

PUBLICATION

Spotlight on SALT: Waiting for the Goldilocks Moment - e-Retailers, Taxes and Jobs

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In our [December 8, 2010 Tax Alert](#), we reviewed how Amazon.com was confronting challenges from aggressive taxing states, namely New York and North Carolina. We noted that other remote vendors should expect to confront a similar taxing environment in other states as these states established their future tax policies regarding e-retailers and other remote vendors. While that landscape remains and has since expanded, the controversy also has taken on an added dimension of negotiation and compromise between Amazon and certain states. Developments since late 2010 demonstrate that states are pursuing a dual-track tax policy vis-à-vis remote vendors like Amazon: (1) aggressive legislative, audit and judicial challenges on the one hand, while (2) extending the hand of compromise on the other.

Background

Decades of U.S. Supreme Court precedents have required direct (mail order) marketers and other remote vendors to have a physical presence with a state before they can be required to collect the state's sales or use taxes from in-state customers. States have also historically asserted this taxing jurisdiction when mail order and other firms had agents, independent contractors, or affiliated entities in the taxing state soliciting sales or performing services that established and maintained a market for the remote company in the state. In some cases, these efforts were sustained by the U.S. Supreme Court.

In 2009, New York became the first state to enact legislation aimed at "e-retailers" like Amazon.com who use website-linking programs involving New York residents. For example, Amazon has an Associates Program whereby independent individuals (Associates) provide a link on their websites or blogs to the Amazon.com website. If a visitor to the Associate's website clicks on the link and makes a purchase from Amazon's website, the Associate is paid a commission. Any purchase made by the visitor takes place solely with Amazon, and all customer inquiries, returns, complaints, refunds, and so on are handled by Amazon without any involvement of an Associate. New York's "Amazon.com law" targeted Amazon (and Overstock.com) and other e-retailers using similar associate or website-linking programs with New York residents. If the e-retailer had at least \$10,000 of gross receipts from sales to New York residents (whether resulting from a website link or otherwise), the e-retailer was presumed to have nexus and was required to collect New York sales and use taxes from all of its New York customers.

The New York statute was challenged by Amazon and upheld first by a New York Supreme Court (New York's trial court of general jurisdiction), and then affirmed in 2010 by a New York appellate court. *Amazon.com LLC v. New York State Dept. of Taxation and Finance* (Nov. 4, 2010). The appellate court agreed that passive advertising in New York that generated \$10,000 or more of sales did not create a taxable nexus with New York. However, that court viewed the digital analog differently by considering Amazon's Associates as (possibly) actively soliciting sales for Amazon in the New York market. On this issue of the statute "as applied" to Amazon, the court remanded for further proceedings, including discovery, on the question of whether the Associates were actively soliciting on Amazon's behalf.

Piling On

Since New York's foray, six other states have enacted similar "click-through nexus" legislation: Arkansas, California, Connecticut, Illinois, North Carolina and Rhode Island. As many as 21 other state legislatures have considered, but not (yet) enacted, similar click-through nexus laws. The Multistate Tax Commission, an interstate compact organization with 22 member states, is in the process of developing a model tax statute that would provide a recommended model "associate" nexus and e-retailer customer notification statute for other states to consider for enactment.

While other states have not enacted explicit click-through nexus laws, Colorado, Oklahoma and South Dakota require e-retailers to send notices to each in-state customer indicating how much state use tax the customers owe the state for their online or direct mail purchases. Colorado's statute goes beyond notification and also requires an e-retailer to provide an annual report (list of customers) to that Department of Revenue.

In addition to its New York legal challenge, Amazon has terminated its Associate Programs with residents of Arkansas, Colorado, Connecticut, Hawaii, Illinois, North Carolina and Rhode Island.

Agreements

Following California's enactment of a click-through nexus law, Amazon.com shuttered its Associate Programs with California residents and began pursuit of a ballot referendum to repeal the law. Afterwards, California agreed to delay implementation of the law in exchange for various agreements from Amazon, including building distribution centers and other facilities in California to create 10,000 full-time jobs and 25,000 seasonal jobs by 2015. If the U.S. Congress fails to enact federal internet sales tax legislation allowing states to impose sales and use taxes on e-retailers, California's associate-nexus law goes into effect September 2012. If such a federal law is enacted, the California law goes into effect in January 2013.

Likewise, Amazon reached agreement with Tennessee under which it will agree to collect sales and use taxes on its sales to Tennessee residents beginning January 1, 2014, unless federal legislation allowing states to impose sales and use taxes on e-retail transactions is enacted before that time. In exchange, Amazon agreed to create 3,500 new jobs in Tennessee and open three previously-announced facilities in that state. Legislation is required to implement the agreement and has just recently been introduced in this 2012 session of the Tennessee General Assembly, H.B. 2370. The bill memorializes the Amazon-Tennessee agreement and extends it to any e-retailer that (a) places one or more distribution facilities in service in Tennessee after January 1, 2011 and before January 1, 2014; (b) makes a capital investment of at least \$350 million; (c) creates at least 3,500 jobs in Tennessee after January 1, 2011 and before January 1, 2014; and (d) maintains at least 3,500 jobs until January 1, 2016. In addition, the proposed legislation also requires any e-retailer that does not have nexus with Tennessee to provide notice to customers that they may owe Tennessee use tax on their internet purchases.

Amazon has reached a similar agreement with Indiana and is reportedly pursuing agreements with other states.

Conclusion

Federal internet sales tax legislation that may permit states to levy their sales and use taxes on remote e-retailers is percolating in Congress. On the one hand, more states should be expected to look at click-through nexus laws as a means to address their fiscal imbalances without creating "new" taxes – while with the other hand they will contemplate incentive agreements with some e-retailers to create jobs.

Brick and mortar retailers, Main Street businesses and e-retailers and vendors of all sizes and stripes should continue to closely monitor the various legislative, administrative and judicial developments, which hopefully at

some point will be fairly balanced (not too hot, not too cold) in protecting constitutional rights and also assuring fair tax collection responsibilities. However, if the past 30 years of state taxation teaches us anything, it is that most of us may grow old waiting for the Goldilocks moment – that is, the elusive, national tax solution to the question of state taxation of remote sales.

If you would like to discuss any of the issues covered in this Alert, please contact any attorney in the Firm's Tax Department.