



Growing Number of States Enact “Amazon” Affiliate Nexus Statutes

*Critics Call Laws Unconstitutional;
Congress Considers Legislative Solution*

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Faced with huge budget deficits, a growing number of states are enacting laws that require certain out-of-state online retailers to collect state sales tax on sales to the residents of the states enacting the new legislation. In the past few months alone, these so-called “Amazon” statutes have become effective in Arkansas, California, Connecticut and Illinois. In all, at least seven states have enacted Amazon statutes since 2008, and more than a dozen state legislatures either have considered or are currently considering similar legislation.

The Amazon statutes generally provide that any seller who enters into an agreement to make a payment to a state resident to refer customers to the seller, whether by means of a link on an Internet Web site or otherwise, and earns at least a minimum amount of revenue from such referrals, is presumed to be actively soliciting business in the state. Unless the seller can rebut the presumption, the seller must collect and remit state sales tax on *all* purchases by state residents, even if the seller has no facilities, property or employees in the state.

Amazon.com’s business model provides a good illustration of the application of New York’s (and most other states’) Amazon statute. Amazon.com is a Delaware corporation with its headquarters in Seattle, Washington.² Amazon.com has no offices, employees, or property in New York.³ However, Amazon.com has created an associate program, which provides financial incentives to Web site operators who refer customers to Amazon.com.⁴ The associate places a link on its Web site that refers customers to Amazon.com. If a customer makes a purchase from Amazon.com after clicking the associate’s link, Amazon.com pays the associate a commission.⁵ If Amazon.com receives more than \$10,000 in revenue annually from referrals from New York associates, Amazon must collect and remit sales tax on *all* purchases by New York residents.⁶ Amazon.com can rebut the presumption, but only if it can establish that *none* of its in-state associates engaged in active solicitation in New York aimed at New York residents.”⁷ Put another way, Amazon would have to establish that

² 81 A.D.3d. 183, 190 (N.Y. App. Div. 2010).

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ N.Y. Tax Law § 1101(b)(8)(vi).

none of its associates did anything more than place passive advertisements or passive links on Internet Web sites.

Proponents of the Amazon statutes argue that by allowing states to collect sales tax on online sales, states can level the playing field between “brick-and-mortar” stores, which generally are required to collect sales tax on all sales “face to face”, and online-only retailers, which can often avoid collecting sales tax. Moreover, supporters argue that the Amazon statutes can help cash-strapped states increase revenue without raising tax rates or imposing new taxes.⁸ But critics argue the Amazon statutes are unconstitutional and may actually decrease, rather than increase, states’ revenues. However, legislation that was recently introduced in Congress could make those objections moot by expressly allowing states to require all out-of-state retailers to collect sales tax on sales to state residents, even where the retailer has not entered into a referral agreement with a state resident.

Background: Constitutional Limits on State Sales and Use Taxes

Traditionally, the obligation to collect state sales tax only applied to in-state businesses and out-of-state businesses with a physical presence in the taxing state.⁹ The limitation on the ability of a state to tax out-of-state sellers comes from the U.S. Constitution. Specifically, the Commerce Clause authorizes Congress to regulate commerce among the states.¹⁰ The Supreme Court has held that the Commerce Clause “is more than an affirmative grant of

⁷ 81 A.D.3d at 199.

⁸ Legally, online purchases from out-of-state retailers already are subject to state use tax — at least in any of the 45 states that imposes a sales tax. But states generally have no way of monitoring residents’ online or out-of-state purchases, and voluntary compliance with state use tax obligations is extremely low. To address this problem, at least four states — Colorado, Oklahoma, South Dakota and Vermont — have enacted use tax notification statutes. The use tax notification statutes generally require that retailers that are not required to collect sales tax inform purchasers of their obligations to pay the applicable use tax. The Colorado statute further requires that such retailers provide annual statements to Colorado residents and to the Colorado Department of Revenue regarding the Colorado residents’ purchases, and imposes a penalty on non-complying retailers. However, the U.S. District Court for the District of Colorado recently issued a preliminary injunction enjoining enforcement of the Colorado statute, leaving the viability of the use tax notification statutes in question. *Direct Marketing Ass’n v. Huber*, 2011 WL 250556, at *7 (D. Colo. Jan. 26, 2011).

⁹ As a result, the “nexus” requirements for imposing sales and use tax collection responsibilities on out-of-state sellers is more stringent than the nexus required to impose state income taxes on such retailers.

¹⁰ The Due Process clause also limits states’ abilities to tax out-of-state sellers. *Quill Corp. v. North Dakota*, 504 U.S. 296, 305-06 (1992). However, the limits that are placed on states’ taxing authority by the Due Process clause are minimal relative to the limits imposed by the Commerce Clause. *See id.* at 308.

power; it has a negative sweep as well.”¹¹ That is, the Commerce Clause prohibits certain state actions that interfere with interstate commerce.¹²

In order to satisfy the requirements of the Commerce Clause, a state must show that there is a sufficient connection between the state and the business it wishes to tax.¹³ A seller whose only connection to the taxing state is by common carrier or through the mail lacks the required “substantial nexus” with the taxing state.¹⁴ However, the substantial nexus requirement is satisfied if an in-state agent actively solicits business for the out-of-state seller.¹⁵

In *Nat’l Bellas Hess v. Dept. of Revenue of Ill.*, the Supreme Court held that Illinois did not have the power to require an out-of-state retailer to collect Illinois use tax, where the retailer’s only connection to Illinois consisted of catalog distributions and product shipments to Illinois residents through the mail.¹⁶ The Court explained that allowing Illinois to impose its use tax on a business with such a minimal connection to Illinois could have a far-reaching impact on interstate commerce:

For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [sellers’] interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose “a fair share of the cost of the local government.” The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements.¹⁷

¹¹ *Quill*, 504 U.S. at 309.

¹² *Id.*

¹³ *Nat’l Bellas Hess v. Dept. of Revenue of Ill.*, 386 U.S. 753, 756 (1967).

¹⁴ *Id.*

¹⁵ *Tyler Pipe Indus., Inc. v. Washington State Dep’t of Revenue*, 483 U.S. 232, 250-51 (1987).

¹⁶ *Id.* at 758.

In *Quill Corp. v. North Dakota*, the Supreme Court reaffirmed the bright-line physical presence test of *Bellas Hess* — *i.e.*, that a seller whose only connection to the taxing state is by common carrier or through the mail lacks the physical presence nexus required by the Commerce Clause to impose sales tax.¹⁸ The Court observed, however, 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.”¹⁹ Indeed, the Court expressly invited Congress to resolve the issue: “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.”²⁰

The Development of State “Amazon” Statutes

Since *Quill* was decided nearly 20 years ago, legislation has been introduced in Congress on several occasions that would permit states to impose sales tax collection obligations on out-of-state sellers. Most recently, on July 29, 2011, bills were introduced in the House of Representatives and the Senate that would allow states to collect sales tax on online purchases, provided certain requirements are met.²¹ The legislation’s prospects for passage are not clear.

In the absence of a nationwide solution, individual states have tried a variety of approaches to collect sales tax on online and mail-order transactions that are beyond the reach of traditional state sales tax laws. In 2008, New York became the first state to enact an Amazon statute. The New York statute provides, in relevant part:

[A] person making sales of tangible personal property or services ... shall be *presumed* to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state

¹⁷ *Id.* at 759-60.

¹⁸ 504 U.S. at 317.

¹⁹ *Id.* at 318.

²⁰ *Id.*

²¹ See, e.g., John Buhl, *Sales Tax Streamlining Bill Introduced in House and Senate*, Tax Notes Today, Aug. 1, 2011 (last visited August 29, 2011); see also Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011);

under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether *by a link on an internet Web site or otherwise*, to the seller, if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods ending on the last day of February, May, August, and November.²²

A seller may rebut the presumption that its in-state contractors or representatives are actively soliciting business by establishing that each New York resident with whom the seller has an agreement did not engage in any solicitation in New York on behalf of the seller that would satisfy the nexus requirement of the U.S. Constitution during the four quarterly periods in question.²³ The rebuttable presumption provision is intended to comply with *Quill's* physical presence nexus requirement. Mere passive advertising will not trigger the New York Amazon statute; rather, the in-state representative must actively solicit business from New York purchasers.²⁴ The New York law also contains a de minimis exception that exempts retailers with revenue of less than \$10,000 per year attributable to referrals from state residents.²⁵

The New York Amazon statute does not apply to all online sales to state residents. But once it has been established that the seller actively solicits business in New York through a contract with a state resident and earns more than \$10,000 per year from such referrals, the seller must collect New York sales tax on *all* sales to New York residents — including sales that are not made through a referral by an in-state person.

Most of the states that have enacted Amazon statutes since 2008 have modeled their statutes after the New York law. For example, the statutes generally provide that a retailer

²² N.Y. Tax Law § 1101(b)(8)(vi) (emphasis added).

²³ *Id.* The New York State Department of Taxation also has created a safe harbor, which allows sellers to avoid the direct collection obligations by (1) including a clause in their referral agreement prohibiting in-state associates from soliciting business, and (2) obtaining a signed certificate from each in-state associate certifying that the associate did not engage in any solicitation during the prior year. N.Y. Dept. of Tax'n & Fin., TSB-M-08(3.1)S, 2008 WL 2620914 (June 30, 2008).

²⁴ See *Amazon.com, LLC v. New York State Dep't of Taxation & Fin.*, 81 A.D.3d. 183, 197-98 (N.Y. App. Div. 2010).

²⁵ N.Y. Tax Law § 1101(b)(8)(vi).

who contracts with an in-state representative to refer customers to the out-of-state retailer, whether through a link on an Internet Web site or otherwise, and earns at least a minimum amount of revenue from such referrals, is *presumed* to be soliciting business in the state. Most of the statutes allow an out-of-state seller to rebut the presumption of active solicitation by establishing, for example, that the in-state representative did nothing more than place a passive link on an Internet Web site.

The Illinois and Connecticut Amazon statutes do not allow sellers to rebut the presumption of active solicitation. Instead, an out-of-state seller who contracts with an Illinois or Connecticut resident to refer customers to the out-of-state seller and earns more than a de minimis amount of revenue from such referrals,²⁶ is *irrebutably* presumed to be actively soliciting business in the state.²⁷ Such retailers must pay state sales tax on *all* sales to Illinois or Connecticut customers. Some commentators have concluded that the Illinois and Connecticut Amazon statutes are unconstitutional because they fail to give a seller a chance to rebut the presumption of active solicitation.²⁸

Amazon.com's Response to the "Amazon" Statutes

Amazon.com, with the support of other online retailers and trade groups, has responded to the Amazon statutes on several fronts. First, Amazon.com has terminated its associate programs in the states that have enacted Amazon statutes. Second, Amazon.com filed a lawsuit in New York challenging the constitutionality of the New York statute. Third, Amazon.com is supporting a ballot initiative in California that would allow voters to repeal the California Amazon statute, perhaps as early as February 2012. Finally, a recent *Wall Street Journal* article reported that, even before the proliferation of state Amazon statutes, Amazon.com issued detailed instructions to its employees regarding where they can travel on business, and what they can do while there, to avoid triggering the obligation to collect

²⁶ In Illinois, the de minimis amount is \$10,000 in the preceding 12 months. 35 Ill. Comp. Stat. § 105/2. In Connecticut, the de minimis amount is \$2,000 in the preceding 12 months. Conn. Gen. Stat. § 12-407.

²⁷ 35 Ill. Comp. Stat. Ann. § 105/2 (1.1) (West 2011); Conn. Gen. Stat. § 12-407(a)(12)(L).

²⁸ See, e.g., Edward A. Zelinsky, *Lobbying Congress: 'Amazon' Laws in the Lands of Lincoln and Mt. Rushmore*, Tax Analysts Special Report, May 23, 2011.

sales tax.²⁹ For example, according to the article Amazon employees were not allowed to send work emails while in certain states.³⁰

In the New York lawsuit, Amazon.com argued that the New York Amazon statute violated the Commerce, Due Process, and Equal Protection clauses of the U.S. Constitution, both facially and as applied to it.³¹ The Supreme Court of New York, Appellate Division, held that the statute is constitutional on its face and does not violate the Equal Protection Clause.³² However, the case was remanded to the trial court to determine whether the statute, as applied to Amazon, violated the Due Process and Commerce clauses.³³

Even if the New York Amazon statutes and other states' Amazon statutes are held to be constitutional, some commentators argue the statutes will nevertheless fail to raise revenue because savvy retailers can avoid the statutes' reach by ending their relationships with in-state associates, complying with applicable safe harbors, or (at least in states other than Illinois and Connecticut) rebutting the presumption that their associates are actively soliciting business. Accordingly, some critics argue the Amazon statutes will decrease state revenue in the aggregate because states will not actually collect additional sales tax but will lose the *income* tax revenue they currently collect from the retailers' in-state associates.³⁴

A Possible Solution: The Main Street Fairness Act

On July 29, 2011, legislation was introduced in Congress that would authorize states to require out-of-state sellers to collect state sales tax — whether or not the out-of-state retailer has a contractor or representative in the state. The Main Street Fairness Act, which was introduced in the Senate by Sen. Richard Durbin of Illinois and in the House of Representatives by Reps. John Conyers of Michigan and Peter Welch of Vermont, would give states the authority to require out-of-state sellers to collect state sales tax — provided the

²⁹ Stu Woo, *Amazon Battles States Over Sales Tax*, Wall Street Journal, Aug. 3, 2011, at A1.

³⁰ *Id.*

³¹ *Amazon.com*, *supra* at 191.

³² *Id.* at 207.

³³ *Id.*

³⁴ *See, e.g., Zelinsky, supra*, n.19.

states are members of the Streamlined Sales and Use Tax Agreement (the "Agreement"). The purpose of the Agreement is to simplify and standardize state sales and use tax laws and procedures in order to reduce the burdens of compliance on businesses and others subject to such taxes. States that are members of the Agreement remain free to set their own sales and use tax rates. As of August 1, 2011, the Agreement has 21 full members and three associate members.

Consistent with the Supreme Court's invitation in *Quill*, the Main Street Fairness Act does not require that the online or out-of-state retailer have a physical presence nexus in the taxing state. Instead, the Act would allow any state that is a member of the Agreement to require an online retailer to collect state use tax on sales to state residents. The legislation contains a "small seller" exception but does not define the term "small seller."

The Main Street Fairness Act's prospects for passage in Congress are uncertain. The bill does not yet have any Republican co-sponsors, but supporters said they were optimistic the legislation would receive Republican support. However, similar legislation has been introduced several times in the past and has failed to win passage.

We are monitoring these developments on behalf of several clients. We also represent taxpayers in connection with audits and other tax controversies. Feel free to [contact us](#) if we can be of any assistance.

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