it seems probable that state taxes on internet sales will be a reality in the near future.¹⁸ This would, however, require the abrogation of the physical presence requirement of *Quill Corp. v. North Dakota*, either by Congressional legislation or the Supreme Court overruling itself.¹⁹

Part II of this comment will give an overview of OTC litigation. Part III will explore Supreme Court precedent regarding the constitutionality of state taxes on out-of-state entities. Part IV will use *Baltimore v. Priceline* as a framework for exploring the constitutional arguments against states imposing sales and use taxes on OTCs. Finally, Part V will discuss the potential abrogation of the Supreme Court's decision in *Quill Corp.* and the potentially enormous impact of the "Amazon Tax" on OTCs and on e-commerce generally.

9. See *infra* Part II.d.

10. See *infra* Part II.e.

11. See *infra* Parts II.f, IV.

12. Mayor & City Council of Balt. v. Priceline.com Inc., No. MJG-08-3319, 2012 WL 3043062 (D. Md. July 24, 2012) (Garbis, J.) [hereinafter Garbis Order].

13. *Id.* at *1; see also *infra* Part IV.

14. Garbis Order, *supra* note 12, at *2.

15. 504 U.S. 298 (1992). See *infra* Part III.b.

16. 430 U.S. 274 (1977). See *infra* Part III.a.

17. See *infra* Part V.b.

18. See *infra* Part V.b.

19. See *infra* Parts III.b, V.a.

II. A BRIEF HISTORY OF OTC LITIGATION

a. Occupancy Taxes

Many states and localities collect “occupancy taxes,” which are taxes imposed upon guests of rented rooms within the borders of the state or locality.²⁰ Generally, these taxes are calculated based on the rate the guest pays for the room.²¹ However, different localities’ statutes differ in language and thus also in judicial interpretation.

In Kentucky, for example, the state statute governing the tax specifies that it applies to “the rent for every occupancy of a suite, room, or rooms, charged by all persons, companies, corporations, or other like or similar persons, groups or organizations doing business as motor courts, motels, hotels, inns *or like or similar accommodations businesses*.”²² In Georgia, the state’s enabling statute creates an excise tax “at the applicable rate on the lodging charges actually collected.”²³ A city ordinance from Columbus, Georgia specifies that the tax be based on the “charge to the public’ for a hotel room.”²⁴

However, many of these taxes have been on localities’ books for decades and thus were drafted before the internet became a primary avenue for booking hotel rooms.²⁵ As such, they were not originally intended to address online reservations and rentals.²⁶

b. Travel Agency Business Models

Travel agencies traditionally operate under one of two business models. Under the “agency model,” an agent refers the guest to the hotel and receives a commission based on the cost of the rental as set by the hotel.²⁷ Under the more commonly employed “merchant model,” an agent rents unused hotel rooms directly to the guest at a marked-up rate, remitting a lower wholesale rate for the room back to the hotel.²⁸

20. This tax is also referred to as “bed tax,” “transient occupancy tax,” or “tourism development tax” in different localities. See Kerra J. Melvin, Comment, *Technology, Travel Companies & Taxation: Should Expedia Be Required to Collect and Remit State Occupancy Taxes on Profits from Facilitating Hotel Room Rentals?*, 8 WASH. J.L. TECH. & ARTS 43, 46 n.2 (2012).

21. *Id.* at 46.

22. KY. REV. STAT. ANN. § 91A.390(1) (2008) (emphasis added).

23. GA. CODE ANN. § 48–13–51(a)(1)(B)(i) (West 2013).

24. *Expedia, Inc. v. City of Columbus*, 681 S.E.2d 122, 128 (Ga. 2009) (citing Columbus Code § 19–111).

25. See Melvin, *supra* note 20, at 47.

26. *Id.*

27. *Id.*

28. *Id.*

Under the merchant model, the transaction between the OTC and the customer is typically broken into three items: (1) the room rental rate as marked up by the OTC, (2) “taxes and services” (including local occupancy taxes), and (3) the total cost as determined by adding the rental rate, taxes, and service fees.²⁹ Thus, a typical transaction could look like this: a hotel offers unused rooms to OTCs for \$100 per room. The OTC rents those rooms to consumers, charging \$200 for the room and \$20 for “taxes and fees,” including local occupancy taxes. The OTC then remits \$108 to the hotel—\$100 for the room, and \$8 for taxes calculated based on the \$100 that the hotel received for the rental. Initially, then, the OTCs paid the occupancy tax based on the wholesale rate rather than the marked up rate they received from customers.³⁰

c. Issue Recognized

In the mid-2000s, localities began to realize that the tax implications of the two models differ.³¹ Under the agency model, the agent is not responsible for any occupancy tax because the guest pays the hotel directly for the room.³² Under the merchant model, though, because occupancy taxes are calculated based on the total amount paid by the hotel guest for the room,³³ the fact that the agent receives the total amount of rent but remits only a portion of it to the hotel seems to put the agent on the hook for the payment of the tax on the amount retained by the agent.³⁴ Localities certainly thought so and started bringing lawsuits against OTCs to compel payment of the tax.

d. Early Litigation – Do Occupancy Tax Statutes Implicate OTCs?

These first occupancy tax cases boiled down to issues of statutory interpretation, yielding disparate outcomes based on different statutory language and judicial interpretation thereof. In *Expedia, Inc. v. City of Columbus*,³⁵ the Georgia Supreme Court rendered an opinion which included an extended analysis of the Columbus occupancy tax.³⁶ The language at issue in that case was “lodging charges actually

29. See, e.g., *Vill. of Rosemont, Ill. v. Priceline.com, Inc.*, No. 09 C 4438, 2011 WL 4913262, at *1 (N.D. Ill. Oct. 14, 2011).

30. *Id.*

31. The first case involving OTCs and state taxes to generate a judicial order seems to be *City of Rome, Ga. v. Hotels.com, LP*, No. 4:05–CV–249–HLM, 2006 WL 6595753 (N.D. Ga., May 9, 2006).

32. See, e.g., *City of Goodlettsville, Tenn. v. Priceline.com, Inc.*, 605 F. Supp. 2d 982, 985 (M.D. Tenn. 2009) (noting that, under the agency model, the hotel “sets the price of the room and is the merchant of record for the transaction, and the consumer pays the hotel directly”).

33. That is, the room rate exclusive of sales taxes. See, e.g., *Vill. of Rosemont*, 2011 WL 4913262, at *1.

34. See Melvin, *supra* note 20, at 48.

35. 681 S.E.2d 122 (Ga. 2009).

36. *Id.* at 127–28.

collected” and “charge to the public,”³⁷ both of which the court interpreted as applying to the payment collected by OTCs.³⁸ The court thus affirmed the trial court’s conclusion that the taxable amount be based on the rate the OTCs charged each customer for the room.³⁹

In contrast, the primary issue in *Louisville/Jefferson County v. Hotels.com*⁴⁰ was whether OTCs were encompassed by the phrase “like or similar accommodations businesses” in Kentucky’s occupancy tax Enabling Statute.⁴¹ The Sixth Circuit did not include travel agencies, either online or “brick-and-mortar,” among these “like or similar accommodations businesses”⁴² and thus did not subject OTCs to the tax.⁴³ The Sixth Circuit reaffirmed its interpretation of “like or similar accommodations businesses” in *City of Columbus v. Hotels.com* in 2012.⁴⁴

e. Statutes Amended

Correctly anticipating likely defeat based on its original statutory language, Baltimore amended its occupancy tax ordinance in 2007.⁴⁵ The amended ordinance taxes “all gross amounts of money *paid to the owners or operators* of hotels in the City by transient guests or tenants for renting, using, or occupying a room or rooms in those hotels for sleeping accommodations.”⁴⁶ “Owners or operators” are defined to include persons “receiving any consideration for the rental of a hotel room for sleeping accommodations, including, without limitation, any broker, service provider, or other intermediary: (i) with which a hotel has contracted to arrange for the rental of a hotel room for sleeping accommodations.”⁴⁷ The District Court for

37. *Id.*

38. *Id.* at 128.

39. *Id.*

40. *Louisville/Jefferson Cnty. Metro Gov’t v. Hotels.com, L.P.*, 590 F.3d 381 (6th Cir. 2009).

41. *Id.* at 384–88; KY. REV. STAT. ANN. § 91A.390(1) (2008) (“The local governing body or bodies shall include the commission in the annual budget and shall provide funds for the operation of the commission by imposing a transient room tax, not to exceed three percent (3%) of the rent for every occupancy of a suite, room, or rooms, charged by all persons, companies, corporations, or other like or similar persons, groups, or organizations doing business as motor courts, motels, hotels, inns, or *like or similar accommodations businesses*.” (emphasis added)).

42. *Louisville/Jefferson Cnty.*, 590 F.3d. at 387–88; *see also Pitt Cnty. v. Hotels.com, L.P.*, 553 F.3d 308, 313 (4th Cir. 2009) (holding that OTCs were not implicated by a North Carolina county ordinance requiring that hotels and “similar type businesses” collect and remit occupancy taxes).

43. *Louisville/Jefferson Cnty.*, 590 F.3d at 390 (affirming district court’s judgment conclusion that OTCs are not “like or similar accommodations businesses” within the meaning of Kentucky’s enabling statute).

44. *City of Columbus, Ohio v. Hotels.com, L.P.*, 693 F.3d 642, 646 (6th Cir. 2012).

45. *See Garbis Order, supra* note 12, at *9 (noting that the previous version of Baltimore’s occupancy tax did not apply to OTCs).

46. BALT. CITY CODE art. 28 § 21-2 (2012) (emphasis added). “Gross amounts of money” are defined as “the total gross payments of any kind . . . received in a retail transaction for which real property is rented . . . without any deduction for charges or other amounts of any services necessary to complete the transaction.” *Id.* § 21-1(b).

47. *Id.* § 21-1(d)(3).

the District of Maryland subsequently interpreted this broad language from the amended statute as subjecting OTCs to the tax.⁴⁸

f. Recent Litigation – Legality of Statutes Challenged

However, a judicial interpretation stating that the tax applies to monies collected by OTCs is by no means the end of the story. In *Baltimore v. Priceline*, for example, the defendant OTCs raised numerous defenses to liability under the amended statute, including that the statute violates the Dormant Commerce Clause.⁴⁹ In denying the OTCs’ motion for summary judgment, the District Court focused in great detail on the Commerce Clause arguments in the most in-depth examination to date of these issues with regard to OTC Occupancy Tax litigation.⁵⁰ Indeed, the success or failure of these constitutional arguments is likely to determine the future of OTC occupancy tax litigation, unless Congress enacts one of the proposed statutes authorizing state taxation of out-of-state internet commerce.⁵¹

III. SUPREME COURT PRECEDENT — THE PHYSICAL PRESENCE REQUIREMENT

The constitutionality of a state tax on an out-of-state entity has long been a thorny issue. The primary question—whether physical presence within a state is required in order for a state tax on an out-of-state entity to be constitutional—has been at the heart of three pivotal Supreme Court cases: *National Bellas Hess, Inc. v. Dep’t of Revenue of Illinois*,⁵² *Complete Auto Transit, Inc. v. Brady*,⁵³ and *Quill Corp. v. North Dakota*.⁵⁴

a. Bellas Hess & Complete Auto

In *National Bellas Hess, Inc. v. Dep’t of Revenue of Illinois*,⁵⁵ the Supreme Court established a bright-line rule in holding that the Due Process and Commerce Clauses prohibit taxation of a retailer “whose only connection with customers in

48. Garbis Order, *supra* note 12, at *1.

49. *Id.* at *2. The statute was also challenged on the grounds that it violates the Due Process Clause, and Equal Protection Clause, and the Internet Tax Freedom Act, as well as that the tax is an “impermissible new sales tax” prohibited by the Maryland Tax Code. *Id.*

50. *Id.* at *2–7; see *infra* Part IV.

51. See *infra* Part V.a.

52. 386 U.S. 753 (1967).

53. 430 U.S. 274 (1977).

54. 504 U.S. 298 (1992).

55. *Bellas Hess*, 386 U.S. at 753.

the State is by common carrier or the United States mail.”⁵⁶ Thus, the Court reversed the Illinois Supreme Court’s holding that National Bellas Hess Inc., a Missouri corporation whose only connection to Illinois was that it mailed merchandise to customers there, was subject to Illinois state use tax on the merchandise it sold for use in Illinois.⁵⁷

The Court explained that the inquiries under the Due Process Clause and Commerce Clause into the constitutionality of a state use tax were similar, in that both required some minimum level of connection between the party being taxed and the taxing locality.⁵⁸ In order for the tax to satisfy the Due Process Clause, the taxing locality must have “given [the retailer] anything for which it can ask in return;”⁵⁹ to satisfy the Commerce Clause, the tax must be designed to compensate the locality for the protection it gives to the retailer.⁶⁰ The Court held that neither applied to the relationship between Illinois and National Bellas Hess and, therefore, Bellas Hess was not subject to the state’s use tax.⁶¹

A decade later, in *Complete Auto Transit, Inc. v. Brady*, the Court revisited the issue of taxation of an out-of-state entity and established a test for the constitutionality of such taxes.⁶² Unlike in *Bellas Hess*, where the Court focused partially on Due Process, the *Complete Auto* test focuses exclusively on the Commerce Clause.⁶³ Under the *Complete Auto* test, a state or local tax imposed on an out-of-state entity is constitutional under the Commerce Clause only if it (1) is “applied to an activity with a substantial nexus to 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.”⁶⁴

The most significant element of the *Complete Auto* test, relative to the Court’s holding in *Bellas Hess*, is that a state tax on an out-of-state entity may be constitutional where a taxed entity has a “substantial nexus” to the taxing state, even if that entity has no physical presence within the state.⁶⁵ This has clear relevance for the OTC litigation because, while OTCs rarely if ever have a physical

56. *Id.* at 758; U.S. CONST. amend. XIV, § 1 (“nor shall any State deprive any person of life, liberty, or property, without due process of law”); U.S. CONST. art. I, § 8, cl. 3 (“The Congress shall have Power . . . to regulate Commerce . . . among the several States . . .”).

57. *Bellas Hess*, 386 U.S. at 754, 760.

58. *Id.* at 756.

59. *Id.* (quotation marks and citation omitted).

60. *Id.* In the Court’s language, the tax “can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.” *Id.* (quotation marks and citation omitted).

61. *Id.* at 758–60.

62. 430 U.S. 274, 279 (1977).

63. *Id.*

64. *Id.*

65. *Id.*

presence in the taxing locality, they may still be deemed to be subject to the tax based on other factors.⁶⁶

b. Quill Corp.

In 1992, the Supreme Court considered the case of *Quill Corp. v. North Dakota*.⁶⁷ In that case, the question was whether North Dakota could impose a use tax upon an office equipment supplier with no significant property in or relation to the state beyond sales to its residents.⁶⁸ Quill, a Delaware corporation, sold office equipment and supplies and solicited business largely by mailing catalogs, flyers, and other advertisements to customers.⁶⁹ It delivered its merchandise to customers “by mail or common carrier” from locations outside of North Dakota.⁷⁰

North Dakota imposed use tax on “property purchased for storage, use, or consumption within the state” from any retailer that “engages in regular or systematic solicitation of a consumer market in th[e] state.”⁷¹ It brought suit, seeking a declaration that Quill was subject to the state’s use tax despite its lack of physical presence within the state.⁷²

The trial court ruled for Quill, citing *Bellas Hess* for the proposition that the lack of any physical presence rendered a state tax unconstitutional under the Due Process and Commerce Clauses.⁷³ The Supreme Court of North Dakota reversed, citing *Complete Auto* and the lower threshold of “substantial nexus”—as opposed to “physical presence”—required for a state tax to be constitutional under the Commerce Clause.⁷⁴ This left the Supreme Court to try to reconcile the apparent inconsistency between its two earlier holdings.

While distancing itself from the *Bellas Hess* bright-line rule with regard to the Due Process Clause,⁷⁵ the Court explained that *Bellas Hess* is not inconsistent with *Complete Auto* with regard to the Commerce Clause.⁷⁶ Instead, “*Bellas Hess* . . . stands for the proposition that a vendor whose only contacts with the taxing State

66. See *infra* Part IV.a (discussing courts’ interpretations of “substantial nexus”).

67. 504 U.S. 298 (1992).

68. *Id.* at 301.

69. *Id.* at 302.

70. *Id.*

71. *Id.* at 302–03.

72. *Id.* at 301.

73. *Id.* at 303.

74. *State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 219 (N.D. 1991), *rev’d* 504 U.S. 298 (1992).

75. *Quill Corp.*, 504 U.S. at 307–08 (acknowledging that the Court’s Due Process jurisprudence had “evolved substantially” since *Bellas Hess*, overruling the “formalistic” physical presence requirement under the Due Process Clause, and explaining that the substantial nexus inquiry with regard to Due Process more properly mirrors the minimum contacts test for *in personam* jurisdiction from *International Shoe v. Washington*, 326 U.S. 310 (1945)).

76. *Id.* at 311.

are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.⁷⁷ The Court went on to reverse the North Dakota high court, explaining:

*The State of North Dakota relies less on Complete Auto and more on the evolution of our due process jurisprudence. The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process “minimum contacts” test, then that corporation also meets the Commerce Clause “substantial nexus” test. We disagree.*⁷⁸

Ultimately, the Court concluded that, while physical presence is no longer required for a finding of substantial nexus under the Due Process clause, it is required for a finding of substantial nexus—and thus constitutionality of state sales & use taxes—under the Commerce Clause.⁷⁹ The Court also indicated that the question of whether out-of-state retailers with no physical presence in a state should be subject to that state’s sales and use taxes is a matter better decided by Congress.⁸⁰

IV. CONSTITUTIONAL ARGUMENTS IN *BALTIMORE v. PRICELINE.COM*

In *Baltimore v. Priceline.com*, the City of Baltimore brought suit against numerous OTCs to recover underpaid occupancy taxes.⁸¹ The Defendant OTCs moved for

77. *Id.*

78. *Id.* at 312. In this passage, the Court acknowledged that it had adopted a “minimum contacts” test with regard to Due Process in *International Shoe*, 326 U.S. at 316, which is much more lenient than the “physical presence” requirement for Due Process outlined in *Bellas Hess*. Nat’l Bellas Hess, Inc. v. Dep’t of Revenue of Ill., 386 U.S. 753, 758 (1967). The “minimum contacts” test is even a lower threshold than the “substantial nexus” test. See *Quill Corp.*, 504 U.S. at 313 (“[T]he ‘substantial nexus’ requirement is not, like due process’ ‘minimum contacts’ requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, . . . a corporation may have the ‘minimum contacts’ with a taxing State as required by the Due Process Clause, and yet lack the ‘substantial nexus’ with that State as required by the Commerce Clause.”). As such, a tax on an out-of-state entity may satisfy due process but still be unconstitutional under the Commerce Clause.

79. *Quill Corp.*, 504 U.S. at 314 (“The State Supreme Court reviewed our recent Commerce Clause decisions and concluded that those rulings signaled a ‘retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach’ and thus supported its decision not to apply *Bellas Hess*. Although we agree with the state court’s assessment of the evolution of our cases, we do not share its conclusion that this evolution indicates that the Commerce Clause ruling of *Bellas Hess* is no longer good law. . . . Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.” (internal citations omitted)).

80. *Id.* at 318; see *infra* Part V.a.

81. See Garbis Order, *supra* note 12, at *1.

summary judgment, arguing that Baltimore's occupancy tax violated the dormant aspect of the Commerce Clause,⁸² which "denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce."⁸³ To support this contention, the OTCs argued that the ordinance failed the *Complete Auto* test⁸⁴ for constitutionality of a state or local tax on an out-of-state entity.⁸⁵

In *Baltimore v. Priceline*, the OTCs unsuccessfully argued that Baltimore's occupancy tax ordinance failed each of the four prongs of the *Complete Auto* test.⁸⁶ The court's discussion of these arguments is highly instructive and provides a framework for examining the constitutionality of imposing local occupancy taxes on out-of-state OTCs.

a. *Substantial Nexus*

The definition of "substantial nexus" has remained elusive.⁸⁷ Even after the Supreme Court upheld the *Bellas Hess*⁸⁸ bright-line rule requiring physical presence for a finding of substantial nexus under the Commerce Clause in *Quill Corp.*,⁸⁹ lower courts have differed over the meaning of that requirement.⁹⁰

In perhaps the most lenient interpretation of "substantial nexus," the United States District Court for the District of Maryland held that the mere presence of a VoIP⁹¹ customer's Maryland billing address was sufficient to create a substantial nexus between the VoIP company and the state of Maryland.⁹² The South Carolina Supreme Court found a substantial nexus on the basis of a trademark ("Toys R Us") being licensed for use in South Carolina, even where the corporation owning the trademark has no physical presence in that state.⁹³ The Supreme Court of Appeals of West Virginia held that a bank's "significant economic presence," as determined by the number and value of transactions with state citizens, was sufficient to satisfy the substantial nexus prong.⁹⁴ However, the Tennessee Court of

82. *Id.* at *2; U.S. CONST. art. I, § 8, cl. 3.

83. *Or. Waste Sys., Inc. v. Dep't of Env'tl. Quality of Or.*, 511 U.S. 93, 98 (1994).

84. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

85. *See Garbis Order*, *supra* note 12, at *2.

86. *Garbis Order*, *supra* note 12, at *3; *see also Complete Auto*, 430 U.S. at 279; *supra* Part III.a.

87. *See, e.g., Julie Roman Lackner, Note, The Evolution and Future of Substantial Nexus in State Taxation of Corporate Income*, 48 B.C. L. REV. 1387, 1391 (2007).

88. *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753 (1967).

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

90. *Compare, e.g., Mayor & City Council of Balt. v. Vonage Am., Inc.*, 569 F. Supp. 2d 535, 538–39 (D. Md. 2008) (not requiring physical presence) *with J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 842 (Tenn. Ct. App. 1999) (requiring physical presence).

91. VOIP stands for "Voice Over Internet Protocol," a method of telecommunication involving the transfer of data over the internet rather than via telephone wires.

92. *Vonage*, 569 F. Supp. 2d at 538–39.

93. *Geoffrey, Inc. v. S.C. Tax Comm'n*, 447 S.E.2d 13, 18 (S.C. 1993).

94. *Tax Comm'r v. MBNA Am. Bank, N.A.*, 640 S.E. 2d 226, 234 (W. Va. 2006).

Appeals held that a lack of physical presence necessarily precludes a finding of substantial nexus.⁹⁵

Given the *Quill Corp.* Court's holding that "a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause,"⁹⁶ only the Tennessee court would seem to have this right. Certainly, *Baltimore v. Vonage* seems wrongly decided on this issue given that the court did not address the physical presence requirement and instead cited *Quill Corp.* only for the proposition that the "'substantial nexus' requirement is 'a means for limiting state burdens on interstate commerce.'"⁹⁷ In *Geoffrey*, however, the South Carolina Supreme Court noted that *Quill Corp.*'s physical presence requirement applies only to the constitutionality of *sales and use taxes* and not to other types of taxes, such as income taxes on royalties resulting from a licensing agreement.⁹⁸ The Supreme Court of Appeals of West Virginia relied on the same logic in *MBNA America Bank*, concluding that the physical presence requirement does not apply to business franchise and corporate net income taxes.⁹⁹

In *Baltimore v. Priceline*, the challenged occupancy tax *was* a sales and use tax, though, and thus without a physical presence, the OTCs would lack the substantial nexus to the taxing state. However, the defendant OTCs "made the strategic decision" not to argue that their business lacked a substantial nexus to Baltimore City.¹⁰⁰ Instead, the defendants argued that *Complete Auto* established a "transactional nexus" requirement and contended that two separate transactions take place when a customer books a room through their site.¹⁰¹ First, "monies [are] paid by consumers (via the OTCs) to the hotels for the use of the hotel rooms;" next, "monies [are] paid by consumers to the OTCs for the provision of the OTC's [sic] travel facilitation services."¹⁰² The argument is that, while occupancy taxes are paid on the first portion, the portion of the transaction relating to the OTCs' services lack a substantial nexus to the taxing locality because the OTCs' offices, call centers, and servers are located outside of Baltimore.¹⁰³ The District Court rejected

95. J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831, 842 (Tenn. Ct. App. 1999) (noting that "the Commissioner has pointed to no case in which the Supreme Court of the United States has upheld a state tax where the out-of-state taxpayer had absolutely no presence in the taxing state"). *But see* Am. Online, Inc. v. Johnson, No. M2001-00927-COA-R3-CV, 2002 WL 1751434, at *2 (Tenn. Ct. App. July 30, 2002) (interpreting Supreme Court precedent as mandating a finding of no substantial nexus "where no activities had been carried on in the taxing state *on the taxpayer's behalf*").

96. *Quill Corp. v. North Dakota*, 504 U.S. 298, 299 (1992).

97. *Vonage*, 569 F. Supp. 2d at 539 (quoting *Quill Corp.*, 504 U.S. at 313).

98. *Geoffrey*, 447 S.E.2d at 18 & n.4.

99. *MBNA Am. Bank*, 640 S.E.2d at 232.

100. Garbis Order, *supra* note 12, at *3-4. The reasons behind the defendants' decision to forego a what appears to be a winning argument are not clear.

101. *Id.* at *3. The OTCs, as the court noted, cited no authority for the purported "transactional nexus" requirement. *Id.*

102. *Id.*

103. *Id.* at *4.

this argument, noting that the consumer sends one payment to the OTCs and, even if it were properly split into two payments as the OTCs suggest, the travel facilitation services *do* have a substantial nexus to Baltimore because these services facilitate travel for the taxpayer to a hotel located in Baltimore.¹⁰⁴

Unlike the defendants in *Baltimore v. Priceline*, most OTC defendants have not abandoned the argument that there is no substantial nexus between them and the taxing locality. Yet, despite the bright-line physical presence rule affirmed in *Quill Corp.*, trial courts have found a substantial nexus between OTCs and the taxing localities even where physical presence is lacking.¹⁰⁵ In diverging from the holding in *Quill Corp.*, courts have focused on the fact that occupancy taxes are levied on the hotel customers rather than on the OTCs themselves. In *Village of Rosemont v. Priceline.com*,¹⁰⁶ the court put it thus:

*First, the tax is levied for the privilege and use of renting a hotel room in Rosemont. The tax is paid by the rentor, who uses the room, regardless of where or how he made the reservation. Second, defendants enter into contracts with hotels in Rosemont for the right to market, facilitate and book reservations for their properties, and they profit from such reservations. The fact that the customer pays for the hotel room online, as opposed to in person at the hotel, is not of constitutional significance, given the nature of the in-state activity involved, i.e., the fact that the consumer stays in a hotel in Rosemont, the majority of the money for the hotel stay is remitted to Rosemont and the purpose of defendants' online transaction is to have the right to use property in Rosemont. Although the hotels are not defendants' regular employees or agents, the services provided by the hotels are significantly associated with the defendants' ability to establish and maintain a market in the taxing state.*¹⁰⁷

104. *Id.*

105. *See, e.g.,* City of Charleston, S.C. v. Hotels.com, LP, 586 F. Supp. 2d 538, 544 (D.S.C. 2008) (“Here, there is both a substantial nexus and a physical presence between the taxing jurisdictions and Defendants, since Defendants are alleged to have proactively marketed, booked, and leased hotel rooms and other accommodations which are physically located in Charleston and Mt. Pleasant.”); City of San Antonio v. Hotels.com, No. SA-06-CA-381-OG, 2008 WL 2486043, at *14 (W.D. Tex. May 27, 2008) (concluding that Defendants’ substantial nexus argument is a “red herring” because, by remitting state tax on the wholesale rate (even if not on the retail rate at OTCs sell to customers), OTCs acknowledge that they are subject to that tax); Travelscape, LLC v. S. C. Dep’t of Revenue, 705 S.E.2d 28, 37 (S.C. 2011) (substantial nexus requirement satisfied where Defendants’ employees made business visits to state, entered into contracts with state hotels, customer actually stays at hotel within the state, and “the services provided by the hotels are significantly associated with [the Defendant’s] ability to establish and maintain a market in South Carolina for its sales”).

106. No. 09-C-4438, 2011 WL 4913262 (N.D. Ill. Oct. 14, 2011).

107. *Id.* at *7 (internal quotation marks and citations omitted).

In effect, this argument focuses on the fact that the activity being taxed in these ordinances is “the payment of money *by transient guests* for renting a hotel room, inclusive of charges for services necessary to complete the rental transaction.”¹⁰⁸ There is little question that the “hotel guest . . . has a substantial nexus to the City because she travels to the City and occupies a room in the City.”¹⁰⁹ As such, the argument goes, the taxable event—the occupation and use of a hotel room by a guest—occurs within municipal boundaries, negating any argument of a lack of substantial nexus between the activity being taxed and the taxing locality. Indeed, “but for the fact that [OTCs have] willingly inserted [themselves] as a matter of contract into the local taxation scheme designed for hotels and their guests, there would be no dispute.”¹¹⁰

However, the fact that the tax is levied on the hotel guests fails to distinguish these cases from *Quill Corp.* In *Quill Corp.*, the question was whether a use tax could be imposed by North Dakota upon an office equipment supplier with no significant property or relation to the state beyond sales to its residents.¹¹¹ Like with the occupancy taxes, the use tax in *Quill Corp.* was to be remitted to the state by Quill, but it was levied—at least theoretically¹¹²—on those of its customers who use the merchandise in North Dakota.¹¹³ This situation seems entirely analogous to the present OTC lawsuits because, in both cases, the customers incur the tax but the merchant is responsible for remitting it to the state.¹¹⁴ In *Quill Corp.*, though, the Supreme Court held that the out-of-state defendant was exempt from the local tax.¹¹⁵ In recent OTC litigation, out-of-state travel companies are being held responsible for local occupancy taxes.¹¹⁶

It remains to be seen exactly how the tension between the recent OTC decisions and *Quill Corp.* will be resolved. However, as the Internet continues to challenge traditional notions of physical boundaries, and as the volume of online sales continues to take a bigger and bigger bite out of taxable sales by brick-and-mortar establishments,¹¹⁷ the holding of *Quill Corp.* seems ever more in need of

108. Garbis Order, *supra* note 12, at *5 (emphasis added).

109. *Id.*

110. *Expedia, Inc. v. City of Columbus*, 681 S.E.2d 122, 128 (2009).

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

112. Presumably, in the eyes of North Dakota, it would be irrelevant whether the corporation remitted tax payments it collected from its customers or simply paid the tax out of its own pocket.

113. See *id.* at 303 (explaining that Quill Corp.’s unwillingness to “collect a use tax from its North Dakota customers” made it liable for the tax in the eyes of the state’s Tax Commissioner).

114. See *supra* Part II.a.

115. *Quill Corp.*, 504 U.S. at 319.

116. See *supra* notes 105–110 and accompanying text.

117. See, e.g., Betsy Morris, *More Consumers Prefer Online Shopping*, WALL ST. J. (June 3, 2013, 10:27 AM), <http://online.wsj.com/news/articles/SB10001424127887324063304578523112193480212> (noting that online shopping “continues to outpace growth in traditional retail” and that, in the United States, e-commerce grew by 15% in 2012, a rate seven times faster than that of total retail spending).

reevaluation. OTC litigation may provide the Supreme Court with a chance to do just that, although it seems more likely that the Court will continue to defer to Congress with regard to taxation of e-commerce.¹¹⁸

b. Fair Apportionment

The second argument against the constitutionality of Baltimore's occupancy tax raised by the OTCs in *Baltimore v. Priceline* is that it fails the fair apportionment prong of the *Complete Auto* test.¹¹⁹ This prong aims "to ensure that each State taxes only its fair share of an interstate transaction."¹²⁰

To succeed in claiming a lack of fair apportionment, the taxpayer must prove that the tax imposed is disproportionate to the business transacted in the taxing locality.¹²¹ Fair apportionment also requires that a tax be both internally and externally consistent.¹²² A tax is internally consistent if it is "structured so that if every State were to impose an identical tax, no multiple taxation would result."¹²³ External consistency relates to "whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State."¹²⁴

In *Baltimore v. Priceline*, the OTCs disputed the external consistency of Baltimore City's occupancy tax, arguing that, because the OTCs' operations occur entirely outside of the taxing locality, the services they provide are beyond that which is "fairly attributable to the economic activity within" the taxing locality.¹²⁵ The Court found this argument unconvincing and reasoned that "the full gross payment for a hotel room, inclusive of any value attributable to rental facilitation, is fairly attributable" to the taxing locality.¹²⁶

Indeed, with regard to sales of goods in general, the Supreme Court has observed that a "transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed."¹²⁷ As such, the Court has "held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale . . ."¹²⁸ In *Baltimore v. Priceline*, the District Court applied this logic to hotel room rentals, concluding that "the retail rental of a hotel room,

118. See *infra* Part V (addressing the possibility that the issues surrounding the "Amazon Tax" may prove the catalyst which forces Congressional reconsideration of the physical presence requirement).

119. See Garbis Order, *supra* note 12, at *5.

120. *Goldberg v. Sweet*, 488 U.S. 252, 260–61 (1989).

121. See *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 180 (1983).

122. *Goldberg*, 488 U.S. at 261.

123. *Id.*

124. *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).

125. See Garbis Order, *supra* note 12, at *5; *Jefferson Lines*, 514 U.S. at 185.

126. Garbis Order, *supra* note 12, at *6 n.8.

127. *Jefferson Lines*, 514 U.S. at 186.

128. *Id.*

whether facilitated online using interstate or international computer servers or in person at the hotel reception desk, is most sensibly viewed as a discrete event facilitated by the laws and amenities of the place of the hotel.”¹²⁹ Thus, the total payment made in the transaction would be fairly attributable to the taxing locality.¹³⁰

This seems compelling. The rental of a hotel room by a customer is the event being taxed and the tax is imposed on the consumer, though the burden of remitting the tax is transferred to whoever accepts payment for the room.¹³¹ It seems in no way unreasonable that the tax be levied on the full amount paid by the consumer, because without the police and fire protection provided by the locality, as well as infrastructural support in the form of city streets, sewers, water, and electricity, hotels would struggle to operate. Moreover, the payment made to an OTC by a consumer is not divided into a room rental rate and a rental facilitation rate.¹³² As such, the OTC’s contribution to the value of the room is not taxed separately,¹³³ greatly weakening the argument that, because their operations are outside of the taxing locality, the tax is unfairly apportioned.

One could argue, however, that because the OTC remits to the hotel only part of the fee it receives from the consumer, this gives a coherent basis for separating the OTC’s contribution to the value of the room from the total amount paid by the consumer. Indeed, it is not clear that the amount of value added by the OTCs need be apparent to the customer in order for fair apportionment to be determined. It would seem the province of the court to evaluate the value added by OTCs to the process of hotel room rental and make the legal determination of fair apportionment. However, as courts seem reluctant to divide the fees into amounts earned by hotels and OTCs respectively, it seems the OTCs will have difficulty carrying the burden of persuasion with regard to unfair apportionment.

c. Discrimination Against Interstate Commerce

The crux of the argument with regard to the discrimination against interstate commerce prong of the *Complete Auto* test is that, while localities seek to collect

129. Garbis Order, *supra* note 12, at *6.

130. *Id.*

131. See *supra* Part II.a.

132. See Melvin, *supra* note 20, at 47 (“When the customer books a hotel room reservation through the OTC’s website, the OTC charges the customer an amount that is greater than the wholesale rate, referred to as the “marked-up rate,” which represents the total amount paid by the consumer. The difference between the marked-up rate and the wholesale rate is the OTC’s profit margin.” (citations omitted)).

133. In *Baltimore v. Priceline*, the District Court further noted that because OTC’s services are available on the internet and the relative profits of the hotel and the OTC from an online transaction are not discoverable by an online customer, the transaction “does not ‘readily reveal the extent to which [the] interstate activity affects the value on which a buyer is taxed.’” Garbis Order, *supra* note 12, at *6 (quoting *Jefferson Lines*, 514 U.S. at 186 (alterations in original)).

occupancy taxes from OTCs, they fail to collect them from local “brick-and-mortar” travel agencies.¹³⁴ This argument rings very close to arguments based on the Equal Protection Clause of the 14th Amendment¹³⁵ and is, if true, certainly appealing on its face. To the extent that states are not collecting tax from local agencies providing the same service as the OTCs, there would indeed seem to be an inequity that both discriminates against interstate commerce and denies the OTCs equal protection under the law.

However, evidence of this alleged discrimination seems to be elusive, perhaps as a result of the general decline in the number of brick-and-mortar travel agencies.¹³⁶ In *Baltimore v. Priceline*, for example, the parties argued over which party bears the burden of proof that such discrimination either was or was not occurring, with neither party providing any evidence one way or another and claiming it was the other’s responsibility.¹³⁷ The District Court sided with Baltimore, noting that the party raising the constitutional challenge bears the burdens of production and persuasion.¹³⁸ Thus, unless OTCs are able to produce evidence of actual discrimination in future cases, this argument must fail. In the meantime, localities would be well advised to ensure they collect the tax from local travel agents if they wish to collect the tax from OTCs.¹³⁹

d. Fair Relation to Services Provided by State

The final prong of the *Complete Auto* test looks to whether a tax is overly burdensome in relation to the benefits the taxed party receives from the taxing locality.¹⁴⁰ The OTCs contend that occupancy taxes imposed upon them are not in fair relation to state or local services they received which, they argue, are very minor

134. See, e.g., Garbis Order, *supra* note 12, at *6.

135. U.S. CONST. amend. XIV, § 1.

136. The number of travel agencies in the United States declined from around 34,000 in the mid-1990s to around 13,000 in 2013. Rebecca L. Weber, *The Travel Agent Is Dying, but It's Not yet Dead*, CNN (Oct. 10, 2013 5:20 AM), <http://edition.cnn.com/2013/10/03/travel/travel-agent-survival/>; see also David Grossman, *The Ever-Changing Role of the Travel Agent*, USA TODAY (Jan. 24, 2007), http://usatoday30.usatoday.com/travel/columnist/grossman/2007-06-22-travel-agents_N.htm (noting that in 2007, 20,000 accredited travel agents remained in the United States). But see U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, OCCUPATIONAL OUTLOOK HANDBOOK: TRAVEL AGENTS (2014), available at <http://www.bls.gov/ooh/sales/travel-agents.htm> (last visited Feb. 24, 2014) (placing the number of travel agents at 73,300 and predicting only a 12% decline in number of travel agents over the next decade); *Barack Obama Annoys Travel Agents by Suggesting They're Obsolete*, ECONOMIST (Aug. 21, 2011, 2:53PM), <http://www.economist.com/blogs/gulliver/2011/08/obama-and-travel-agents>.

137. Garbis Order, *supra* note 12, at *8 n.13.

138. *Id.* (citation omitted); see also *Baude v. Heath*, 538 F.3d 608, 613 (7th Cir. 2008) (“When some form of heightened scrutiny applies—as it does if a law’s own terms treat in-state and out-of-state producers differently—then the burdens of production and persuasion rest on the state. But when challenging a law that treats in-state and out-of-state entities identically, whoever wants to upset the law bears these burdens.”).

139. Failure to do so would also bolster arguments regarding violation of due process and equal protection.

140. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

given their lack of physical presence in the locality. In essence, the argument is that OTCs cannot benefit from local fire or police protection, for example, while working at their desks in another state.

This contention is easily rebutted. Without such services as cities and states provide—fire protection, police protection, infrastructure—guests would be unlikely to travel to, let alone stay overnight in, said cities or states. Thus, it could be argued that without the state services, there would be no guests, and hotels would not be viable as rental establishments. Without hotels, defendants’ business would not exist, so the OTCs do benefit, albeit indirectly, from the services provided by the state.

Courts have generally preferred a more direct approach in rejecting this argument, however, focusing instead on the fact that the OTCs are not the parties being taxed. As was succinctly stated in *Baltimore v. Priceline*, “[t]he tax is directly related to the civil services provided by the City to the transient guest and thus any benefits the OTC does or does not receive are immaterial with regard to this inquiry.”¹⁴¹ In other words, because the hotel guest is the party being taxed, and the hotel guest *does* benefit from the civil services provided by the locality, the tax bears a fair relation to the services provided by the locality. Under either approach, though, OTCs are unlikely to prevail with regard to the fair relation prong.

V. BROADER ISSUES OF STATE REGULATION OF INTERNET COMMERCE

a. *Abrogation of Quill Corp.’s Physical Presence Requirement*

Under the Supreme Court’s holding in *Quill Corp. v. North Dakota*, OTCs must prevail in occupancy tax cases where they lack a physical presence in the taxing locality.¹⁴² However, the fact that the majority of the OTC cases are decided against the OTCs, in contravention of Supreme Court precedent, highlights a shift in the landscape with regard to e-commerce and raises questions about the continuing viability of the physical presence requirement.

The continuing rapid growth of internet commerce,¹⁴³ which can be conducted from nearly anywhere on earth, makes the physical presence requirement seem

141. Garbis Order, *supra* note 12, at *7 (emphasis added).

142. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 301–02 (1992) (reaffirming physical presence requirement for a state tax to be constitutional as set forth in *Bellas Hess*, 386 U.S. 753, 758 (1967)); see also *infra* Part III.b.

143. See, e.g., Justin Lahart, *E-Commerce Surge May Hit Tax Revenue*, WALL ST. J. (FEB. 17, 2011, 3:42 PM), <http://blogs.wsj.com/economics/2011/02/17/e-commerce-surge-hits-state-local-tax-revenue/>; Betsy Morris, *More Consumers Prefer Online Shopping*, WALL ST. J. (JUNE 3, 2013, 10:27 AM), <http://online.wsj.com/news/articles/SB10001424127887324063304578523112193480212>; Thad Rueter, *E-retail Spending to Increase 62% by 2016*, INTERNETRETAILER (Feb. 27, 2012, 9:52 AM), <http://www.internetretailer.com/2012/02/27/e-retail-spending-increase-45-2016>.

increasingly obsolete. However, the same argument was made in relation to mail-order business in 1992 when *Quill Corp.* was decided.¹⁴⁴ While that decision predated the e-commerce boom, the growth of purchases through catalogues and mail-orders was significant enough for many to question the wisdom of maintaining a physical presence requirement.¹⁴⁵ Nevertheless, the Court effectively reaffirmed the *Bellas Hess* bright-line rule at that time, even if it intended it to be a temporary fix while Congress considered whether to act.¹⁴⁶

Is the explosion of interstate commerce over the internet, coupled with two decades of Congressional inaction in this area, sufficient to force the Court to explicitly reverse itself? While the estimated \$23B of revenue states lose annually by not taxing online sales¹⁴⁷ might seem a strong incentive, recent legislative attempts to overrule *Quill Corp.* may stay the Court's hand.¹⁴⁸ Indeed, the Supreme Court recently declined to review a New York sales tax law applicable to online purchases,¹⁴⁹ perhaps indicating the Court's continuing deference to Congress on the issue of state taxation of e-commerce.

b. The "Amazon Tax" and the Changing Landscape of Retail Sales

In 2011, the "Main Street Fairness Act" was introduced in both houses of Congress.¹⁵⁰ The Act, which expired without being enacted, would have overruled the Supreme Court's decision in *Quill Corp.* and would have allowed states to collect sales taxes on out-of-state internet sales.¹⁵¹ This was far from the first piece of legislation to affect a tax on online sales. In addition to several bills in the United States Congress,¹⁵² a number of states have passed legislation seeking to collect tax from internet retailers who make above a specified amount of money through

144. *Quill Corp.*, 504 U.S. at 303 (referencing the N.D. Supreme Court's observation that mail-order business had grown "from a relatively inconsequential market niche" to a "goliath" between 1967 and 1989).

145. *Id.*

146. *Id.* at 311; see also Todd S. Snyder, *Ending the Internet Tax Moratorium*, 60 J. MO. B. 66, 68 (2004) ("The removal of the Due Process Clause as a roadblock opened a door for Congress, under its commerce powers, to legislatively empower the states to require the collection of these taxes. The Supreme Court in *Quill* specifically invited Congress to act in this area . . .").

147. See Ezra Klein, *The Long Shadow of Quill Corp. v. North Dakota*, WASH. POST (July 9, 2012, 6:51 AM), <http://www.washingtonpost.com/blogs/wonkblog/wp/2012/07/09/the-long-shadow-of-quill-corp-v-north-dakota/>.

148. See *infra* Part V.b.

149. *Overstock.com, Inc. v. N.Y. Dep't of Taxation & Fin.*, 987 N.E.2d 621 (N.Y. 2013), *cert denied*, 134 S. Ct. 682, 682 (2013).

150. H.R. 2701, 112th Cong. (2011); S. 1452, 112th Cong. (2011).

151. See H.R. 2701; S. 1452.

152. See Matt Schaefer, *Bill Introduced in Congress to Override Quill in Favor of Streamlined Sales and Use Tax Agreement*, EYES ON ECOM LAW (Aug. 8, 2011, 8:00 AM), <http://eyesonecomlaw.blogspot.com/2011/08/bills-introduced-in-congress-to.html> (noting the introduction of similar bills in 2003, 2006, 2007, and 2010).

affiliates in the state, called an “affiliate tax” or “Amazon tax.”¹⁵³ Given that subjecting online retailers to state tax would eliminate one of the primary advantages they currently enjoy, it is no surprise that major online retailers such as Amazon and eBay worked hard to oppose such measures.¹⁵⁴

The “Marketplace Fairness Act of 2013” is another, more comprehensive piece of legislation aimed at establishing a mechanism for taxing online sales.¹⁵⁵ Passed by the Senate in May 2013, the act authorizes the states that have adopted the Streamlined Sales and Use Tax Agreement¹⁵⁶ to collect sales and use tax from remote sellers that have annual gross receipts of over \$1 million.¹⁵⁷ In exchange, these states must take specific measures to simplify the calculation of their sales and use taxes in order to make it feasible for companies to comply with each state’s tax scheme.¹⁵⁸ Moreover, states must provide software to remote sellers that will calculate the sales and use taxes due on each transaction, so that smaller sellers are not prohibitively disadvantaged compared to larger sellers with the resources to do this for themselves.¹⁵⁹

153. See Michael R. Gordon, *Up the Amazon Without a Paddle: Examining Sales Tax, Entity Isolation, and the ‘Affiliate Tax’*, 11 N.C. J. L. & TECH. 299, 318 (2010) (noting that “the ‘affiliate tax’ or ‘Amazon tax’ is truly not a tax but is instead a constitutional way to collect taxes that are already owed”). More specifically, “states are creating legislation, commonly, but inaccurately, called an ‘affiliate tax,’ which provides that if a company makes a certain amount of money through an affiliate’s presence in the state, it is deemed to have legal physical presence and is required to collect sales taxes.” *Id.* at 299.

154. Amazon has spent significant amounts in past years lobbying Congress not to enact such a tax, see *Amazon Spends \$480,000 Lobbying Government in 3Q*, ASSOCIATED PRESS (Jan. 4, 2011, 10:42 AM), <http://www.businessweek.com/ap/financialnews/D9KHJV01.htm>, as well as ceasing affiliate activities in states which have passed the affiliate tax. See Jessica Fender, *Amazon Fires Colorado Affiliates in Protest*, DENVER POST (Mar. 8, 2010, 1:29 PM), <http://blogs.denverpost.com/thespot/2010/03/08/amazon-fires-colorado-affiliates-in-protest/6554/>.

155. Marketplace Fairness Act, H.R. 684, 113th Cong. (2013); S. 743, 113th Cong. (2013).

156. The Streamlined Sales and Use Tax Agreement is a cooperative effort between 44 states “to simplify sales and use tax collection and administration by retailers and states” in an attempt to encourage internet sellers to collect tax on sales to customers in member states. *What is the Streamlined Sales and Use Tax Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_1 (last visited Feb. 5, 2014). As of January 1, 2014, 24 states had become either full or associate members of the Agreement. *Streamline State Status 01-01-2014*, http://www.streamlinedsalestax.org/uploads/images/state%20map%202014_1_1.jpg (last visited Feb. 5, 2014).

157. See H.R. 684, S. 743 § 2(c) (establishing the “Small Seller Exception”).

158. H.R. 684, S. 743 § 2(b)(2). Sales and use taxes vary enormously from locality to locality, often in utterly counter-intuitive ways. In some states, an item that might otherwise be taxed as candy will be taxed as food if it contains wheat, meaning a Snickers bar would be taxable one way and a Kit-Kat bar another. JAMES GRIMMELMANN, *INTERNET LAW: CASES AND PROBLEMS* 82 (3d ed. 2013).

159. H.R. 684, S. 743 § 2(b)(2)(D)(ii).

Perhaps counter-intuitively, Amazon has offered its support for such measures in recent months,¹⁶⁰ presumably counting on its growing nationwide infrastructure, wide range of products, and planned same-day delivery¹⁶¹ to keep its advantage over online competitors. While it might seem odd that Amazon would wish to disadvantage itself thus, the company is either bowing to the inevitable¹⁶² or is making a very shrewd move. In the latter case, Amazon can likely assume that being able to offer lower prices on a greater selection of merchandise at greater convenience to the customer will allow it to maintain its advantage over traditional brick-and-mortar retailers, even if it must pay local sales and use taxes. But, if other online retailers face increased competition from these brick-and-mortar retailers due to the imposition of sales and use taxes, it would seem Amazon could substantially extend its advantage over online retailers and brick-and-mortar retailers alike.¹⁶³ Wal-Mart and eBay seem to agree, given that both are also experimenting with same-day delivery service.¹⁶⁴

Of course, if the Marketplace Fairness Act passes into law and overrules *Quill Corp.*, there will be little to prevent OTCs from being subject to state and local occupancy taxes.¹⁶⁵ It is possible that the test for the constitutionality of state taxation of an out-of-state entity will revert to the *Complete Auto* test, which makes

160. See Catherine Dodge, *Amazon Parts with eBay to Lobby for Streamlined Online Sales Tax*, BLOOMBERG (Nov. 16, 2011, 12:01 AM), <http://www.bloomberg.com/news/2011-11-16/amazon-parts-with-ebay-to-lobby-for-streamlined-online-sales-tax.html>. Amazon has entered agreements to collect sales tax on its internet sales with several states, including New Jersey, Virginia, South Carolina, and California. See Robert Wood, *Widespread Amazon and Internet Taxes Coming Soon*, FORBES (June 17, 2012, 11:39 PM), <http://www.forbes.com/sites/robertwood/2012/06/17/widespread-amazon-and-internet-taxes-coming-soon/>; Farhad Manjoo, *I Want it Today: How Amazon's Ambitious New Push for Same-Day Delivery Will Destroy Local Retail*, SLATE (July 11, 2012, 5:53 PM), http://www.slate.com/articles/business/small_business/2012/07/amazon_same_day_delivery_how_the_e_commerce_giant_will_destroy_local_retail_.html.

With other states, Amazon has agreed to future payment of sales taxes on internet sales, but has requested payment be deferred while it sets up distribution facilities in those states, promising the addition of thousands of jobs to the state economy in exchange for the deferral. See David Slade, *Amazon Tax Bills Come Due*, POST & COURIER (updated Mar. 23, 2012, 6:27 PM), <http://www.postandcourier.com/article/20120128/PC05/301289934> (“Amazon’s exemption from collecting the South Carolina tax on sales was tied to the company’s promise to invest in the state and create jobs, which the company did when its Lexington County distribution center opened last fall.”).

161. See, e.g., Manjoo, *supra* note 160; Jessica Stillman, *Amazon Takes on Same-Day Delivery: How Can Small Businesses Compete?*, FORBES (Dec. 5, 2012, 1:46 PM), <http://www.forbes.com/sites/ups/2012/12/05/amazon-takes-on-same-day-delivery-how-can-small-businesses-compete/>.

162. See generally David H. Gershel, *The Day of Reckoning: The Inevitable Application of Sales Tax to Electronic Commerce*, 14 TUL. J. TECH. & INTELL. PROP. 335 (2011).

163. Manjoo, *supra* note 160 (“It’s hard to overstate how thoroughly [Amazon’s] move will shake up the retail industry. Same-day delivery has long been the holy grail of Internet retailers If it can pull that off, the company will permanently alter how we shop. To put it more bluntly: Physical retailers will be hosed.”).

164. Stillman, *supra* note 161; Anne D’Innocenzio, *Wal-Mart Tests Same Day Delivery for Holidays*, USA TODAY (Oct. 9, 2012, 7:33 PM), <http://www.usatoday.com/story/money/business/2012/10/09/walmart-same-day-delivery/1622867/>.

165. See, e.g., *supra* Part IV.

no explicit mention of a physical presence requirement.¹⁶⁶ And, based on the Court's reasoning in *Baltimore v. Priceline*, local occupancy taxes will likely pass the *Complete Auto* test and be imposed on OTCs.¹⁶⁷

But even if some such act does not pass, OTCs and other online businesses will still likely find themselves subject to state sales and use taxes. Numerous states are passing laws that will require that consumers pay sales tax on internet purchases.¹⁶⁸ One way or another, then, the physical presence dam is set to burst, either as a result of Congressional action overruling *Quill Corp.*, or of the Supreme Court overruling *Quill Corp.* itself.

VI. CONCLUSION

State taxation of internet sales and services by out-of-state entities is coming.¹⁶⁹ However, under the Supreme Court's holding in *Quill Corp.*, the imposition of sales & use taxes on internet retailers with no physical presence in the taxing state remains unconstitutional because it violates the Commerce Clause.¹⁷⁰ The substantial revenue that states are losing by not being able to tax online sales and services by out-of-state entities¹⁷¹ and the mounting number and types of challenges to the requirement¹⁷² suggest that *Quill Corp.* must soon be overruled, either by the Supreme Court itself or by Congressional legislation.¹⁷³

Of course, the overruling of *Quill Corp.* would have a significant import to OTC litigation regarding local occupancy tax. If the physical presence requirement for state taxation is abrogated, the relevant test for whether a state tax is constitutional would seem to be the *Complete Auto* test, which requires only that there be a "substantial nexus" between the taxing locality and the taxed entity.¹⁷⁴ Under this test, based on the District Court's opinion in *Baltimore v. Priceline*,¹⁷⁵ OTCs would likely be subject to local occupancy taxes.¹⁷⁶

166. The test instead requires only a "substantial nexus" between the taxing locality and the taxed entity. See *supra* Part III.b.

167. See *supra* Part IV.

168. See Klein, *supra* note 147 (citing Amrita Jayakumar, *States, Congress Rallying for an E-Sales Tax*, WASH. POST (July 8, 2012), http://www.washingtonpost.com/business/economy/states-congress-rallying-for-an-e-sales-tax/2012/07/08/gJQACKtpWW_story.html). But see Performance Mktg. Ass'n v. Hamer, 998 N.E.2d 54, 59–60 (Ill. 2013) (striking down the Illinois law requiring online retailers to collect and remit state sales tax).

169. See generally Gershel, *supra* note 162.

170. See *supra* Part III.b.

171. Estimates put the amount of tax revenue lost by States at around \$23B. See Klein, *supra* note 147.

172. Namely, the increasing number of OTC cases and the imminence of taxation of online sales. See *supra* Part V.b.

173. See *supra* Part V.b.

174. See *supra* Part III.a.

175. Garbis Order, *supra* note 12.

176. See *supra* Part IV.

In short, the bell will soon toll for *Quill Corp. v. North Dakota*. The Supreme Court seems unlikely to overrule the case itself, given that interstate commerce is for Congress to regulate and evidenced by its recent denial of cert in *Amazon.com v. N.Y. Dep't of Taxation & Finance*.¹⁷⁷ The question, then, is how long it will take Congress to pass a measure allowing state taxation of e-commerce. Given the increase in legislation to that effect among states and in Congress,¹⁷⁸ it seems a good bet that OTCs will not escape paying local occupancy taxes for very much longer.

177. 134 S. Ct. 682 (2013).

178. See *supra* Part V.b.