Nos. 13-252 & 13-259

IN THE
Supreme Court of the United States

OVERSTOCK.COM, INC.,
Petitioner,
AND

AMAZON.COM LLC AND AMAZON SERVICES LLC,
Petitioners,
v.

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, ET AL.,
Respondents.

On Petitions for a Writ of Certiorari to the New York Court of Appeals

BRIEF OF ECONOMISTS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*[1]

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represent that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amici* or their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *amici* represent that all parties were provided notice of *amici*'s intention to file this brief at least 10 days before its due date and that all parties have consented to the filing of this brief. Petitioners have filed letters with the Court granting blanket consent to the filing of *amicus* briefs. The separate written consent of Respondents is being filed contemporaneously with this brief.

SUMMARY OF ARGUMENT

The challenged New York statute hampers economic growth and thereby conflicts with the core purpose of the Commerce Clause. The statute discourages Internet retailers from using "affiliate marketing" programs and thereby closes an important market entry point to nascent entrepreneurs, damping innovation and reducing competition and overall economic growth.

Moreover, statutes imposing the same tax-collection duties on both in-state and out-of-state retailers, though facially neutral, essentially subsidize in-state physical retailing. Such laws are a form of protectionism and are economically equivalent to laws that facially discriminate against out-of-state goods.

Finally, deviation from the existing rule providing safe harbor for out-of-state retailers will have far-reaching and under-appreciated consequences. In particular, eliminating the incentive Internet retailers currently have to remain physically absent from a particular state will spur the expansion of their warehouse and distribution networks. The associated decreases in delivery times will allow Internet retailers to match more closely the immediacy of traditional brick-and-mortar retailing, accelerating the erosion of valuable public benefits that flow from physical retail spaces.

These economic consequences, which flow from the decision below, will likely worsen unless this Court intervenes. This case therefore presents issues of economic significance that provide a compelling reason for certiorari.

REASONS FOR GRANTING CERTIORARI

I. NEW YORK'S "AMAZON TAX" AND SIMILAR LAWS HARM THE U.S. ECONOMY BY CLOSING IMPORTANT MARKET ENTRY POINTS FOR ENTREPRENEURS AND THEREBY CONFLICT WITH THE CORE PURPOSE OF THE COMMERCE CLAUSE.

The challenged New York statute hampers economic growth and thereby conflicts with the core purpose of the Commerce Clause. The statute imposes tax-collection duties on out-of-state Internet retailers who contract with New York residents for "affiliate" advertising services. By conditioning tax-collection obligations on a retailer's use of affiliate marketing, the statute burdens interstate commerce not only by damping the retailer's sales,[2] but also by discouraging interstate contracts for an important form of advertising. Indeed, the affiliate marketing programs that the statute deters represent an important market entry point for entrepreneurs who are critical engines of economic growth and innovation.

Affiliate marketing programs produce economic benefits because they provide funding to—and encourage entrepreneurial risk taking by—small local website owners. Those effects stem from the basic principle that increases in the stock of physical capital, investment in the development of human capital, and improvements in technology promote higher

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[2] *See* Austan Goolsbee, *In a World Without Borders: The Impact of Taxes on Internet Commerce*, 115 Q. J. ECON. 561, 568 (2000) (estimating that applying sales taxes to existing Internet sales would reduce the number of online buyers by as much as 24%).

rates of economic growth.[3] As workers become more experienced, they become more productive and as a result, enjoy a rise in real wages.[4] Entrepreneurs—by creating new businesses and generating employment opportunities for those workers with growing skill sets—are a critical source of the investment in human capital that increases productivity and fuels economic growth.[5] Just as worker productivity is dependent on strategic investments in human capital, business formation is likewise dependent on a cohort of entrepreneurs making a similar investment in human capital and starting successful new businesses.

Entrepreneurs learn by doing. Often they start a business that fails, only to start new business after

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[3] *See generally* N. Gregory Mankiw, David Romer & David N. Weil, *A Contribution to the Empirics of Economic Growth*, 107 Q. J. ECON. 407 (1992) (incorporating human capital into the standard Solow Growth Model and generating empirical results).

[4] *See generally* JACOB MINCER, SCHOOLING, EXPERIENCE, AND EARNINGS (1974). Mincer's seminal work, the foundation for much of the modern empirical research on the effects of education and experience on wages, develops the "Mincer Equation," which models the logarithm of earnings as the sum of years of education and a quadratic function of years of potential experience. *See also* Kenneth Burdett, Carlos Carrillo-Tudela & Melvyn G. Coles, *Human Capital Accumulation and Labor Market Equilibrium* 52 INT'L ECON. REV. 657 (2011).

[5] *See* David Audretsch & Max Keilbach, *Entrepreneurship Capital and Economic Performance*, 38 REGIONAL STUD. 949, 956 (2004) (incorporating entrepreneurial capital into the standard Solow Growth Model and reporting statistically significant results).

new business until they finally achieve success.[6] It is by getting "their hands dirty" and subsequently overcoming failure that many entrepreneurs learn the hard lessons required for success. The development of a successful economy therefore largely depends on the availability of "entry points" where the young, inexperienced, and those with limited but growing skill sets have an opportunity to become productive contributors to the economy.[7]

By providing the much-needed revenue stream nascent entrepreneurs need to start their own businesses, affiliate programs like those burdened by the statute at issue represent one such critical entry point. As these new entrepreneurs start their own businesses, they develop the skills necessary to advance their businesses to a higher level, either in the creation of their own products or the delivery of higher valued services.

In a recent survey of over 1600 affiliates, it was discovered that[8]:

- Half are under the age of 40;
- 59.5% work from home;

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[6] *See generally* Steven Callander, *Searching and Learning by Trial and Error*, 101 AM. ECON. REV. 2277 (2011) (developing a model of learning by trial and error).

[7] *See* Edward P. Lazear, *Entrepreneurship*, 23 J. LAB. ECON. 649 (2005) (developing theory of the entrepreneur as "jack-of-all-trades" and linking successful business formation with varied work and educational opportunities"); Eric A. Hanushek & Ludger Woessmann, *The Role of Cognitive Skills in Economic Development*, 46 J. ECON. LITERATURE 607 (2008) (arguing that development of skills rather than mere educational attainment is an important determinant of earnings).

[8] AFFSTAT, 2013 AFFILIATE SUMMIT AFFSTAT REPORT, issuu.com/affiliatesummit/docs/affstat-2013.

- 40.5% have been affiliates only since 2010;
- 28.8% have been removed from at least one program because of state legislation;
- 32.7% have felt some effect as the result of state legislation;
- 51% make less than $10,000 a year as affiliates; and
- 52.9% participate in 10 or more affiliate programs.

By using the existence of these in-state affiliates to trigger a retailer's obligation to collect sales taxes on *all* sales to New York residents, the statute at issue in effect operates as an enormous tax on the affiliate programs themselves. Unsurprisingly, Overstock discontinued its relationships with its New York affiliates as soon as the law went into effect. *See* Overstock Pet. 7. The law therefore closed off an important form of interstate commerce to new small business owners, eliminating this critical entry point for entrepreneurial activity and slowing expected economic growth; all without even succeeding in collecting additional tax revenues from Overstock's customers.

Eliminating avenues for the development of entrepreneurial acumen both decreases market competition and hinders the development of new products, resulting in needless inefficiency. This inefficiency leads to a reduction in economic activity and higher prices for consumers. Economies grow (and create jobs) when businesses compete by providing the best products at the lowest possible price[9] and new prod-

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[9] *See* Boyan Jovanovic, *Selection and the Evolution of Industry*, 50 ECONOMETRICA 649, 649–70 (1982) (developing what has

ucts are allowed to displace old ones.[10] The reduction in business formation that results from the elimination of an easy and low-cost entry point for entrepreneurs effectively hampers competition, which harms economic growth and consumer welfare.

Moreover, many new businesses have innovative products that are just entering the market and have yet to gain a loyal following with consumers. Participation in an affiliate program enables such a business to generate much needed revenue when it needs it most: while it is struggling to stay afloat long enough to develop a customer base.[11] Hence the New York statute's economic disincentive on Internet retailers utilizing independent affiliates will likely reduce the introduction of desirable new products into the marketplace by making it more difficult for

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come to be called the "J-model," which uses firm efficiency to predict growth and success).

[10] *See generally* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY (3rd ed., Harper Perennial Modern Classics 2008) (1950). Schumpeter's influential theory of "creative destruction" is based on the idea that the type of competition capable of driving economies forward to new heights occurs when new products displace (destroy) old ones. *See also* Daniel F. Spulber, *Competition Among Entrepreneurs*, 19 INDUS. & CORP. CHANGE 25 (2010) (providing a modern explanation of Schumpeter's idea).

[11] Developing multiple revenue streams can be critically important to start-up entrepreneurs. *See* William B. Gartner, Casey J. Frid & John C. Alexander, *Financing the Emerging Firm*, 39 SMALL BUS. ECON. 745, 752 (2012) (finding that 83.8% of nascent entrepreneurs contributed personal funds to their start-up effort with a median personal contribution of $5,500 and about a third used external sources with a median external amount of $8,250).

young entrepreneurs to bridge the gap between a promising concept and a profitable company.

II. IMPOSITION OF TAX-COLLECTION DUTIES ON OUT-OF-STATE RETAILERS IS A FORM OF PROTECTIONISM ECONOMICALLY COMPARABLE TO LAWS THAT FACIALLY DISCRIMINATE AGAINST OUT-OF-STATE GOODS.

In assessing a law that requires out-of-state retailers to collect state sales taxes, it is tempting to import "fair trade" concepts that are often invoked in the context of international trade.[12] Not requiring Internet retailers to collect state sales taxes might appear unfair because it makes it more difficult for companies within the state to compete on the basis of price. Thus, the call for requiring Internet retailers with no physical presence in the state to collect sales tax is often couched in terms of promoting a "level playing field." *See* C.A. Br. of Respondents at 10.

While New York's statute is superficially nondiscriminatory in attempting to subject Internet retailers to the same tax collection burden as in-state stores, the law attempts to pass a large share of the tax burden to out-of-staters for the benefit of local residents and businesses. In the context of state sales tax collection, out-of-state retailers are not similarly situated to in-state ones. Those with a physical presence in the state, especially traditional brick-and-mortar stores, reap substantial benefits from a whole host of government-provided goods and services: po-

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[12] *See, e.g.*, JOSEPH E. STIGLITZ & ANDREW CHARLTON, FAIR TRADE FOR ALL: HOW TRADE CAN PROMOTE DEVELOPMENT 1–11 (2006).

lice and fire protection, public utilities and sewers, roads, parking spaces and structures, and many others. Many of these benefits are vital for the principle source of economic advantage associated with physical retailing: the ability of the customer to touch a good and immediately take it home upon purchase.[13] These government benefits are public subsidies that directly benefit the retailer with a physical presence, and they offset the burden of collecting taxes for the state and municipality. The Internet retailer, on the other hand, would bear all of the same burdens while receiving only a fraction, if any, of these benefits.[14]

From an economic perspective, this Court's "substantial nexus" analysis in *Quill* was therefore sound in essentially equating laws that shift an undue portion of the tax burden to entities with no physical presence in the state with facially discriminatory

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[13] A recent study demonstrates that consumers closer to a physical retailer are less likely to buy identical goods online. *See* Chris Forman, Anindya Ghose & Avi Goldfarb, *Competition Between Local and Electronic Markets: How the Benefit of Buying Online Depends on Where You Live*, 55 MGMT. SCI. 47, 47–57 (2009).

[14] Out-of-state Internet retailers indirectly reap the benefits of state highways and police protection when they ship their products into a state by common carrier, but then so did the mail-order retailer at issue in *Quill*. *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298, 302 (1992). The issue is one of proportionality.

It is also worth noting that an out-of-state retailer is already paying, albeit indirectly, for the state benefits it receives in connection with shipping. The costs of shipping by common carrier must cover the common carrier's tax burden, including, for example, state licensing fees for its fleet and the taxes paid on fuel.

laws.[15] *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298, 311–15 (1992). New York's law is similar in operation to a tariff on out-of-state goods and is another form of protectionism designed to benefit local businesses at the expense of out-of-staters. The economic harm threatened by such protectionism implicates the core policies underpinning the Commerce Clause and demands this Court's intervention. *See West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 206–07 (1994).

III. ELIMINATING THE SAFE HARBOR FOR OUT-OF-STATE RETAILERS WILL HAVE FAR-REACHING ECONOMIC CONSEQUENCES, INCLUDING THE EROSION OF PUBLIC BENEFITS THAT ACCOMPANY PHYSICAL RETAILING.

If New York's law succeeds in forcing out-of-state Internet retailers to collect sales tax (rather than simply eliminating affiliate programs), it will risk substantial economic harm with little corresponding benefit. Not only does New York's law hinder competition and slow economic growth as described above, but it threatens to undermine the very entities that it seeks to protect: local brick-and-mortar retailers. This far-reaching (though less understood) economic

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[15] This Court has often recognized that the concept of "discrimination" depends on whether the entities being compared are similarly situated. *See, e.g.*, *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 342 (2007) (quoting *Gen. Motors Corp. v. Tracy,* 519 U.S. 278, 298 (1997)) ("Conceptually, of course, any notion of discrimination assumes a comparison of substantially similar entities."). Treating dissimilar entities the same can be as discriminatory as treating similarly situated entities differently.

effect of affiliate nexus taxes further counsels this Court's review.

To the extent they succeed in requiring Internet retailers to collect sales tax, New York's law and other similar statutes remove the incentive that large online retailers like Amazon and Overstock currently have to remain physically absent from certain states. What many policymakers fail to understand is that physical entry into a state does not mean that Internet retailers will begin opening retail stores. National Internet retailers enjoy cost savings and a corresponding price advantage arising both from the saved expense of not operating physical retailing locations and, more important, their superior use of technology and logistics to operate more efficiently.[16] Thus, if changes in state taxation schemes eliminate their incentive to remain physically absent from a certain state, these retailers are likely to expand into new territory, not by opening physical stores, but by leveraging their existing core competencies to maintain a price advantage over many traditional retail stores; namely by increasing their warehouse and distribution networks and therefore decreasing their delivery times. By significantly reducing delivery times, Internet retailers will more closely match the primary advantage of brick-and-mortar retailers: the opportunity such traditional stores create for a con-

[16] A comparison with Barnes & Noble showed that Amazon had considerably lower selling and administrative costs (as well as lower real estate costs) as a percentage of sales. *See* Andrew J. Schlauch & Steven Laposa, *E-tailing and Internet-Related Real Estate Cost Savings: A Comparative Analysis of E-tailers and Retailers*, 21 J. REAL EST. RES. 43, 52 (2001).

sumer to pull a product off the shelf and take it home that same day.[17]

The problem with this scenario is that physical retailers—especially those offering valuable in-store services—create important public benefits that will be lost as physical retailing loses its viability. Physical retailers often create more economic value than they are able to capture, and thereby generate positive externalities that benefit the public as a whole. Physical stores provide a host of valued services such as the opportunity to see, feel, and even try (or try on) products; knowledgeable salesmen who can answer product questions; a form of recreation for shoppers; and a type of quasi-public setting that increasingly provides our shared social space.[18] These public benefits are reflected in a number of ways. Retail districts have a positive impact on neighboring property values, generate higher tax revenues from the spillover effects that occur as shoppers take ad-

[17] Since 2010, Amazon has spent almost $13.9 billion building 50 new warehouse facilities. This brings its total number of warehouses to 89. *See* Danielle Kucera, *Amazon Ramps up $13.9 Billion Warehouse Building Spree*, BUSINESSWEEK, Aug. 20, 2013, available at http://www.businessweek.com/news/2013-08-20/amazon-speeds-warehouse-spending-amid-ebay-delivery-threat-tech.

[18] In some contexts, stores that generate particularly large positive externalities are able to capture a portion of the value they create in ways other than sales revenues. In shopping malls for example, an attractive retailer that drives traffic to the mall location, thereby benefiting the mall's other tenants, is typically charged a lower per-foot rent for its retail space. The difference in the per-foot rent for the less well-known store and rate charged to the more desirable one reflects the value of the externalities that the retailer attracting foot traffic has generated.

vantage of adjoining businesses like restaurants, and draw tourists from outside municipal boundaries.

As shopping has become more of a recreational rather than a merely economic activity, brick-and-mortar retailers have found it increasingly difficult to fully monetize the valuable benefits they create.[19] Many people like to window shop, or use shopping malls merely to socialize. Increasingly, customers test or inspect a product in a high-service retail store and then return home to buy it at a lower price from an online store.[20] Although physical retailers have never been able to fully capture the value they create, their continued existence—and the existence of the public goods they generate—depends on their ability to convert the traffic they attract into a sufficient number of sales to remain profitable.[21]

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[19] Shopping as a social and cultural phenomenon is captured and analyzed in STEVEN MILES, SPACES FOR CONSUMPTION: PLEASURE AND PLACELESSNESS IN THE POST-INDUSTRIAL CITY (2010).

[20] This practice is known as showrooming. As Internet retailers cut delivery times by expanding their warehouse and distribution networks, this dynamic will become more and more prevalent.

[21] In a somewhat different context, the Court has previously recognized the economic importance of ensuring that high-service retailers are not driven out of the market. *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 890–91 (2007) ("[D]iscounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. . . . If the consumer can . . . buy the product from a retailer that discounts because it has not spent capital providing services or developing a quality reputation, the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a level lower than consumers would otherwise prefer.").

The bright-line physical-presence rule articulated in *Quill* has, until now, served as a significant inducement for online retailers to stay out of a geographic market. Not only has that rule provided clear guidance upon which firms have structured a multi-billion dollar industry, it has also helped to preserve the status quo for physical retailers. But the New York statute at issue and others like it may contribute to undermining the viability of many physical retailers, thus threatening a hollowing-out of the retail experience that disserves the public interest in maintaining a vibrant physical retail environment.

In sum, the New York law will not likely even accomplish its goal of protecting traditional retailers. That makes the burden it imposes on interstate commerce even less justifiable. And the loss of public goods associated with physical retailing only compounds the economic damage. The extent of these likely consequences of the law illustrates the national economic importance of the issues presented in this case. That alone warrants this Court's review. *See Pharmaceutical Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644, 650 (2003) (plurality op.) ("grant[ing] certiorari because the questions presented" implicating how States may "effectively regulate[] out-of-state commerce" raise issues "of national importance").

CONCLUSION

The petitions for a writ of certiorari should be granted.

Respectfully submitted,

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